



PRUDENTIAL

NEWS RELEASE

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PRUDENTIAL PLC DELIVERS VERY STRONG 2008 FULL YEAR RESULTS

Embedded Value:

- EEV Operating Profit of £2,961 million up 17%
- New Business Profit of £1,307 million up 8%
- Asset management operating profit up 3% to £345 million
- EEV Shareholders' funds up 2% to £15.0 billion
- Net asset value per share £5.99 (2007: £5.91)
- Return on Embedded Value of 15.0% (2007: 15.4%)

IFRS:

- IFRS statutory operating profit of £1,347 million up 12%
- IFRS Shareholders' funds of £5.1 billion (2007: £6.1 billion)
- Net asset value per share £2.03 (2007: £2.45)

Capital & Cash:

- Robust IGD capital surplus estimated at £1.7 billion (2007: £1.9 billion), £2.5 billion on completion of transfer of Taiwan agency business
- Holding Company cash flow positive at £54 million
- 2008 full year dividend increased by 5% to 18.90 pence per share

Mark Tucker, Group Chief Executive said:

"These results represent a very strong absolute and relative performance in quite exceptional circumstances. Our focus has remained resolutely on delivering value over volume, whilst carefully managing our risks, capital and cash. Group EEV operating profit was up 17 per cent to £2,961 million and Group IFRS statutory operating profit was up 12 per cent to £1,347 million. New business profits increased by 8 per cent and the Group margin increased from 42 per cent to 43 per cent, demonstrating the resilience and sustainability of our retirement led strategy.

Prudential is one of the strongest insurers in the world. Our prudent but proactive approach has ensured our Group capital and cash position remains very robust, with an estimated IGD surplus of £1.7 billion, which will increase by £800 million on completion of the transfer of our Taiwanese agency business. In line with our conservative dividend policy, we are pleased to announce an increase in the final dividend of 5 per cent to 12.91 pence per share.

All our businesses performed well in 2008. New business profit in Asia grew 15 per cent to £741 million; Jackson saw new business profit up 3 per cent to £293 million; while new business profit in the UK was down only 1 per cent at £273 million. Asset management had an excellent year with operating profit up 3 per cent to £345 million. In relative terms Prudential outperformed the market, demonstrating the resilience of our strategy and the strength of our operations worldwide.

2009 will be a challenging year and we will continue to focus on balancing growth with cash and capital generation. Our geographic diversification, distribution strategy, product mix and disciplined approach all mean we can focus on the most profitable opportunities in the pre and post-retirement sector. Combined with our dynamic approach to risk management, this means we are well placed to outperform over the economic and financial cycle.”

Group Chief Executive’s Report

I am pleased to report that Prudential delivered a strong performance in all its businesses in 2008, and maintained a healthy capital position despite the banking liquidity crisis in mid-year and the onset of the most severe worldwide recession in more than a generation.

This achievement once again demonstrated the soundness of the strategy the Group has followed in recent years. Our selective spreading of geographic risk across different continents and types of economy, our focus on the most profitable opportunities in the pre- and post-retirement sector in each of our chosen markets, and our resolute refusal to pursue sales volume targets at the expense of profit have once again proved their worth. We have said in the past that this is a formula for outperformance, and this has held true amid the particularly testing conditions of recent months.

As well as reaffirming our strategy, these results also reflect the operational expertise and excellence that our operating divisions around the world bring to bear, and fully justify our commitment to nurturing the financial strength of the Group through prudent management of capital resources.

Group Performance

During 2008, our Group operating profit before tax from continuing operations, on the European Embedded Value (EEV) basis, rose to £2,961 million, an increase of 17 per cent. This means our EEV operating profit before tax has grown at a compound annual rate of 25 per cent since the end of 2004. The Group’s return on embedded value was 15.0 per cent (2007: 15.4 per cent).

On the statutory International Financial Reporting Standards (IFRS) basis, operating profit before tax from continuing operations increased by 12 per cent to £1,347 million. As a result, our IFRS operating profit before tax has now grown at a compound annual rate of 21 per cent since the end of 2004.

Operating profit in the Group’s asset management operations increased by £11 million to £345 million in very difficult trading conditions in all markets. Net inflows at M&G were £3.4 billion and our asset management business in Asia recorded net inflows of £0.9 billion.

Equally important, our Group capital position remains robust. Using the regulatory measure of the Insurance Groups Directive (IGD), the Group’s capital surplus was estimated at £1.7 billion with a solvency ratio of 162 per cent. Through an innovative transaction we have been allowed by the regulator to include £0.3 billion of the shareholders’ economic interest in the future transfers from the UK With-Profits Fund, which in total was worth £1.7 billion at 31 December 2008. Going forward, there is the opportunity to develop similar transactions which may allow us to access more of the residual £1.4 billion if required.

Our IGD position will be further strengthened during 2009 by around £0.8 billion on completion of the transfer of the agency back-book business in Taiwan, a transaction that we announced on 20 February 2009.

In addition to this strong capital position, the total credit reserve for the UK annuity shareholder business is £1.4 billion.

We also retain significant flexibility and capacity for other management actions to improve and protect our position still further, were the need to arise.

Taking all these factors into account alongside our proactive approach to risk management, we are confident that our Group remains resilient to any further deterioration in market conditions across all asset classes.

Our cash flow position has been improving over a number of years, and in 2008 we achieved our target of being operating cash flow positive at the Group level, with a cash surplus of £54 million.

Given this robust financial position, the Board has recommended a final dividend of 12.91 pence per share, bringing the full-year dividend to 18.90 pence per share, an increase of 5 per cent. The dividend is covered 2.24 times by post-tax IFRS operating profit from continuing operations.

Our Strategy

The Group's overriding objective remains the generation of sustainable value for our shareholders, resulting from sound strategic positioning to capture long-term growth opportunities in the pre- and post-retirement market, combined with a focused approach to delivering the optimal level of capital-efficient profitable growth in the short and medium term.

The bedrock of our strategy is to be both highly international and very selective. We look to maintain an internationally diverse portfolio of businesses, embracing countries that are at different stages of economic development but which all share one key attribute: the opportunity for us to build a market-leading operation with prospects for sustainable long-term profitable growth and a superior rate of return on capital. In every market we choose to enter, we also benefit from an operating model that enables each of our businesses to stay close to its customers and their needs when formulating product and distribution strategies, while taking a consistent, disciplined Group-wide global approach to managing risk, capital and cash.

Within this proven framework, we maintain a strong and consistent focus on the retirement savings, income and protection sectors. This has many different facets, ranging from providing regular savings products that accumulate funds for retirement, through healthcare protection at all ages, to helping those entering or already in retirement to organise their finances so as to secure an efficient retirement income. As demographic and welfare trends worldwide continue to reinforce the need for personal savings to provide income in retirement, and as the 'baby-boomer' generation in the Western world makes the transition from employment into retirement, our strong presence, assets and capabilities in the sector will position us to capture a disproportionate share of this growing profit pool over the coming years.

The Group's particularly strong association with the Asian region, which has been our primary focus for investment and expansion in recent years, has also been vindicated by recent events. Of course, Asian markets did feel the impact of the global financial turmoil in mid-2008, and the region's economic performance has undoubtedly suffered as a consequence of the downturn in Western markets for its goods. Nevertheless, Asia was the only region worldwide to record high single-digit economic growth in 2008. Going forward, we believe that Asia's fundamentals of continued economic growth, increasing mass affluence and shifting demographics will continue to be powerful drivers of profitable growth in the future. In line with our stated strategy to review acquisition opportunities, we did look at AIA's assets in Asia. Following careful consideration against our strict financial criteria and our strategic objectives, we decided not to proceed with an offer for any of these assets.

The US remains the largest retirement market in the world, validating our strategy to position Jackson to meet the pre- and post-retirement needs of the baby-boomer generation. As in the UK, the retirement and near-retirement population will represent the fastest growing segment of the market in the US over the next decade.

Overall we believe that our strategy, and the consistency with which we execute it, are the core factors that differentiate us from our peers.

Product and Distribution Strategy

In all our operations, our aim is to have a suite of products that delivers good value and meets customers' needs without being unduly capital intensive or leaving the Group overly exposed to the economic cycle. While we would not claim to be recession-proof, we have shown that we are recession-resistant. The need to fund retirement savings and provide for income in retirement is not going to go away - and this makes our revenue streams highly resilient, even though at different points in the cycle customers may prefer to achieve their goals through different products and investment options.

In Asia, we continued to benefit in 2008 from our focus on regular premium products, as sales of single premium products suffered amid the market dislocation experienced in the second half of the year. In addition, the breadth of our offering enabled us to refocus our energies on higher-margin health and protection products, and also on with-profits for the more cautious investor.

In the US, the prevailing economic uncertainty and equity market volatility had a negative impact on variable annuity sales in 2008. However, fixed annuity product sales increased as customers became more risk averse. Jackson's strength across the annuity product range enabled us to anticipate this change and meet shifting demand. We executed this change while maintaining our disciplined approach to pricing, despite intense price pressures in the variable annuity market. Our successful hedging of variable annuity guarantees meant our equity hedging gains more than offset the drop in equity markets during the year.

During 2008, Prudential's UK Insurance Operations benefited from our strength in the individual annuity market, supported by a significant flow from internal vesting pensions and continuing high conversion rates.

At the same time, with consumers seeking greater security and stability amid unprecedented market volatility, the financial strength of our with-profit funds and our long-term investment performance, proved to be further advantages. We remain a market leader in both individual annuities and with-profits, as well as in the corporate pensions market and the emerging equity release market.

Across our asset management businesses we have broad multi-asset capabilities covering all asset classes. Once again, these enable us to tailor our offerings to changing market conditions and customer preferences. M&G's investment performance and distribution strength were key drivers behind M&G's robust profits, net sales performance and clear relative outperformance.

We are also maintaining our proud track record of innovation in product design. In the UK in 2008 we introduced an income drawdown product and enhanced lifestyle pricing for annuities. And we continued to build on our success in the with-profits sector by extending our multi-asset capabilities across additional product structures. In Asia we continue to build our health and protection product range, and have enjoyed great success in developing Shariah-compliant products in both Indonesia and Malaysia.

Our operating model also enables us to be flexible in distribution, identifying and developing the specific distribution mix that will create the optimal value in each market. In Asia, for example, we are unique in that we have developed both the largest regional network of tied agents and also excellent partnerships with Standard Chartered and many other banks across the region. In the United States, our highly successful distribution model focuses on our industry leading wholesaler teams, who offer genuine added-value to the independent financial advisor channel while also distributing products through Regional Broker Dealers and banks. In the UK, we have a diverse multi-channel approach including direct sales, financial advisers and partnerships.

In asset management, our businesses achieve similar flexibility through a multi-channel, multi-geography distribution approach in both the retail and institutional marketplaces.

A further manifestation of our flexibility is our portfolio of valuable, market-leading brands. Brands create value through their relationship and resonance with customers. Whether you look at Prudential, Jackson, M&G or any of our other brands, each has a clear personality and values that helps us build and sustain customer loyalty and trust. The benefits of this trust were especially apparent in 2008, when the collapse in consumer confidence in the financial services sector saw us benefit from a concerted 'flight to quality'.

Risk and Capital Management

The events of 2008 have put the balance sheets and capital positions of all insurance companies under close scrutiny. Few anticipated the depth of the banking crisis or the speed of onset of recession in the western economies. But at Prudential we entered 2008 in a generally defensive mode in expectation of a general downturn in the economic outlook - and this certainly stood us in good stead as events unfolded.

Despite the downturn, the capital position of the Group remained strong in 2008, in the face of a testing combination of highly volatile and declining equity markets, falling interest rates, widening spreads on corporate bonds, and rapidly deteriorating credit conditions. Our defensive stance on credit exposure in particular served us well - as did the comprehensive equity hedging strategies that we had put in place in the US to protect against product guarantees.

Given the crisis in the global banking industry in 2008, it is worth restating the fundamental differences between life insurers and banks - a distinction that extends to the two industries' business models, capital ratios and regulatory needs. Insurers do not borrow short and lend long, do not give out credit, are structurally long in terms of liquidity, and are much better able to hold assets to maturity without risk of forced selling at depressed prices.

Equally important, at Prudential effective capital and risk management are central to our approach to managing the Group. We took to heart the lessons from the last downturn in 2002 and 2003, and responded by improving our skills base, reducing concentration levels, and managing our exposures prudently, but proactively. These measures paid off in 2008.

During the year we also took the decision not to proceed with the reattribution of the inherited estate in the UK With-Profits Sub-Fund of Prudential Assurance Company. This decision was taken after an exhaustive

review of the potential benefits and disadvantages of such a move for policyholders and shareholders, the conclusion from which was that it would be in their best long-term interests to maintain the strength and stability inherent in the status quo. This cautious approach on behalf of policyholders and investors was supported at the time by most market commentators, and has been amply vindicated by subsequent events.

We also remain comfortable with the Group's liquidity position at both holding and subsidiary company level. The holding company has significant internal sources of liquidity. As well as cash and near-cash assets of £1.2 billion - more than sufficient to meet all our requirements for the foreseeable future - the Group also has in place £2.1 billion of undrawn committed banking facilities.

One result of our consistently cautious capital and cash management strategy is our ability to maintain our conservative dividend policy, as reflected in the dividend announced with these results. Going forward, our Board will continue to focus on delivering a growing dividend, the size of which will of course continue to reflect the Board's view at the time of the Group's financial position and needs, including available opportunities for profitable investment. The Board believes that, in the medium term, a dividend cover of around two times is appropriate to maintain a progressive, though conservative, dividend policy.

Investing for the Future

Amid all the turmoil in the global markets, it is imperative that we continue to invest for the future to ensure we are positioned to accelerate out of the economic slowdown and maintain our record of outperformance.

Key to this will be our ability to prepare for, identify and capture emerging growth opportunities. With this in mind, in 2008 we continued to reinforce the already strong positions of our businesses in our chosen markets - and these efforts have continued into 2009, with a particular focus on recruiting the best talent.

Improving the efficiency of our operations remains an ongoing objective. As announced in our 2007 full-year results, the first phase of our UK cost reduction programme delivered savings of £115 million per annum. The agreement with Capita, which commenced in April 2008, will ultimately deliver a further £60 million per annum of savings and will enable our UK business to achieve its total cost savings target of £195 million by the end of 2010. In the US we are already a market leader in terms of operational efficiency and have service levels that are externally acknowledged as world class. We will continue to invest in maintaining and extending this leadership through further systems simplification, enabling us to stay ahead of the competition.

Outlook

It is clear that 2009 will be a challenging year. Indeed, there is an increasing likelihood that in some parts of the world recession will continue into 2010. However, the global economy will ultimately rebound - albeit at different times and different speeds in different markets.

Given the uncertainty in the operating environment we have taken a prudent approach to our plans for 2009. This means focusing on balancing new business with cash generation, and making it our absolute priority to ensure that our balance sheet and capital position remain robust. At the same time, we will continue to position our businesses to take advantage of any improvement in market conditions.

It is my firm belief that this cautious but proactive strategy will allow us both to continue to outperform over the economic cycle.

ENDS

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Notes to Editors:

1. In addition to the financial statements provided with this press release, additional financial schedules, including full details of the Group's investments, are available on the Group's website at www.prudential.co.uk/prudential-plc/
2. The results in this announcement are prepared on two bases: International Financial Reporting Standards ('IFRS') and European Embedded Value ('EEV'). The IFRS basis results form the basis of the Group's statutory financial statements. The supplementary EEV basis results have been prepared in accordance with the principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV disclosures published in October 2005. Where appropriate the EEV basis results include the effects of IFRS.

Period on period percentage increases are stated on an actual exchange rate basis.

3. Annual premium equivalent (APE) sales comprise regular premium sales plus one-tenth of single premium insurance sales.
4. Present value of new business premiums (PVNBP) are calculated as equalling single premiums plus the present value of expected new business premiums of regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution.
5. An interview with Mark Tucker, Group Chief Executive, (in video/audio/text) will be available on both www.cantos.com and www.prudential.co.uk/prudential-plc/ from 07.00am today.
6. There will be a conference call today for wire services at 07.30am (GMT) hosted by Mark Tucker, Group Chief Executive and Tidjane Thiam, Chief Financial Officer. Dial in telephone number: 020 8609 0793. Passcode: 797476#
7. A presentation to analysts will take place at 09.30am (GMT) at Governor's House, Laurence Pountney Hill, London, EC4R 0HH. An audio cast of the presentation and the presentation slides will be available on the Group's website, www.prudential.co.uk/prudential-plc/
8. A media roundtable will take place at 12pm (GMT) at 12 Arthur Street, London, EC4R 9AQ. To attend please call Sunita Patel on 020 7548 2466.
9. High resolution photographs are available to the media free of charge at www.newscast.co.uk on +44 (0) 207 608 1000 or by calling Sunita Patel on 020 7548 2466.
10. Total number of Prudential plc shares in issue as at 31 December 2008 was 2,496,947,688.

11. Financial Calendar 2009:

First Quarter 2009 Interim Management Statement	14 May 2009
Annual General Meeting	14 May 2009
Interim Results 2009	13 August 2009
Third Quarter 2009 Interim Management Statement	28 October 2009

2008 Final Dividend

Ex-dividend date	8 April 2009
Record date	14 April 2009
Payment of dividend	22 May 2009

2009 Interim Dividend

Ex-dividend date	19 August 2009
Record date	21 August 2009
Payment of dividend	24 September 2009

12. About Prudential plc

Prudential plc is a company incorporated and with its principal place of business in England, and its affiliated companies constitute one of the world's leading financial services groups. It provides insurance and financial services directly and through its subsidiaries and affiliates throughout the world. It has been in existence for over 160 years and has £249 billion in assets under management (as at 31 December 2008). Prudential plc is not affiliated in any manner with Prudential Financial, Inc, a company whose principal place of business is in the United States of America.

Forward-Looking Statements

This statement may contain certain "forward-looking statements" with respect to certain of Prudential's plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements containing the words "believes", "intends", "expects", "plans", "seeks" and "anticipates", and words of similar meaning, are forward-looking. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond Prudential's control including among other things, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, the impact of competition, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; and the impact of changes in capital, solvency or accounting standards, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate. This may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. As a result, Prudential's actual future financial condition, performance and results may differ materially from the plans, goals, and expectations set forth in Prudential's forward-looking statements. Prudential undertakes no obligation to update the forward-looking statements contained in this statement or any other forward-looking statements it may make.

PRUDENTIAL PLC 2008 PRELIMINARY ANNOUNCEMENT

RESULTS SUMMARY

European Embedded Value (EEV) Basis Results **	2008	2007*
	£m	£m
Asian operations	1,335	1,099
US operations	593	635
UK operations:		
UK insurance operations	1,081	859
M&G	286	254
	1,367	1,113
Other income and expenditure	(302)	(297)
Restructuring costs	(32)	(20)
Operating profit from continuing operations based on longer-term investment returns**	2,961	2,530
Short-term fluctuations in investment returns	(5,127)	174
Mark to market value movements on core borrowings	656	223
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	(15)	(5)
Effect of changes in economic assumptions and time value of cost of options and guarantees	(581)	748
(Loss) profit from continuing operations before tax (including actual investment returns)	(2,106)	3,670
Operating earnings per share from continuing operations after related tax and minority interests**	88.6p	74.5p
Basic earnings per share	(54.1)p	121.2p
Shareholders' equity, excluding minority interests	£15.0bn	£14.6bn

International Financial Reporting Standards (IFRS) Basis Results **

Statutory IFRS basis results	2008	2007
(Loss) profit after tax attributable to equity holders of the Company	£(396)m	£947m
Basic earnings per share	(16.0)p	38.7p
Shareholders' equity, excluding minority interests	£5.1bn	£6.1bn

Supplementary IFRS basis information	2008	2007
Operating profit from continuing operations based on longer-term investment returns**	£1,347m	£1,201m
Operating earnings per share from continuing operations after related tax and minority interests**	42.5p	33.3p

	2008	2007
Dividends per share declared and paid in reporting period	18.29p	17.42p
Dividends per share relating to reporting period	18.90p	18.00p
Funds under management	£249bn	£267bn

* The Company has adopted the principles of IFRIC 14 in accounting for pension schemes. The adoption and other minor presentational changes give rise to consequential changes to the comparative results for 2007 (see notes 4, 5 and 10).

****Basis of preparation**

Results bases

The EEV basis results have been prepared in accordance with the European Embedded Value Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV disclosures published in October 2005. The basis of preparation of statutory IFRS basis results and supplementary IFRS basis information is consistent with that applied for the 2007 results and financial statements.

Operating profit based on longer-term investment returns

Consistent with previous reporting practice, the Group analyses its EEV basis results and provides supplementary analysis of IFRS profit before tax attributable to shareholders, so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. On both the EEV and IFRS bases, operating earnings per share are calculated using operating profits from continuing operations based on longer-term investment returns, after related tax and minority interests. These profits exclude short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. Under the EEV basis, where additional profit and loss effects arise, operating profit based on longer-term investment returns also excludes the mark to market value movements on core borrowings and the effect of changes in economic assumptions and changes in the time value of cost of options and guarantees arising from changes in economic factors. After adjusting for related tax and minority interests, the amounts for these items are included in the calculation of basic earnings per share.

Discontinued operations

The results for continuing operations shown above and throughout this preliminary announcement exclude those in respect of discontinued banking operations, which were sold on 1 May 2007.

BUSINESS REVIEW

CFO OVERVIEW

Introduction

Prudential achieved a strong performance in 2008, despite extremely challenging global economic and financial markets. The results, as summarised below, show that we have delivered solid growth in sales and operating profits, maintained a robust capital position, and met the target we set ourselves of generating a positive Group holding company cash flow in 2008. We have also continued to act on our commitment to increased transparency, by giving additional disclosures on International Financial Reporting Standard (IFRS) basis results and free surplus generation.

We expect markets to remain challenging for some while. However, our long-term growth and profitability potential remains intact and we are well positioned to take advantage of the opportunities existing in the pre and post-retirement market in our chosen geographies. In 2009, we will focus on balancing new business with cash generation and capital preservation. We will continue, in a volatile environment, to manage risk in a prudent but proactive manner.

Performance and Key Metrics

	AER ^{4/8}			CER ^{4/8}	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
Annual premium equivalent (APE) sales	3,025	2,868	5%	3,003	1%
Present value of new business premiums (PVNBP)	22,529	21,308	6%	22,348	1%
New business profit (NBP)	1,307	1,205	8%	1,278	2%
NBP Margin (% APE)	43%	42%		43%	
NBP Margin (% PVNBP)	5.8%	5.7%		5.7%	
Net investment flows	4,266	7,975	(47%)	8,474	(50%)
External funds under management	62,279	68,669	(9%)	74,523	(16%)
EEV basis operating profit on long-term business from continuing operations ⁽¹⁾⁽²⁾	2,906	2,509	16%	2,651	10%
Total EEV basis operating profit from continuing operations ⁽²⁾⁽⁵⁾	2,961	2,530	17%	2,676	11%
EEV basis shareholders' funds	14,956	14,600	2%	16,447	(9%)
Return on Embedded Value ⁽⁶⁾	15.0%	15.4%			
Total IFRS operating profit from continuing operations ⁽³⁾⁽⁵⁾	1,347	1,201	12%	1,262	7%
IFRS shareholders' funds	5,058	6,062	(17%)	6,765	(25%)
Holding company cash flow ⁽⁷⁾	54	(82)	166%	(82)	166%
IGD capital surplus (as adjusted*) (£bn)	1.7	1.9	(11%)	1.9	(11%)

*IGD before allowing for final dividend estimated at £1.7 billion (£1.4 billion at 31 December 2008 and in addition £0.3 billion subsequently allowed by the FSA). 2007 IGD surplus was £1.9 billion.

Notes to the table- page 3/4

During 2008, our continued and targeted investment in areas that deliver profitable growth enabled us to improve our operating performance on both an European Embedded Value (EEV) and IFRS basis.

Group operating profit before tax from continuing operations on the EEV basis increased by 17 per cent to £3.0 billion. This was largely driven by a 23 per cent increase in in-force profit from £1.3 billion to £1.6 billion and an eight per cent increase in new business profit from £1.2 billion to £1.3 billion. After tax and minority interest the Group saw a loss for the period of £1.3 billion. This was driven primarily by short-term fluctuations of £5.1 billion. Insurance companies hold a large number of assets over the long-term, the value of which will vary over time, therefore negative and positive fluctuations are to be expected.

On the statutory IFRS basis our operating profit increased by 12 per cent to £ 1.3 billion. A particularly significant factor in this increase was a rise of 70 per cent in our Asia IFRS operating profit. After tax and minority interest the Group saw a loss of £396 million largely driven by short-term fluctuations. As with EEV reporting, positive and negative short-term fluctuations are expected in an insurance company.

In the extremely volatile environment we have experienced in 2008, we have maintained a strong focus on risk, capital and cash management. We achieved our target of being cash flow positive in 2008 at the holding company level, with a cash surplus of £54 million.

Risk and capital

Our capital position is strong, driven by our conservative risk and capital management. Our Insurance Groups Directive (IGD) capital surplus is estimated at £1.7 billion before allowing for the 2008 final dividend, giving a solvency ratio of 162 per cent. This total is composed of our IGD surplus at 31 December 2008, estimated at £1.4 billion; together with an additional £0.3 billion that the FSA has subsequently allowed us to include in our IGD surplus going forward as a result of an innovative structure we have developed. Our IGD capital surplus on a consistent basis (i.e. before allowing for a dividend) was £1.9 billion at the end of 2007 and £1.4 billion at the end of the third quarter of 2008.

The £0.3 billion of additional IGD capital reflects our ability to realise a portion of the shareholders' economic interest in the future transfers from the UK with-profits fund, which in total was worth £1.7 billion at 31 December 2008. Going forward, we have an opportunity to develop similar transactions, which may allow us to access more of the residual £1.4 billion if required.

The reported results for 2008 include the results of the agency distribution business in Taiwan. However, on 20 February 2009 we entered into an agreement to transfer the assets and liabilities of this business to China Life Insurance Company (Taiwan) pending regulatory approval. The business to be transferred includes Prudential's legacy interest rate products in Taiwan, and the agreement is significantly value enhancing for the Group. On completion the transfer will give rise to a net increase in the Group's IGD surplus of approximately £0.8 billion, further strengthening our already robust capital position. Embedded value will increase by approximately £90 million after restructuring costs.

In addition to this strong capital position, the total credit reserve for the UK shareholder annuity funds stood at £1.4 billion at the end of the year. We increased this credit reserve by £0.8 billion in 2008, and it is now equivalent to 80bps per annum over the lifetime of the assets. This reserve would allow us to withstand a recurrence of the average Moody's default experience during the Great Depression, occurring every year for the remaining life of the book.

These factors, combined with the Group's strong underlying earnings capacity, our established hedging programmes and additional areas of financial flexibility, position the Group to withstand significant further deteriorations in market conditions should they occur.

- An instantaneous further 40 per cent fall in equity markets from 31 December 2008 levels would reduce the IGD surplus by £350 million.
- A 150bps reduction in interest rates from 31 December 2008 would reduce the IGD surplus by £300 million (the effect would be less following the completion of the sale of our Taiwan legacy agency book).
- Credit defaults of ten times the expected level would have an impact of £500 million in excess of the annual reserve release.

The global debt markets have experienced unprecedented conditions in 2008, with illiquidity and credit spreads reaching all-time highs. Our debt portfolio on an IFRS basis was approximately £95 billion at 31 December 2008. Total defaults experienced for shareholder backed business on the book in 2008 were £174 million (0.4 per cent of the portfolio).

Our main area of shareholder credit risk exposure is within Jackson. As at 31 December 2008, Jackson's fixed income portfolio was approximately £24 billion, of which 93 per cent was investment grade and seven per cent high yield. Total defaults and impairment charges were £624 million in 2008, of which £78 million was in respect of default experience, £419 million in respect of impairment charges, and the remaining £127 million reflecting losses incurred on the sale of assets.

Given the movement in spreads observed in the US, unrealised losses for the year were £3.2 billion. It should be noted that we apply a policy of holding assets to maturity, which in economic terms limits the impact of current price levels.

Our strategy, focused on the pre and post-retirement market in Asia, the US and the UK, our distribution expertise, our product strength, our prudent but proactive risk management are key competitive advantages in a challenging environment. We have defined our plans and growth ambitions so as to be able to generate cash and conserve capital. This will position us well to take advantage of any improvement in market conditions whenever, and wherever they occur.

Notes to Results highlights

⁽¹⁾ *Long-term business profits after deducting Asia development expenses and before restructuring costs.*

⁽²⁾ *Based on longer-term investment returns from continuing operations. Operating profit is stated excluding the effect of short-term fluctuations in investment returns against the long-term assumptions, the effect of changes in economic assumptions and changes in the time value of cost of options and guarantees arising from changes in economic factors, actuarial gains and losses on defined benefit schemes and the mark to market value movements on borrowings.*

⁽³⁾ *Based on longer-term investment returns from continuing operations. Operating profit is stated excluding the effect of short-term fluctuations in investment returns against the long-term assumptions, and the shareholder's share of actuarial gains and losses on defined benefit schemes.*

⁽⁴⁾ *Actual exchange rate (AER) and Constant exchange rate (CER).*

⁽⁵⁾ *The comparative results for 2007 have been adjusted for the effects of adoption of the principles of IFRIC 14 as described in notes [10] and [Q] of the EEV supplementary information and IFRS financial statements.*

⁽⁶⁾ *Return on Embedded value is based on EEV operating profit from continuing operations after tax and minority interests as a percentage of opening embedded value (shareholder's funds on a EEV basis)*

⁽⁷⁾ *Prior Year excludes sale proceeds from Egg*

⁽⁸⁾ *The 2007 comparative for new business sales and premiums have been adjusted to reflect the inclusion of sales for the Group's UK health insurance joint venture operation, PruHealth. The*

presentation of the operating profit for 2007 has been adjusted to allocate £10 million of profit from the result of new to in-force business to prevent distortion to the published new business margin, so as to reflect consistently in the 2008 and 2007 results the 50 per cent economic interest in the Group's China joint venture.

In the Business Review (BR), year-on-year comparisons of financial performance are on a Actual exchange rate (AER) basis, unless otherwise stated.

EEV results

Prudential plc is the holding company of Prudential Group. The principal activity of our subsidiary operations is the provision of financial services to individuals and businesses in Asia, the US and UK.

	AER ^{4/8}			CER ^{4/8}	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
EEV basis operating profit from continuing operations					
Insurance business:					
Asia	1,309	1,042	26%	1,135	15%
US	586	627	(7%)	678	(14%)
UK	1,037	855	21%	855	21%
Development expenses	(26)	(15)	(73%)	(17)	(53%)
Long-term business profit	2,906	2,509	16%	2,651	10%
UK general insurance commission	44	4		4	
Asset management business:					
M&G	286	254	13%	254	13%
Asia asset management	52	72	(28%)	78	(33%)
Curian	(3)	(5)	40%	(5)	44%
US broker-dealer and asset management	10	13	(23%)	14	(29%)
	345	334	3%	341	1%
Other income and expenditure	(302)	(297)	(2%)	(300)	(1%)
Total EEV basis operating profit from continuing operations	2,993	2,550	17%	2,696	11%
Restructuring costs	(32)	(20)	(60%)	(20)	(60%)
Total EEV basis operating profit from continuing operations after restructuring costs	2,961	2,530	17%	2,676	11%

In 2008, Prudential Group's total EEV basis operating profit from continuing operations based on longer-term investment returns was £2,961 million, up 17 per cent from 2007.

During the year, the Group generated long-term profits of £2,906 million, comprising new business profits of £1,307 million (2007: £1,205 million), in-force profits of £1,625 million (2007: £1,319 million) and Asia development costs of £26 million (2007: £15 million). New business profit from insurance business, at £1,307 million, was eight per cent higher than in 2007, reflecting a resilient sales performance in Asia and sales in the US and UK broadly in line with the previous year. The average Group new business profit margin was 43 per cent (2007: 42 per cent) on an APE basis and 5.8 per cent (2007: 5.7 per cent) on a PVNBP basis. This rise reflects an increase in the average margin in Asia, partly offset by a slight decline in the average US and UK margin. In-force profit increased by 23 per cent on 2007 to £1,625 million. In aggregate, net assumption changes had an impact of £118 million positive, and experience variances and other items were £271 million positive.

Operating profit from the asset management business rose to £345 million, up three per cent from £334 million in 2007, reflecting a very strong performance from M&G despite the market volatility experienced in the second half of 2008.

Other income and expenditure totalled a net expense of £302 million compared with £297 million in 2007. This result primarily consists of interest payable on core structural borrowings of £172 million (2007: £168 million), Group Head Office costs of £130 million (2007: £129 million) and Asia Regional Head Office costs of £41 million (2007: £38 million), offset by investment return and other income of £47 million (2007: £49 million). Investment return income includes a one-off profit of £47 million crystallised on the sale of a seed capital investment in an Indian mutual fund, partly offset by lower interest income.

Restructuring costs of £32 million (2007: £20 million) comprised £28 million (2007: £19 million) recognised on an IFRS basis, and an additional £4 million (2007: £1 million) recognised on the EEV basis for the shareholders' share of costs incurred by the PAC with-profits fund.

EEV basis profit after tax and minority interests (AER)

	2008 £m	2007 £m	Change %
Total EEV basis operating profit from continuing operations after restructuring costs	2,961	2,530	17%
Short term fluctuations in investment returns:	(5,127)	174	
Asia	(1,063)	226	
US	(1,344)	(9)	
UK	(2,407)	(42)	
Other	(313)	(1)	
Actuarial gains and losses on defined benefit pension schemes:	(15)	(5)	
Effect of change in economic assumptions:	(550)	748	
Asia	(34)	201	
US	267	81	
UK	(783)	466	
Effect of change in time value of cost of options and guarantees:	(31)	0	
Asia	8	9	
US	11	8	
UK	(50)	(17)	
Movement in mark to market value of core borrowings:	656	223	
US	37	9	
Other	619	214	
(Loss)/Profit from continuing operations before tax	(2,106)	3,670	(157%)
Tax	771	(927)	
(Loss)/Profit from continuing operations after tax before minority interests	(1,335)	2,743	(149%)
Discontinued operations (net of tax)	0	241	
Minority interests	(3)	(21)	
(Loss)/Profit for the period	(1,338)	2,963	(145%)

In our calculation of EEV operating profit, we use longer-term investment return assumptions rather than the actual investment returns achieved. Short-term fluctuations in investment returns represent the difference between the actual investment return and the unwind of discount on the value of in-force and expected returns on net worth. Group short-term investment fluctuations were negative £5,127 million in 2008, compared to positive £174 million in 2007.

In our Asian business, short-term investment fluctuations in investment returns were negative £1,063 million, compared to positive £226 million in 2007. This sharp change reflects the lower-than-expected returns achieved in most territories and significantly higher volatility in investment markets. The main negative contributors in absolute amounts were our businesses in Hong Kong, Singapore and Taiwan.

In our US business, short-term fluctuations in investment returns were negative £1,344 million, primarily consisting of: a negative £412 million resulting from the difference between the actual investment returns included in operating profit in respect of fixed income securities and the assumed long term investment return; a negative £733 million resulting from the capitalisation changes in the expectations of future profitability on variable annuity business in force, due to the return on the actual variable investment account ("separate account") being lower than the long-term return reported within operating profit, offset by the impact of the associated hedging position; and a negative £199 million resulting from the difference between the actual investment returns and the longer-term returns included within operating profit relating to equity-type investments and other items.

In our UK business, the short-term fluctuations in investment returns were negative £2,407 million. This figure primarily reflects the difference between the actual investment return of negative 19.7 per cent for the with-profits life fund and the long-term assumed return of positive 6.6 per cent. Short-term fluctuations on the shareholder-backed annuity business of negative £213 million represent negative investment return on surplus assets and default experience. Short-term fluctuations on the unit linked business of negative £111 million represent the capitalised reduction in future fees arising from the fall in market values experienced during the year.

The actuarial loss of £15 million (2007: loss of £5 million) included in total profit reflects the shareholders' share of actuarial gains and losses on the Group's defined benefit pension schemes.

In our Asian business, economic assumption changes were negative £34 million. This mainly comprises a negative charge in Taiwan of £239 million as a result of extending the phased bond yield progression period out by five years from 31 December 2013 to 31 December 2018, offset by the positive changes in other territories, mainly reflecting the reduction in risk discount rates.

In our US business, economic assumption changes were positive £267 million. These primarily reflected a reduction in the risk discount rates following a reduction in the US 10-year Treasury rate, partially offset by a reduction in the separate account return assumption.

In our UK business, economic assumption changes were negative £783 million, primarily reflecting the net effect of changes to the assumed fund earned rate and the risk discount rate due to the reduction in gilt rates. The impact of these effects on with-profits business is negative £466 million. The economic assumption changes relating to the shareholder annuity business is negative £317 million.

The mark-to-market movement on core borrowings was a positive £656 million. This reflected a reduction in fair value of core borrowings, as the decrease in interest rates was more than offset by the widening of the credit spread, thereby increasing overall market yields on comparable debt securities.

The effective tax rate at an operating tax level was 26 per cent (2007: 27 per cent), generally reflecting the expected tax rates. The effective tax rate at a total EEV level was 37 per cent (2007: 25 per cent) on a loss of £2,106 million, primarily reflecting that there is no deferred tax charge associated with the mark to market value movement on core borrowings.

IFRS results

IFRS basis operating profit on longer-term investment returns from continuing operations	AER ⁴			CER ⁴	
	2008 £m	2007 £m	Change %	2007 £m	Change %
Insurance business:					
Asia	321	189	70%	212	51%
US	406	444	(9%)	480	(15%)
UK	545	524	4%	524	4%
Development expenses	(26)	(15)	73%	(17)	56%
Long-term business profit	1,246	1,142	9%	1,199	4%
UK general insurance commission	44	4		4	
Asset management business:					
M&G	286	254	13%	254	13%
Asia asset management	52	72	(28%)	78	(33%)
Curian	(3)	(5)	40%	(5)	44%
US broker-dealer and asset management	10	13	(23%)	14	(29%)
	345	334	3%	341	1%
Other income and expenditure	(260)	(260)	0%	(263)	1%
Total IFRS basis operating profit based on longer-term investment returns before restructuring costs	1,375	1,220	13%	1,281	7%
Restructuring costs	(28)	(19)	47%	(19)	47%
Total IFRS basis operating profit based on longer-term investment returns after restructuring costs	1,347	1,201	12%	1,262	7%

Group operating profit before tax from continuing operations based on longer-term investment returns on the IFRS basis after restructuring costs was £1,347 million an increase of 12 per cent on 2007.

Our Asian operations IFRS operating profit for long-term business increased from £189 million in 2007 to £321 million in 2008. In Indonesia the results increased from £35 million to £55 million whilst in the established operations the growth was more muted, growing from £153 million to £162 million. For our Korean operation the result improved from a loss of £13 million to a profit of £12 million. The driver for the growth was the implementation, for IFRS reporting purposes, of a more appropriate basis of deferring and amortising acquisition costs rather than continue with the local regulatory basis reporting. Our Indian operation posted a loss of £6 million, before development expenses for the agency field force which are now shown separately in the analysis. The result also reflects that as the business matures it is appropriate to now defer and amortise acquisition costs, resulting in a benefit of £19 million. In Taiwan, where the IFRS basis of reporting reflects US GAAP for the insurance assets and liabilities of the business the result increased by £15 million to £60 million. The result for other operations increased from £12 million to £38 million reflecting mainly reserve releases in the Japanese operation.

Our US business's IFRS operating profit of £406 million was down by nine per cent on 2007. This was mainly due to accelerated levels of Variable Annuities DAC amortisation as a result of large negative equity market movements. These impacts were partially offset by positive operating derivative income on variable annuity business, reflecting the increase in market value of the net short derivative positions due to falling equity prices. The decision to acquire additional hedging protection in the derivatives markets in 2007 at favourable prices demonstrated its value amid the falling equity markets experienced in 2008. The US operation's results are based on US GAAP, adjusted where necessary to comply with IFRS, as the Group's basis of presenting operating profit is based on longer-term investment returns.

Longer-term returns for the US operation's fixed income securities incorporate a risk margin reserve (RMR) charge for longer-term defaults and amortisation of interest-related realised gains and losses. Jackson's hedging of its variable annuity guarantees offset the effect of the 38.5 per cent drop experienced in the US equity markets in 2008.

In our UK business, total IFRS operating profit increased by 12 per cent in 2008 to £589 million. The increase of four per cent achieved for the long-term business reflected profits attributable to the with-profits business of £395 million together with 15 per cent growth from the long-term shareholder backed business. IFRS profits from the shareholder annuity business includes the impact of strengthening the allowance for credit defaults partly offset by profits emerging from a rebalancing of the asset portfolio. Non-long term business IFRS profit reflected profit from General Insurance commission which increased to £44 million, with cash beginning to emerge following the 2002 sale of the business to Churchill.

M&G's operating profit for 2008 was £286 million, an increase of 13 per cent over 2007. This represented a strong financial performance in the light of the prevailing challenging market conditions. Higher profits from the fixed income business and higher performance-related fees were partially offset by the negative impact of market conditions, particularly in the retail business.

The Asian asset management operations reported operating profits of £52 million, down by 28 per cent on 2007, reflecting decreases in funds under management and performance-related fees due to market volatility.

The operating profit from the US broker-dealer and asset management businesses was £10 million, a decrease of 23 per cent on 2007. Curian recorded losses of £3 million in 2008, an improvement on its losses of £5 million in 2007, as the business continued to invest to build scale.

IFRS basis profit after tax

	AER ⁴		
	2008	2007	Change
	£m	£m	%
Operating profit from continuing operations based on longer-term investment returns after restructuring costs	1,347	1,201	12%
Short-term fluctuations in investment returns	(1,783)	(137)	
Asia	(200)	(71)	
US	(1,058)	(18)	
UK	(212)	(47)	
Other	(313)	(1)	
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	(14)	(1)	
(Loss)/Profit before tax from continuing operations attributable to shareholders	(450)	1,063	(142%)
Tax attributable to shareholders' profits	59	(354)	
(Loss)/Profit from continuing operations for the financial year after tax	(391)	709	(155%)
Discontinued operations (net of tax)	0	241	
Minority interests	(5)	(3)	
(Loss)/Profit for the year attributable to equity holders of the company	(396)	947	(142%)

The total loss before tax and minority interests on an IFRS basis was £450 million in 2008, compared with a profit of £1,063 million for 2007. This reduction primarily reflects adverse short-term fluctuations experienced in investment returns.

In calculating the IFRS operating profit, we use longer-term investment return assumptions rather than actual investment returns achieved. The actual movements in asset values beyond the longer-term assumptions appear in the profit and loss account as short-term fluctuations in investment returns, with the exception of Jackson, where unrealised gains or losses on debt securities feature directly as movements in shareholder reserves.

The £1,783 million charge for short-term fluctuations in investment returns mainly comprises £200 million, £1,058 million and £212 million relating to our Asian, US and UK operations respectively.

Our Asian operations' negative short-term fluctuations of £200 million primarily reflected movements in Vietnam, Taiwan and Japan of £81 million, £65 million and £34 million respectively. The result in Vietnam mainly reflected the two-thirds fall in the Vietnam equity market. Taiwan's short-term fluctuations mainly reflected CDO losses of £40 million combined with losses of £103 million resulting from the 39 per cent fall in the country's stock market, offset by gains of £108 million in the bond portfolio. In Japan there were a number of contributory factors, the largest of these being losses of £14 million reflecting the 42 per cent fall in the country's stock market and unrealised losses of £13 million on Leveraged Super Senior notes.

Our US results include a £1,058 million charge (2007: £18 million charge) for short-term fluctuations in investment returns. This comprises £535 million in respect of debt securities, £439 million in respect of freestanding derivatives and embedded derivative liabilities, £69 million for equity type securities and a net £15 million for other items.

The £535 million charge for debt securities reflects the levels of defaults, losses on sale, and writedowns in excess of the allowance for longer-term defaults included in the operating result. The main constituent of the £439 million charge is £369 million for freestanding derivatives held to manage the fixed annuity and other general account business. There is also a charge of £70 million in respect of Guaranteed Minimum Withdrawal Benefit and other embedded derivative liabilities for the difference between the effect of applying year-end AA corporate bond rate and equity volatility curves in the total result rather than longer-term levels, as applied in determining the operating result.

Our UK operations' short term fluctuations charge of £212 million reflects asset value movements, principally for the shareholder-backed annuity business, of negative £170 million and £42 million for the effect of credit downgrades on the measurement of annuity liabilities.

Other short term fluctuations charge of £313 million includes £190million for unrealised value movements in Prudential Capital and £71 million on the sale of an investment in an Indian Mutual Fund.

The effective rate of tax on operating profits, based on longer-term investment returns, was 22 per cent (2007: 32 per cent). The effective rate of tax at the total IFRS profit level for continuing operations was 13 per cent (2007: 33 per cent). The effective rate of tax on operating profits is lower than 2007 reflecting a combination of the settlement of issues with HM Revenue and Customs at amounts below those previously provided and a reduction in amounts previously provided on outstanding issues with HM Revenue and Customs. The effective rate of tax at total IFRS profits level is lower than expected, substantially due to a restriction on the ability to recognise deferred tax assets on all losses in Asia and the US.

Earnings per share

	2009	2007
	p	p
EPS based on Operating Profit from continuing operations after Tax and minority interest		
- EEV	88.6	74.5
- IFRS	42.5	33.3
Basic EPS based on total profit/ (loss) after minority interest		
- EEV	(54.1)	121.2
- IFRS	(16.0)	38.7

Dividend per share

The directors recommend a final dividend for 2008 of 12.91 pence per share payable on 22 May 2009 to shareholders on the register at the close of business on 14 April 2009. The interim dividend for 2008 was 5.99 pence per share. As a result, the total dividend for the year, including the interim dividend and the recommended final dividend, amounts to 18.90 pence per share compared with 18.00 pence per share for 2007, an increase of five per cent. The total cost of dividends in respect of 2008 was £469 million.

The full year dividend is covered 2.24 times by post-tax IFRS operating profit from continuing operations.

Dividend cover is calculated as operating profit after tax on an IFRS basis, divided by the current year interim dividend plus the proposed final dividend.

The Board will maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account our Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

Shareholders' funds

On the EEV basis, which recognises the shareholders' interest in long-term businesses, shareholders' funds at 31 December 2008 were £15.0 billion, an increase of £0.4 billion from the 2007 year-end level (2007: £14.6 billion). This two per cent increase primarily reflects the following components: a total EEV basis operating profit of £2,961 million; a positive impact of exchange movements of £2,010 million; a tax credit of £771 million; a positive movement on the mark-to-market of core debt of £656 million; partially offset by a £5,127 million adverse movement in short-term fluctuations in investment returns and dividend payments of £453 million which is itself partially offset by proceeds for new share capital subscribed of £170million.

The shareholders' funds of £15.0 billion at year end 2008 comprised £5.3 billion for our Asian long-term business operations, £4.3 billion for our US long-term business operations, £4.9 billion for our UK long-term business operations and £0.5 billion for our other operations.

At the year end, the embedded value for the Asian long-term business was £5.3 billion. The established markets of Hong Kong, Singapore and Malaysia contributed £3,982 million to the embedded value generated across the region. Korea (£338 million), Indonesia (£314 million) Vietnam (£269 million) also made substantial contributions. Prudential's other Asian markets, excluding Taiwan, contributed an aggregate £567 million in embedded value. Taiwan had a negative embedded value of £205 million.

The sensitivity of the embedded value of our country operations to interest rate changes varies widely across the region. In aggregate, a one per cent decrease in interest rates, along with all

the consequential changes noted above, would result in a negligible change to our Asian business's embedded value.

Statutory IFRS basis shareholders' funds at 31 December 2008 were £5.1 billion, compared with £6.1 billion at 31 December 2007. This result represented a decrease of £1.0 billion, reflecting operating profit of £1,347 million, a foreign exchange credit of £631 million, and a tax credit of £747 million; offset by unfavourable movement in short-term fluctuations in investment returns of negative £1,783 million, a net unrealised value change on Jackson debt securities of negative £1,640 million and the balance of dividend payments of £453 million partially offset by proceeds of new share capital subscribed of £170 million.

The net unrealised value change on Jackson debt securities is explained by net unrealised losses of negative £2,710 million, (being the gross unrealised losses of £3,197 million less unrealised gains of £487 million) reflecting temporary market movements due to the effects of widening global credit spreads offset partially by the effect of reduced risk-free interest rates and a steepening yield curve. These unrealised losses were further offset by associated DAC of £1,070 million.

Holding company cash flow

	<u>2008</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>
Cash remitted by business units:		
Life businesses:		
UK	295	261
US	144	122
Asia	163	148
	<u>602</u>	<u>531</u>
Other:		
Asia	234	38
M&G	167	139
UK	30	3
Total cash remitted to Group	1,033	711
Net interest paid	(128)	(96)
Dividends paid	(453)	(426)
Scrip dividends and share options	167	183
Cash remittances after interest and dividends	619	372
Tax received	130	40
Corporate activities	(177)	(200)
Cash flow before investment in businesses	572	212
Capital invested by business units:		
Life businesses:		
Asia	(310)	(92)
UK	(126)	(145)
	<u>(436)</u>	<u>(237)</u>
Other:		
Asia	(82)	(57)
Total capital invested in business units	(518)	(294)
Increase/(Decrease) in operating cash	54	(82)
Egg sale net proceeds	0	527
Total holding company cash flow	54	445
Contributed by Life Business	166	294

Our Group holding company received £1,033 million in cash remittances from the various business units in 2008, up from £711 million in 2007. This figure includes the shareholders' statutory life fund transfer of £279 million from the UK business.

Cash remitted increased in 2008 by £322 million compared to 2007. This was primarily due to the growth in Asia remittances and the increase in UK General Insurance commission. Asia's remittances grew by £211 million, primarily due to a one-off remittance of £115 million related to Singapore. Asia also realised seed capital from E.Sun Bank and ICICI Asset Management totalling approximately £77 million, and recorded additional cash flow releases from Asian operations as their in-force books matured.

Capital invested in business units grew from £294 million in 2007 to £518 million in 2008, due to an increase of £243 million in Asia's requirements. The growth in Asia was primarily due to the injection of £186 million to meet solvency requirements, of which £66 million was in Taiwan and £72 million in Japan. The remainder was predominately due to business-driven cash injections to support new business growth. Capital of £126 million was injected into UK shareholder-backed business, mainly to support new business. Jackson's capital position remained robust in 2008, and no capital injection was required.

Net interest paid in 2008 increased by £32 million to £128 million compared to 2007, as lower interest rates prevailing in 2008 led to a decrease in interest received on central shareholders' funds.

After dividends and net interest paid, there was a net cash inflow of £619 million (2007: £372 million). There was a significant take-up of scrip dividends in 2008 and 2007.

Tax received in 2008, at £130 million, was £90 million higher than the previous year, reflecting the fact that the 2007 figure was exceptionally low as a result of foreign exchange gains reducing the level of taxable losses. During 2008 the Group holding company paid £177 million in respect of corporate activities, including costs related to the process of considering a reattribution of the inherited estate.

In aggregate, there was an operating cash inflow of £54 million in 2008, compared to an outflow of £82 million in 2007.

Depending on the mix of business written and the opportunities available, we continue to expect the UK shareholder-backed business to become cash positive in 2010.

Free Surplus Generation

Sources and uses of free surplus generation for the Group's life and asset management operations

Free surplus generation for the Group's life business represents the free surplus generated from the in-force operations during the period less the investment in new business.

For asset management operations we have defined free surplus generation to be IFRS profits for the period. Group free surplus also includes the general insurance commission earned during the period and excludes head office, restructuring and net financing costs.

We believe that the underlying free surplus generated from the in-force book is an important measure in understanding the performance of our business. During 2008 we generated £1,680 million of underlying free surplus (2007: £1,388 million).

Free surplus is used by our life companies for investment in new business, and to provide for specific items, such as the provision established in 2008 for additional credit reserves under statutory reporting. In 2008 we invested £825 million of free surplus (2007 £544 million) in new business and established £770 million (2007: nil) for statutory credit reserves on a Pillar 1 statutory basis.

The total movement in free surplus net of tax in the period can be analysed as follows:

	2008	2007
	£m	£m
Free surplus at 1 January*	1,915	1,375
<i>Free surplus generation</i>		
Underlying free surplus generated in the period	1,680	1,388
Provisions for additional allowance for credit risk	(770)	0
Market related items	(1,068)	141
Investment in new business	(825)	(544)
<i>Free surplus generated in the period prior to methodology changes</i>	(983)	985
Gross cash remitted by business units	(1,033)	(711)
Capital injected by business units	518	294
Net cash remitted by the business units	(515)	(417)
Other movements	442	(28)
Free surplus at 31 December*	859	1,915

*Includes IFRS net assets excluding goodwill for asset management operations

The negative £1,068 million of market related movements in 2008 includes £268 million of bond losses in the US; £268 million in respect of the drop in interest rates in Taiwan, including the impact of extending out the phased bond yield progression period by five years from 2013 to 2018; and £532 million of other short term fluctuations in investment returns.

Other movements comprised reallocations of certain statutory reserves and required capital from value in-force to net worth of £187 million in 2008, foreign exchange movements, the mark-to-market of Jackson's assets backing surplus and required capital, and other capital movements.

Excluding Taiwan, free surplus for the remaining life and asset management operations would have been approximately £1.8 billion at 31 December 2008.

The embedded value for the life operations assumes 45 per cent of the value in-force and required capital at 31 December 2008 will convert to free surplus in the next five years, and 68 per cent within 10 years. The actual free surplus generated from the current in-force policies in any future period will depend on the level of future assumption and experience variances that will actually arise. Over the last four year cumulative period, operating variances (after excluding the statutory credit reserve in 2008 and reallocations between net worth and value in-force of £187 million undertaken in 2008) have been £42 million which represented approximately one per cent of the projected in-force for the life business.

The table below shows Group free surplus generated for life and asset management operations, as defined above, over the last four years.

Cumulative free surplus analysis	2008	2007	2006	2005	2005-2008 (cumulative)
	£m	£m	£m	£m	£m
Expected in force cash flows (including expected return on net assets)*	1,744	1,299	1,182	992	5,217
Changes in operating assumptions and variances	(64)	89	(29)	46	42
	1,680	1,388	1,153	1,038	5,259
Provision for additional allowance on credit risk	(770)	0	0	0	(770)
Changes in non-operating assumptions and variances	(1,068)	141	56	(189)	(1,060)
Actual in-force cash flow	(158)	1,529	1,209	849	3,429
New business	(825)	(544)	(554)	(562)	(2,485)
Free surplus generated in the period prior to methodology changes	(983)	985	655	287	944
Reallocations between net worth and value in-force	(187)	0	0	0	(187)
Free surplus generated in the period	(1,170)	985	655	287	757

* Expected in-force cash flow includes asset management of IFRS operating profits and GI commission

Investment of free surplus in new business by life operations

Value created through investment in new business by life operations

	2008				2007			
	Asia £m	US £m	UK £m	Group £m	Asia £m	US £m	UK £m	Group £m
Free surplus invested in new business	(243)	(289)	(293)	(825)	(194)	(200)	(150)	(544)
Increase in required capital	42	265	165	472	21	183	104	308
Net worth invested in new business	(201)	(24)	(128)	(353)	(173)	(17)	(46)	(236)
Value of in-force created by new business	751	214	325	1,290	646	202	246	1,094
Post tax new business profit for the period	550	190	197	937	473	185	200	858
Tax	191	103	76	370	170	100	77	347
Pre tax new business profit for the period	741	293	273	1,307	643	285	277	1,205

New business sales (APE) 1362 716 947 1287 671 910

New business margin % (APE) 54% 41% 29% 50% 42% 30%

Internal rate of return >20% 16% 14% > 20% 18% * 18%

Note*: UK excluding the Equitable Life deal 14%

The average free surplus undiscounted payback period for business written in 2008 was

Asia	4 years
US	5 years
UK	6 years

Overall, our Group wrote £3,025 million of sales on an APE basis during the year. To support these sales, we invested £825 million of capital (2007: £544 million). This amount covers both new business strain, including commissions, of £353 million and the required capital of £472 million. The total capital investment for new business amounted to approximately £27 million per £100 million of APE sales (2007: £19 million). These sales provided a post-tax new business contribution to embedded value of £937 million (2007: £858 million).

In Asia, capital was invested to support sales at an average rate of £18 million per £100 million of APE sales. (2007: £15 million).

In the US, capital was invested to support sales at an average rate of £40 million per £100 million of APE sales (2007: £30 million).

In the UK, capital was invested to support sales at an average rate of £31 million per £100 million of APE sales (2007: £16 million).

The increase in capital requirements year on year was caused predominantly by a change in business mix in our UK annuity business, with bulk annuity business being written by shareholder-backed companies in 2008, rather than by the with-profits fund as in 2007, and with higher reserves being established for credit contingency. Higher capital usage in the US resulted from the change in business mix from variable annuities to other business.

Basis of preparation of results

The European Union (EU) requires that all listed European groups prepare their financial statements in accordance with EU approved IFRS. Since 1 January 2005, Prudential has been reporting its primary results on an IFRS basis.

As a signatory to the European Chief Financial Officers' (CFO) Forum's EEV Principles, Prudential also reports supplementary results on an EEV basis for the Group's long-term business. We combine these results with the IFRS basis results of the non long-term businesses to provide a supplementary operating profit under EEV. References in this report to operating profit relate to profit based on long-term investment returns.

Under both EEV and IFRS, operating profits from continuing operations based on longer-term investment returns exclude short-term fluctuations in investment returns and shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. Under EEV, where additional profit and loss effects arise, operating profits based on longer-term investment returns also exclude the mark-to-market value movement on core borrowings, together with the effect of changes both in economic assumptions and also in the time value of the cost of options and guarantees arising from changes in economic factors.

In broad terms, IFRS profits for long-term business contracts reflect the aggregate of statutory transfers from with-profits funds and profits on a traditional accounting basis for other long-term business. Although the statutory transfers from with-profits funds are closely aligned with cash flow generation, the pattern of IFRS profits over time from shareholder-backed long-term businesses will generally differ from the cash flow pattern. Over the life of a contract, however, aggregate IFRS profits will be the same as aggregate cash flow.

Life insurance products are long-term by their nature, and the profit on them is generated over several years. In Prudential's opinion, accounting under IFRS alone does not fully reflect the inherent value of these future profit streams. Instead, adding embedded value reporting to the IFRS accounting and specific additional disclosures, particularly on capital and cash flow, provides investors with a better sense of underlying profitability of our Group's long-term businesses. Embedded value reporting is a valuable supplement to statutory accounts.

The results for the year ended 31 December 2008 have been prepared using International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and endorsed by the European Union (EU). The results in this preliminary announcement have been prepared in accordance with IFRS applicable at 31 December 2008 and have been taken from the group's Annual Report and Accounts which will be available on the company's website on 15 April 2009.

The preliminary announcement for the year ended 31 December 2008 does not constitute statutory accounts as defined in section 240 of the Companies Act 1985. The results on an IFRS basis for the full year 2008 and 2007 have been audited by KPMG Audit PLC. The auditor has reported on the 2008 and 2007 financial statements and the report was unqualified and did not contain a statement under section 237(2) or (3) of the Companies Act 1985. The Group's 2007 Report and Accounts have been filed with the Registrar of Companies.

RISK AND CAPITAL MANAGEMENT

Introduction

As a provider of financial services, including insurance, we recognise that the managed acceptance of risk lies at the heart of our business. As a result, effective risk management capabilities represent a key source of competitive advantage for our Group. To maximise this advantage, we have embedded a risk and capital management framework and culture that drives the rigorous risk and capital management and optimisation of risk adjusted returns across the Group.

The Group's risk appetite framework sets out our tolerance to risk exposures as well as our approach to risk management and return optimisation. Under this approach, we monitor our risk profile continuously against agreed limits. Our main strategies for managing and mitigating risk include asset liability management, using derivatives to hedge relevant market risks, and implementing reinsurance and corporate insurance programmes.

RISK OVERSIGHT

Group risk appetite

We define and monitor aggregate risk limits for our earnings volatility and our capital requirements:

- (a) Earnings volatility: the objectives of the limits are to ensure that (a) the volatility of our earnings is consistent with our stakeholders' expectations, (b) the Group has adequate earnings (and cash flows) to service debt, expected dividends and to withstand unexpected shocks, and (c) earnings (and cash flows) are managed properly across geographies and are consistent with our funding strategies. The two measures we apply to monitor the volatility of our earnings are European Embedded Value (EEV) operating profit and International Financial Reporting Standards (IFRS) operating profit.
- (b) Capital requirements: the limits aim to ensure that (a) the Group meets its solvency capital requirements at all times, (b) the Group achieves its desired target rating to meet its business objectives, and (c) supervisory intervention is avoided. The two measures we apply are the EU Insurance Groups Directive (IGD) capital requirements and economic capital requirements.

Our risk appetite framework forms an integral part of our annual business planning cycle. Throughout the year, our Group Risk function monitors the Group's risk profile against the agreed limits. Using submissions from business units, Group Risk calculates our position (allowing for diversification effects between business units) relative to the limits implied by the risk appetite statements.

Local limits are agreed with each of our business units to ensure that the aggregate risk exposure remains within the defined Group-level risk appetite. Each business unit determines its own individual risk position by calculating the impacts (on earnings and capital measures) of a shock to its market, credit, insurance and operational risk exposures and agrees them with Group Risk and the Group Asset and Liability Committee (ALCO).

We use a two-tier approach to apply the limits at business unit level. Firstly, we calculate business unit risk limits. These ensure that, provided each business unit keeps within its limits, the Group risk position will remain within the Group limits. Secondly, the impact on the risk position is considered as part of Group Risk's scrutiny of large transactions or departures from plan proposed by individual business units.

In the event that any of the business unit plans imply risk limits will be exceeded, this will necessitate a dialogue between Group Head Office (GHO) and the relevant business unit or units. Exceeding Group limits may be avoided if, for example, limits in other business units are not fully utilised, or if the diversification effect at Group level of a particular risk with other business units means the Group limit is not breached. Ultimately, authorisation to breach limits would require approval from GHO.

The continuing market dislocation and the increased risk of default has increased emphasis on the management of market and credit risk in the course of 2008. Market risk is managed such that as conditions evolve the risk profile is maintained within risk appetite, and in addition to business unit operational limits on credit risk, we set counterparty risk limits at Group level. Limits on our total Group-wide exposures to a single counterparty are specified within different credit rating 'categories'. Group Risk and the Group ALCO monitor our actual exposures against these limits on a monthly basis.

Risk exposures

The Group Risk Framework deploys a common risk language, allowing meaningful comparisons to be made between different business units. Risks are broadly categorised as shown below.

Category	Risk type	Definition
Financial risks	Market risk	The risk that arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates.
	Credit risk	The risk of loss if another party fails to meet its obligations, or fails to do so in a timely fashion.
	Insurance risk	The inherent uncertainty as to the occurrence, amount and timing of insurance liabilities. This includes adverse mortality, morbidity and persistency experience.
	Liquidity risk	The risk that a business, though solvent on a balance sheet basis, either does not have the financial resources to meet its obligations as they fall due or can secure them only at excessive cost.
Non-financial risks	Operational risk	The risk of direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events. This includes legal and regulatory compliance risk.
	Business environment risk	Exposure to forces in the external environment that could significantly change the fundamentals that drive the business's overall objectives and strategy.
	Strategic risk	Ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Group's capabilities.

Market risk:

Equity risk

Most of the equity exposure in our UK business arises from the with-profits fund which is partially protected against falls in equity markets through an active hedging policy. The fund also includes a large inherited estate – estimated at £5.4 billion at 31 December 2008. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy.

In Asia, a high proportion of our in-force book is made up of unit-linked products with limited shareholder exposure to equities. We have minimal direct shareholder exposure to Asian equity markets outside our unit-linked holdings.

In the US, where we are a leading provider of variable annuities, there are well-understood risks associated with the guarantees embedded in our products. We provide guarantees for minimum death benefit (GMDB) on all policies in this class, minimum withdrawal benefits (GMWB) on 67 per cent of the book, and minimum income benefits (GMIB) on only 11 per cent. To protect the shareholder against the volatility induced by these embedded options, we use both a comprehensive hedging programme and reinsurance.

In our variable annuity sales activities, we focus on meeting the needs of conservative and risk averse customers who are seeking reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers select conservative investment options and, importantly, buy fewer guarantee products compared to the industry as a whole. We are able to achieve this because our unique and market leading operational platform allows us to tailor more than 3,000 product combinations, thereby ensuring that our customers are not

sold guarantees they do not need. We seek to sell at a price where we can hedge or reinsure our risks. Many of our competitors offer 'bundled' products where the customer pays for guarantees that they do not require. In contrast, our more tailored offering avoids the sale of unnecessary guarantees, enabling us to remain globally price competitive while pricing each of our individual guarantees appropriately. This enables us to be price-competitive while not over-exposing our business to guarantee risk. Also, the conservative nature of our investment options makes hedging a more straightforward process.

It is our philosophy not to compete on price. Our individual guarantees tend to be more expensive than the market average, because we seek to sell at a price where we can hedge or reinsure our risks.

We do not actively market GMIB, and where it is selected we reinsure. We use reinsurance to cover both the in-force book and new business for the life of the policy. If reinsurance were not available, we would not sell GMIB options.

We take a macro approach to hedging that covers market risk in the US business, including all exposure to GMDB and GMWB guarantees. Within this macro approach we make use of the natural offsets that exist between the variable annuity guarantees and the fixed-indexed annuity book, and then use a combination of Over The Counter (OTC) options and futures to hedge the residual risk, allowing for significant market shocks and limiting the amount of capital we are putting at risk. The hedging programme covers both the in-force book and new business for the 'greeks' – i.e. changes in equity market levels, the rate of change in market levels and equity market volatility, as well as interest rate movements. In addition we hedge the fees on variable annuity guarantees.

A combination of Jackson's sales approach, disciplined pricing and dynamic hedging of its variable annuity guarantees meant that Jackson's equity hedging gains offset the effect of the 38.5 per cent drop experienced in US equity markets in 2008 on a statutory capital basis. This outcome compared favourably to the industry as a whole. Indeed, Jackson was one of only a handful of US life insurance companies to achieve this level of success with its variable annuity hedging programme in 2008.

Interest rate risk

Interest rate risk arises primarily from Prudential's investments in long-term debt and fixed income securities. Interest rate risk also exists in policies that carry investment guarantees on early surrender or at maturity, where claim values can become higher than the value of backing assets as a result of rises or falls in interest rates.

Interest rates primarily impact our Asia, US and UK with-profit businesses. In Asia, our exposure will be reduced following our agreement with China Life Insurance Company Ltd (Taiwan) to transfer the agency-based business in Taiwan, which includes Prudential's legacy products which contain interest rate risk. The remaining exposure in Asia arises mainly from guarantees on traditional shareholder-backed life products and asset-liability mismatches, primarily in Japan and Korea. This exposure is within our risk appetite, and we manage it carefully on an ongoing basis. We have a range of risk mitigation options available to us should we wish to reduce this exposure further. However, it is important to note that interest rates in some territories are currently at historically low levels, which has the effect of mechanistically reducing our downside risk.

In the US there is interest rate risk across the portfolio. We manage fixed annuity interest rate exposure through a combination of interest rate swaps and interest rate options, to protect capital against rates rising quickly, and through the contractual ability to reset crediting rates annually. The average traditional fixed annuity crediting rate is 91bps above the guaranteed crediting rate. Historically, we have had a significant IGD sensitivity relating to the mark-to-market accounting of interest rate derivatives. During the final quarter of 2008, we worked with the Michigan State regulator to recognise the effectiveness of interest rate hedging, and the statutory valuation now accounts for hedges and the hedged items on a consistent basis.

In the UK the investment policy for the shareholder backed annuity business is to match investment returns with annuity payments. Where these cash flows are not matched exactly there is some exposure to asset and liability mismatches and this exposure can be increased by, for example, the current low interest rate environment. There is an interest rate risk in the UK with-profit fund.

Foreign exchange risk

Prudential operates in the UK, the US, Continental Europe and 13 countries in Asia. Inevitably, the geographical diversity of our businesses means that we are subject to the risk of exchange rate fluctuations. Prudential's international operations in the US and Asia, which represent a significant proportion of our operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in our consolidated financial statements when results are expressed in pounds sterling.

We do not generally seek to hedge foreign currency revenues, as these are substantially retained locally to support the growth of the Group's business and meet local regulatory and market requirements. However, in cases where a foreign surplus is deemed to be supporting Group capital or shareholders' interests, this exposure is hedged if we deem it economically optimal to do so. Currency borrowings and derivatives are used to manage exposures within the set limits.

Credit risk

The global debt markets experienced unprecedented conditions in 2008, with illiquidity and credit spreads reaching all-time highs. Our debt portfolio on an IFRS basis was estimated at £95 billion at 31 December 2008.

Of this total, £59 billion was in the UK insurance operations, of which £38 billion was within the UK with-profits fund. The fund also includes a large inherited estate – estimated at £5.4 billion. Outside the with-profits fund, £4 billion was held in unit-linked funds where the shareholder risk is limited, and there was £17 billion backing the shareholder annuity business and other non-linked business, of which £13 billion related to corporate bonds and £4 billion was in government securities, or equivalent.

Within the UK shareholder annuity funds, we have built up a significant credit reserve of £1.4 billion to allow for future defaults on a statutory basis. This reserve can withstand the equivalent of the average default experience during the Great Depression occurring every year over the life of the portfolio.

In 2008, we have experienced credit defaults for UK operations of £93 million that relate to shareholder funds (0.5 per cent of the portfolio).

Asia's debt portfolio totalled £11 billion at 31 December 2008. Of this, approximately 64 per cent was invested in Unit-Linked and with-profits funds with minimal shareholder risk. The remaining 36 per cent is shareholder exposure and is invested predominantly (85 per cent) in government bonds. For Asia, the portfolio has performed very well, with 2008 defaults totalling only £20 million.

The final and most significant area of exposure to credit risk for the shareholder is Jackson in the US. At 31 December 2008 Jackson's fixed income portfolio was estimated at £24 billion, comprised of £16 billion of Corporate Debt, £2 billion of Commercial Mortgage Backed Securities (CMBS), £4 billion of Residential Mortgage Backed Securities (RMBS) and £2 billion of other instruments. We entered the cycle in a defensive position and continue to manage the portfolio rigorously.

The US Corporate Debt portfolio of £16 billion is 92 per cent investment grade. Concentration risk is low, with the top ten holdings accounting for only five per cent of the portfolio. The high-yield portfolio is also well diversified with an average holding of £8 million. Our single largest sector exposure in the investment grade portfolio is Utilities at 13 per cent. We actively manage the portfolio and will sell exposure as events dictate; for example, we reduced our holding in both Lehman and Washington Mutual early in 2008.

Within the RMBS portfolio of £4 billion, the agency guaranteed portion is 50 per cent. Another 25 per cent of the portfolio relates to investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. Our exposure to the 2006/2007 vintages totals £946 million of which £617 million is invested in the senior part of the capital structure, thereby significantly reducing the risk of defaults and the magnitude of loss if a shortfall does occur. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS is only £329 million.

The CMBS £2 billion portfolio is performing strongly, with 85 per cent of the portfolio being AAA and only [one] per cent below investment grade. We materially reduced our non-AAA purchases after 2004 in response to the significant deterioration in underwriting standards observed in the market and in line with rating agencies' guidelines. The entire portfolio has an average credit enhancement level of 30 per cent. This provides significant protection, since it means the bond has to incur a 30 per cent loss, net of recoveries, before we are at risk.

In 2008, Jackson's total defaults were £78 million of which £5 million were incurred in the fourth quarter. As part of our active management of the book we incurred net losses of £127 million on the sale of impaired bonds, of which £67 million was incurred in the fourth quarter of 2008.

IFRS write-downs excluding defaults for the year were £419 million, an increase of £228 million in the fourth quarter of 2008.

The impairment process reflects a rigorous review of every single bond and security in our portfolio. We believe that the accounting rules for impairments are necessarily conservative and not always consistent with economic losses. So, while the accounting requires us to book them as losses through our income statement, we would expect only a proportion of these impairments eventually to turn into defaults, and some of the impaired securities to recover in price over time.

In considering potential future losses for Jackson, it is essential to examine the key components of the debt portfolio. As at 31 December 2008, 93 per cent of Jackson's total debt portfolio of £24 billion consisted of investment grade securities and seven per cent were high yield. To put potential future losses in context, global annual default rates over the past 50 years have averaged 0.5 per cent for investment grade and 10 per cent for high yield. Historically, the highest global annual default rates during a recession have averaged 1.6 per cent for investment grade and 15.4 per cent for high yield, although not necessarily in the same year (Source: Moody's Global Corporate Finance - February 2008).

Applying peak global annual default rates and making conservative assumptions for recoveries to our portfolio would generate losses of approximately £350 million for one year that could be absorbed by our current IGD surplus as estimated at 31 December 2008.

Unrealised Credit Losses

Jackson's gross unrealised losses moved from £439 million at 31 December 2007 to £3,178 million at 31 December 2008. This change was largely due to a market-wide re-pricing of risk and not to specific problems within Jackson's portfolio. The entire market for fixed income securities has been re-priced downwards from historically tight spreads of approximately 100 bps during the first half of 2007 to historically wide spreads of over 640 bps on investment grade paper at the end of 2008. Wider credit and liquidity spreads are causing the average investment grade security to trade around the mid to high 80s as a percentage of nominal value. Unrealised losses on securities priced at less than 80 per cent of face value were £1.9 billion at 31 December 2008. It is our intention to hold these fixed income securities to maturity – an approach, which in economic terms limits the impact of the current market dislocation.

Jackson's unrealised losses rose in the fourth quarter by £1.3 billion as credit spreads moved to all-time highs and bond prices to all-time lows. It is important to bear in mind that in the increase of £ 1.3 billion in the fourth quarter of 2008, about £446 million is directly due to the depreciation of sterling against the US dollar. We believe that the accounting impact of these unrealised losses significantly overstates the risk of economic losses on our portfolio at current price levels.

Insurance risk

The processes of determining the price of our products and reporting the results of our long-term business operations require us to make a number of assumptions. In common with other industry players, the profitability of our businesses depends on a mix of factors including mortality and morbidity trends, persistency, investment performance, unit cost of administration and new business acquisition expenses.

For example, the assumption that we make about expected levels of mortality is particularly relevant for our UK annuity business, where in exchange for their accumulated pension fund pension annuity policyholders receive a lifetime guaranteed payment. We conduct rigorous research into longevity risk using data from our substantial annuitant portfolio. As part of its pension annuity pricing and reserving policy, Prudential UK assumes that current rates of

mortality continuously improve over time, at levels based on adjusted data from the Continuous Mortality Investigations (CMI) projections published by the Institute and Faculty of Actuaries.

Prudential's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Where appropriate, allowance is also made for the relationship – either assumed or historically observed – between persistency and investment returns, and for the resulting additional risk.

Liquidity risk

We remain comfortable with our liquidity position both at holding and subsidiary company level. The holding company has significant internal sources of liquidity which are sufficient to meet all of our requirements for the foreseeable future without having to make use of external funding. In aggregate our Group has £2.1 billion of undrawn committed facilities, of which we have recently renewed £1.4 billion of the undrawn syndicated committed banking facility for a further three years as well as renewing the £500 million securities lending back-up facility.

Non-financial risk

Prudential is exposed to operational, business environment and strategic risk in the course of running its businesses. We process a large number of complex transactions across numerous and diverse products, and are subject to a number of different legal and regulatory regimes. We also have a significant number of third-party relationships that are important to the distribution and processing of our products, both as market counterparties and as business partners. More detail on the risk factors that may affect Prudential's operating results and financial condition, and accordingly the trading price of our shares are provided.

We use quantitative analysis of operational risk exposures material to the Group to inform our decisions on the overall amount of capital held and the adequacy of the corporate insurance programme.

CAPITAL MANAGEMENT

Regulatory capital

Group regulatory capital (IGD)

Prudential is subject to the capital adequacy requirements of the Insurance Groups Directive (IGD) as implemented by the Financial Services Authority (FSA) in the UK. The IGD pertains to groups whose activities are primarily concentrated in the insurance sector.

The IGD capital adequacy requirements involves aggregating surplus capital held in our regulated subsidiaries, from which Group borrowings, except those subordinated debt issues that qualify as capital, are deducted. No credit for the benefit of diversification is allowed for under this approach. The IGD test is passed when this aggregate number is positive. A negative result at any point in time is a notifiable breach of UK regulatory requirements.

Our capital position is strong, driven by our prudent but proactive risk management. Our IGD capital surplus is estimated at £1.7 billion before allowing for the 2008 final dividend, giving a solvency ratio of 162 per cent. This is composed of our IGD surplus at 31 December 2008 estimated at £1.4 billion, and in addition £0.3 billion that the FSA has subsequently allowed us to include in our IGD surplus going forward, as a result of an innovative structure we have developed. Our IGD capital surplus on a consistent basis (i.e. before allowing for a dividend) at the end of 2007 and at the end of the third quarter 2008 stood at £1.9 billion and £1.4 billion respectively. The movement from £1.9 billion at 31 December 2007 to the estimated £1.7 billion benefitted from the £0.3 billion allowed by the FSA. The remaining decrease of £0.5 billion in 2008 comprises net earnings of £0.8 billion, management actions of £0.6 billion and positive foreign exchange movements of £0.2 billion, offset by the 2007 final dividend of £0.3 billion, market related risk of £0.4 billion, strengthening of UK credit reserves of £0.8 billion and £0.6 billion of credit related impairments and default losses in the US.

The £0.3 billion additional IGD capital reflects our ability to realise a portion of the shareholders' economic interest in the future transfers from the UK with-profits fund, which in total was worth £1.7 billion at 31 December 2008. Going forward, we have the opportunity to develop similar transactions, enabling us to access more of the residual £1.4 billion if we decide to do so.

We have been able to maintain a stable IGD position in challenging markets. The options we have to manage available and required capital can be classified into, increasing available capital and reducing required capital.

Our ability to access more of the shareholder economic interest in the with-profit fund up to a level of £1.4 billion, and our ability to access to future profits on other in-force business through financial reinsurance are examples of how we have the potential to increase available capital.

We can also manage our required capital through both the level and the mix of new business and by maintaining pricing discipline. We have employed and will continue to employ other risk mitigation strategies such as hedging and reinsurance when necessary.

In addition to this strong capital position, the total credit reserve for the UK shareholder annuity funds was £1.4 billion at the end of the year. We have increased this credit reserve by £0.8 billion in 2008 and it is equivalent to 80bps per annum over the lifetime of the assets. This reserve would allow us to withstand a repeat of the average Moody's default experience during the Great Depression, occurring every year throughout the life of the book.

On the 20 February 2009 we announced that we have entered into an agreement to transfer the assets and liabilities of our agency distribution business in Taiwan to China Life Insurance Company Ltd (Taiwan) pending regulatory approval. The business to be transferred includes Prudential's legacy interest rate products in Taiwan, and the agreement is significantly value enhancing for the Group. On completion the transfer will give rise to a net increase in the Group's IGD surplus of approximately £0.8 billion, further strengthening our already robust capital position.

These factors, together with our Group's strong underlying earnings capacity, our established hedging programmes and our additional areas of financial flexibility, position us to withstand possible significant further deterioration in market conditions.

Solvency II

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The application of Solvency II to international groups is still unclear and there is a risk of inconsistent application in different EU member states, which may place Prudential at a competitive disadvantage to other European and non-European financial services groups.

Like Basel II in the banking industry, the new approach is expected to be based on the concept of three pillars – minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements. However, the scope is wider than Basel II and will cover valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements.

A key aspect of Solvency II is that the focus on risks and capital requirements will be aligned more closely with economic capital methodologies. Solvency II will encourage companies to improve their risk management processes and may allow companies to make use of internal economic capital models if approved by the local Regulator.

Capital allocation

Prudential's approach to capital allocation takes into account a range of factors, especially risk adjusted returns on capital, the impact of alternative capital measurement bases (accounting, regulatory, economic and ratings agency assessments), tax efficiency, and wider strategic objectives.

We optimise capital allocation across the Group by using a consistent set of capital performance metrics across all business units to ensure meaningful comparison. Capital utilisation, return on capital and new business value creation are measured at a product level. The use of these capital performance metrics is embedded into our decision-making processes for product design and product pricing.

Our capital performance metrics are based on economic capital, which provides a view of our capital requirements across the Group, allowing for realistic diversification benefits. Economic capital also provides valuable insights into our risk profile and is used both for risk measurement and capital management.

Stress testing

We use regular stress testing and sensitivity analysis to monitor the robustness of the Group's regulatory and economic capital position.

Stress testing has been carried out to assess the resilience of the Group's regulatory capital position (IGD) to withstand significant further deterioration in market conditions. The findings include:

- An instantaneous further 40 per cent fall in equity markets from 31 December 2008 levels would reduce the IGD surplus by £350 million.
- A 150bps reduction (subject to a floor of zero) in interest rates from 31 December 2008 would reduce the IGD surplus by £300 million (the effect would be less following completion of the sale of our Taiwan legacy agency book).
- Credit defaults of ten times the expected level would have an impact of £500 million in excess of the annual reserve release.

We also test the impact of a range of 'shock' scenarios on the Group's regulatory and economic capital. The scenarios for this testing are selected using both in-house views and external assessments such as the FSA's annual Financial Risk Outlook. The purpose is to assess the resilience of the Group's capital position to a range of key threat scenarios.

Capital base

Capital structure

Prudential Group's capital on an EEV basis consists of £14,956 million of shareholders' funds and net core debt at market value after cash and short term investments of £818 million, and includes £1,250 million of holding company subordinated long term and perpetual debt.

Subordinated – or 'hybrid' – debt is debt capital which has some equity-like features, and which would rank below other senior debt in the event of a liquidation. These characteristics mean hybrid debt can be treated as capital for FSA regulatory purposes. All of our Group's hybrid debt which qualifies under the FSA's definition is held at Group level. As a result, it is taken as capital into the parent solvency test under the IGD.

Following the implementation of the IGD, raising our long-term debt in hybrid form benefits us from a regulatory capital standpoint. We intend to do this by taking advantage of favourable market conditions as they arise.

Balance Sheet Structure (EEV basis)

	2008	2007
	£m	£m
Long term business	14,633	13,939
Other business including fund management	1,642	1,677
Other net liabilities	(501)	(143)
	15,774	15,473
Financed by:		
Equity shareholders funds	14,956	14,600
Perpetual preferred securities	513	679
Subordinated debt	737	817
Senior debt	733	833
Cash & short-term investments	(1,165)	(1,456)
	15,774	15,473

The balance sheet includes unallocated surplus for the PAC with-profits fund that has yet to be allocated either to policyholders or shareholders. These assets are not generally available to the Group, other than as they emerge through the statutory transfer of the shareholders' share of the surplus as declared from the fund over time. The EEV shareholders' equity reflects the value of future shareholder cash flows from in-force business. In determining these cash flows, the shareholders' interest is derived by increasing final bonus rates so as to exhaust the surplus over the lifetime of the in-force with-profits business, other than in extreme scenarios where the excess cost of meeting policyholder claims is fully attributed to shareholders.

Shareholders' borrowings and financial flexibility

The core structural borrowings of our shareholder-financed operations at 31 December 2008 totalled £2,958 million on an IFRS basis, compared with £2,492 million at the end of 2007. The increase during the year reflected exchange conversion losses amounting to £468 million predominantly on our long term borrowings of €500 million, US\$1 billion, US\$300 million, US\$250 million and US\$250 million surplus notes .

After adjusting for holding company cash and short-term investments of £1,165 million, our net core structural borrowings at 31 December 2008 were £1,793 million, compared with £1,036

million a year earlier. The increase on the 2007 figure reflected net cash inflows of £54 million, exchange conversion losses of £816 million including the £468 million on long-term borrowings identified above, and £354 million in respect of a US\$2 billion net investment hedge of the currency exposure of the net investments in the US operations.

Our core structural borrowings at 31 December 2008 included £1,761 million borrowed at fixed rates of interest, with maturity dates ranging from 2009 to perpetuity. A significant proportion – amounting to £1,232 million – of the core borrowings was denominated in US dollars, in order to provide partial hedging of the currency exposure arising from our Group's investment in Jackson.

We have also put in place an unlimited global commercial paper programme. As at 31 December 2008, commercial paper totalling £278 million, US\$916 million, €359 million and CHF10 million has been issued under this programme. We also have a £5,000 million medium-term note (MTN) programme, under which the outstanding subordinated debt at 31 December 2008 was £435 million and €520 million, while the senior debt outstanding was £200 million and US\$12 million.

In addition, our holding company has access to £1,600 million of committed revolving credit facilities, provided by 15 major international banks, and renewable between December 2010 and February 2012; and an annually renewable £500 million committed securities lending liquidity facility. Apart from a small drawdown to test the process, these facilities were not drawn on during the year, and there are no amounts outstanding under the committed credit facilities at 31 December 2008. The commercial paper programme, the MTN programme, the committed revolving credit facilities and the committed securities lending liquidity facility are all available for general corporate purposes and to support the liquidity needs of our holding company.

We manage our Group's core debt within a target level consistent with our current debt ratings. At 31 December 2008, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders' funds plus debt) was 10.7 per cent, compared with 6.6 per cent at 31 December 2007.

Prudential plc has strong debt ratings from Standard & Poor's, Moody's and Fitch. Prudential's long-term senior debt is rated A+ (stable outlook), A2 (stable outlook) and AA- (stable outlook) from Standard & Poor's, Moody's and Fitch, while short-term ratings are A-1, P-1 and F1+.

The financial strength of PAC is rated AA+ (negative outlook) by Standard & Poor's, Aa1 (rating under review for possible downgrade) by Moody's and AA+ (stable outlook) by Fitch Ratings.

Jackson's financial strength is rated AA (stable outlook) by Standard & Poor's and A1 (stable outlook) by Moody's.

Risk mitigation and hedging

We manage our actual risk profile against our tolerance of risk. To do this, we maintain risk registers that include details of the risks we have identified and of the controls and mitigating actions we employ in managing them. Any mitigation strategies involving large transactions – such as a material derivative transaction – are subject to scrutiny at Group level before implementation.

We use a range of risk management and mitigation strategies. The most important of these include: adjusting asset portfolios to reduce investment risks (such as duration mismatches or overweight counterparty exposures); using derivatives to hedge market risks; implementing reinsurance programmes to limit insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.

During 2008, our risk management and mitigation initiatives resulted in the rebalancing of the Group's USD hedge to reflect our exposure to IGD regulatory surplus held in USD. Since the year-end we have also implemented additional equity hedging in Jackson to reduce the exposure to further falls in the level of the S&P index. A wide range of capital management initiatives and risk mitigation options remain available to the Group to manage the IGD capital position. These include the use of reinsurance and similar structures to crystallise the value of future cash flows, the implementation of further hedging strategies, and taking steps to conserve and/or release capital.

We have contingency plans in place for a range of operational risk scenarios, including incident management and business continuity plans. As a contingency plan for liquidity risk, the Group has arranged access to committed revolving credit facilities and committed securities lending facilities.

BUSINESS UNIT REVIEW

Insurance Operations

Asia

	AER ^{4/8}			CER ^{4/8}	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
Asia					
APE sales	1,362	1,287	6%	1,369	(1%)
NBP	741	643	15%	693	7%
NBP margin (% APE)	54%	50%		51%	
NBP margin (% PVNBP)	10.1%	9.3%		9.4%	
Total EEV basis operating profit*	1,309	1,042	26%	1,135	15%
Total IFRS operating profit*	321	189	70%	212	51%

*Based on longer-term investment returns excluding fund management operations, development and regional head office expenses.

Prudential was an early mover in recognising the long-term growth potential in Asia. Leveraging a foothold established in the 1920's, we have created an unparalleled business in the region that holds market-leading positions in the world's most populous and dynamic economies. As a result Prudential already has over 11 million customers in Asia. Distribution is predominantly through tied agents, and we have built up one of the region's largest agency forces numbering some 425,000 at 31 December 2008. We complement our agency distribution in the region with a number of distribution agreements with leading banks and brokers. Prudential is a pioneer in capital efficient unit linked products in Asia, and is particularly strong in the regular premium savings sector. More recently we have increased our focus on higher-margin protection products, both as riders to savings policies and standalone.

Prudential's operations in Asia are unified under the Prudence face icon, which retains a consistently high recognition rate, outperforming other financial service companies in the region. We operate distinct life insurance businesses in 12 markets. These are all managed by local teams with strategic leadership and technical support provided by the regional team (based in Hong Kong). Every opportunity is taken to leverage synergies and best practices around the region, and from the wider Prudential Group, particularly in areas such as product development, channel distribution and asset liability management. The Asian businesses operate with common principles and within a regionally managed risk framework. We consistently win industry awards for the quality of our operations in Asia, including our customer service,

Underpinning Prudential's success in the region is the breadth and depth of our management teams and staff. These comprise a combination of market-leading international specialists and the very best local talent.

Our current strategy in Asia is to leverage our platform to generate further shareholder value by continuing to increase the scale of our operations. This is reflected in the following strategic commitments: further increasing agency scale and productivity, continuing to build distribution through partnerships, sharpening the focus on health and protection products, developing segmented retirement solutions and strengthening customer relationships.

Although externally the highest profile measure of success is new business volumes and how this translates into market share, Prudential's internal focus is on EEV NBP. Our business in Asia maintains strict financial disciplines to ensure that there is always a strong correlation between business volumes and the value generated, as reflected in the shareholders' embedded value metrics. As the scale of our business in Asia continues to increase as evidenced by premium revenues of £5.5 billion in 2008, there is a greater focus on demonstrating the emergence of

this value in terms of distributable IFRS profits and cash. Given the current economic climate, a thorough review has been undertaken of all the operations' solvency positions from the local regulatory and the IGD perspectives. Optimising capital efficiency from the Group's perspective has always been a priority, but with the worldwide collapse of market valuations and interest rates we paid particular attention to this during 2008.

Initiatives in 2008

Agency

During the year, Prudential increased its average number of agents in the Asia region by 21 per cent to 425,000, with the largest increases in Indonesia (up 43 per cent to 57,000) and India (up 21 per cent to 287,000). With the exception of Thailand, all of our Asian operations expanded their agency forces during 2008.

The challenging economic environment did suppress industry-wide agency productivity in terms of APE per agent in 2008. Our, average productivity was 21 per cent lower than in 2007 with the main cause being lower average case sizes. The main driver of this decline was lower average case size, which fell by 12 per cent due to the tougher economic climate and higher proportions of (highly profitable) health and protection business. However, the average number of cases per active agent per month was only marginally lower in 2008 than in 2007 – a performance that reflects the resilience of our agency force in a depressed market.

Disposal of PCA Life Taiwan's Agency Business

When Prudential entered the Taiwanese market in 1999, traditional "compulsory dividend" life policies were the only type of savings and protection policy permitted by the regulator. These policies are unique to Taiwan and have claims, guaranteed surrender values and local statutory reserves calculated on a prescribed actuarial basis, which includes an underlying interest rate assumption based on two-year interest rates at the time the policy is sold.

Prudential's acquisition of Chinfon Life included a back book with interest rate assumptions at around 6.5 per cent and expected liability duration of 30 to 40 years. Since then interest rates in Taiwan have declined and – despite economists' consistent projections of a rise – rates stood at just 1.4 per cent at 31 December 2008. Provisions required under the local solvency requirements have been offset by profits generated from new business, particularly following the introduction of unit-linked business in 2002. The net cash strain we experienced from this back book was running at the rate of around £50 million per annum.

However, for us as an EU domiciled group we are subject to the requirements of the IGD in measuring solvency. For IGD purposes the liability on the back book is crystallised at around £800 million, with the potential to increase significantly under the proposed Solvency II valuation rules. In reviewing the allocation of capital across the Group, we saw an opportunity to materially improve our capital position by releasing the economic capital supporting the agency distribution business. Therefore on 20 February 2009, we announced that we had agreed to transfer the assets and liabilities of the agency distribution business in Taiwan, including the capital consuming back book, to China Life Insurance Ltd (Taiwan) subject to regulatory approval. The transfer will include all policies previously issued by agency, the agency contracts and the agency related support operations. Upon completion there will be a one-off negative IFRS impact of approximately £595 million after restructuring costs. Free surplus for Life and asset management business at 31 December 2008 including Taiwan was £859 million and £1.8 billion excluding it.

We will continue to be an active and committed player in the Taiwanese life insurance market through our successful bancassurance, direct marketing and other non-agency distribution

channels. Bank and direct sales accounted for 29 per cent of our new business in Taiwan in 2008.

Partnership

Our bank distribution strategy is heavily influenced by our agency competencies, since we do not simply rely on bank counter staff to promote insurance products, but also deploy a highly-trained and specialised sales force sitting in the bank branches. These Financial Service Consultants (FSC's) are managed in a very similar way to the agency force; they are accountable for high standards of quality and productivity and they are rewarded for results. There were 8,900 FSCs at 31 December 2008 up 11 per cent on prior year and during 2008 FSCs generated 81 per cent of the region's bank new business.

During 2008 and in early 2009 we expanded and extended our successful bank distribution agreement with Standard Chartered Bank (SCB). We now work with SCB in nine markets and are currently exploring further opportunities for protection and Takaful products. SCB Taiwan had a particularly impressive fourth quarter, and Prudential's overall new business from SCB in Asia increased by 35 per cent during 2008.

Total new business from the bank channel grew by 27 per cent during 2008 and accounted for 20 per cent of total new business.

Health and Protection

Prudential is implementing a structured and disciplined approach to expanding its health and protection business in Asia. A new regional team has been formed with sales management, product development, underwriting, claims, operations and business development expertise. Underwriting processes have been reengineered to improve customer service; claims turnaround is now more efficient; and quotation systems have been upgraded to alert agents to appropriate health riders as attachment opportunities to augment core products.

With this foundation in place, innovative products, tailored for each market are being rolled out. For example, in the fourth quarter of 2008 our business in Malaysia launched a critical illness plan that pays the full sum assured for up to three claims, with cover until age 85. Over two thousand policies were sold within the first month.

Critical factors in our success in health and protection, include integrating the product initiatives with the distribution channels, and tailoring sales support activities to the agency, bank and direct channels. For example, health products have been incorporated into agency incentive programmes, and a standalone health care product was launched into the SCB channel with simplified underwriting and compelling media campaigns to capture direct business and provide leads for other channels.

During 2008 new business APE was up 34 per cent, reflecting these products' particular suitability to challenging economic conditions, with their emphasis on protection rather than savings and their lower average premiums. The results from India (up 259 per cent) and Malaysia (up 49 per cent) were particularly encouraging.

Retirement

Like the West, Asia has rapidly ageing populations and a growing need for financial advice and products to help people save for retirement, secure an income during retirement and protect their financial well being throughout life.

Prudential has already taken a lead in raising the awareness of the need for retirement financial planning through the 'What's Your Number?' campaigns, and the retirement planning message

continues to be reinforced through fully integrated marketing and promotional materials. For example, our websites in Hong Kong, Taiwan, Malaysia and Korea now include retirement calculators.

Although market conditions have not been conducive to major new initiatives in the retirement space during 2008, Prudential continues to develop and launch new retirement orientated products. For example, in Korea and Malaysia we launched variable annuity products that provide a guaranteed minimum income on retirement.

Financial performance

In 2008, Prudential delivered new business APE of £1,362 million in Asia, representing growth averaging six per cent over 2007. Although some official market statistics are not yet available, Prudential estimates that it is the leading foreign company or joint venture in seven of its twelve life markets. Prudential grew market share in six of our 12 countries during 2008.

Indonesia was the strongest performer, with new business APE rising by 45 per cent, followed by China and Malaysia, up 31 per cent and 24 per cent respectively. Market conditions were challenging in all markets and especially so in Korea, Taiwan and Singapore where sales fell by 15 per cent, 12 per cent and 11 per cent respectively.

The industry in Korea saw a shift away from variable unit-linked products, and towards risk-based and interest-sensitive products. PCA Life Korea, however, remained diligently focused on value not volume. In Taiwan, Prudential had a very successful retirement campaign launch in May and June 2007 that was not repeated in 2008. However, there was encouraging momentum, particularly in the bank distribution channel in the final quarter with sales up 83 per cent over the third quarter of 2008. In Singapore regular premium sales were resilient and remained at the same level as 2007, but total APE was depressed by lower single premium sales, following changes to the Central Provident Fund rules.

Total new business profits increased by 15 per cent as the average profit margin increased from 50 per cent to 54 per cent. This profit enhancement was mainly due to changes in product mix, country mix and economic assumptions. Of the six markets we disclose separately, five (China, Hong Kong, India, Indonesia and Taiwan) reported increases in new business profit margins compared with 2007.

Total EEV operating profit from long-term business at £1,309 million increased by 26 per cent compared to 2007. In-force embedded value profits in Asia rose to £568 million in 2008, an increase of 42 per cent from 2007. In-force profit in 2008 was driven by the unwind of discount of £434 million, net assumption changes of £135 million, and net experience variances of £(1) million. The net positive assumption changes were driven by persistency assumptions for Singapore, Hong Kong and Malaysia reflecting recent experience of reduced lapse rates. These were offset by changes in Taiwan and Korea mainly relating to premium holidays and expense assumption changes, together with mortality and morbidity assumption changes in Singapore, Taiwan and Hong Kong and a decrease in corporation tax in Indonesia. All operations saw positive experience variances on mortality but these were offset by negative persistency experience in Korea.

The IFRS operating profit for long-term business increased from £189 million in 2007 to £321 million in 2008. In Indonesia the results increased from £35 million to £55 million whilst in the established operations (Singapore, Hong Kong and Malaysia) the growth was more muted, growing from £153 million to £162 million.

In Korea the loss of £13 million in 2007 improved to a profit of £12 million in 2008, principally due to a local regulatory change in accounting basis for acquisition costs.

India posted a loss of £6 million, before charging development expenses related to the investment in the agency force. The result also reflects that as the business matures it is appropriate to now defer and amortise acquisition costs, resulting in a benefit of £19 million.

In Taiwan, where the IFRS basis of reporting reflects US GAAP for the insurance assets and liabilities of the business the result increased by £15 million to £60 million. The result for other operations increased from £12 million to £38 million reflecting mainly reserve releases in the Japanese operation.

Each operation has a target for IRR on new business of at least 10 percentage points above the relevant country risk discount rate, which varies across Asia from 3 per cent to 17 per cent. Our aggregate IRR in Asia remained in excess of 20 per cent in 2008.

United States

	AER ⁴			CER ⁴	
	2008	2007	Change	2007	Change
United States	£m	£m	%	£m	%
APE sales	716	671	7%	724	(1%)
NBP	293	285	3%	308	(5%)
NBP margin (% APE)	41%	42%		43%	
NBP margin (% PVNBP)	4.1%	4.3%		4.3%	
Total EEV basis operating profit*	586	627	(7%)	678	(14%)
Total IFRS operating profit*	406	444	(9%)	480	(15%)

*Based on longer-term investment returns excludes broker dealer, fund management and Curian

The United States is the world's largest retirement savings market, and is continuing to grow rapidly. As 78 million baby boomers reach retirement age, their retirement assets will shift from asset accumulation to income distribution. There are already \$2 trillion of assets generating retirement income in the US — and this amount is forecast to rise to some \$7.3 trillion by 2029.

During 2008, the US financial services industry faced an unprecedented array of challenges: the S&P 500 index fell by 38.5 per cent (compared to a 3.5 per cent increase in 2007); governmental interest rates fell to historic lows; and global markets experienced a significant increase in volatility, particularly during the last four months of the year. In addition, credit markets seized and global credit spreads widened to historic levels. As a result of these conditions, many financial service businesses sought to raise new capital in order to maintain their solvency.

These factors caused uncertainty in the market, as consumers and producers tried to anticipate future equity movements and questioned the financial stability of product providers. At the same time, however, increasing credit spreads and falling equity markets created favourable market conditions for the sale of fixed annuities. These developments provided a competitive advantage to companies able to participate in both the variable and fixed annuity spaces.

Initiatives in 2008

Distribution

The success in the marketplace of Prudential's US business, Jackson, continues to be driven by our industry-leading distribution organisation and product innovation, coupled with our sound evaluation of product economics. Our long-term goals for Jackson include the continued and profitable expansion of our share of the US annuities and retail asset management markets, which we plan to achieve by building on our advantaged position in the advice-based distribution channels. Ongoing profitable growth in Jackson's share of the US annuities market largely depends on the continued enhancement and expansion of our existing product offering, increased penetration of existing distribution channels and entry into new distribution channels, as well as opportunistic inorganic growth.

Innovation

Innovation in product design and speed to market continue to be key drivers of Jackson's competitiveness in the variable annuity market. High-quality and cost-effective technology, has allowed Jackson to offer a comprehensive product portfolio that can be customised to meet the needs of individual customers. We offer products on an unbundled basis, enabling customers to select those benefits that meet their unique financial requirements and to pay

only for those benefits they truly desire. In our view, leveraging this advantage is a more sustainable long-term strategy than competing on price – Jackson will not sacrifice product economics for a short-term increase in market share.

In 2008, Jackson maintained its track record of continued product innovation by enhancing our variable annuity offering with the addition of three new guaranteed minimum withdrawal benefits (GMWB) and eight new portfolio investment options. We also introduced two fixed annuity products designed specifically for the bank channel, and a fixed index annuity that offers a choice between two market indexes and two contract lengths.

Customer Service

Inevitably, the difficult market conditions in 2008 resulted in higher call volume to our service centres. Despite this increased workload, we once again demonstrated the ability to service investors' and advisers' needs accurately and efficiently, by earning recognition as a World Class service provider in the Service Quality Measurement Group's (SQM) latest benchmarking study of North American service centres. Historically, only 5 per cent of service centres receive World Class designation, but 2008 marked the fourth year that Jackson has achieved World Class status. We also earned SQM's 'Highest Customer Satisfaction by Industry' award for having the highest rate of customer satisfaction in the financial services industry.

In 2008, the FRC Adviser Insight Series on Marketing Effectiveness found that Jackson was rated as number one in 'Sales Support Satisfaction', and was the only VA provider rated in the top 10 for 'Overall Satisfaction' among advisers.

Financial performance

Jackson delivered record total APE sales of £716 million in 2008, representing a seven per cent increase over 2007, during a year when the industry faced numerous challenges. While admittedly aided by exchange rate movements during the year, APE retail sales in 2008 were £596 million, the highest level in the company's history. This achievement continues to demonstrate the resilience of Jackson's business model and the importance of diversification within our product portfolio.

Variable annuity APE sales of £349 million in 2008 were down 23 per cent from 2007, reflecting continued volatility in US equity markets and intense price competition. Throughout the year, we maintained our disciplined approach to the pricing of our variable annuities. In the first three quarters of 2008, we ranked fourth in variable annuity net flows in the US, and experienced a very low level of outflows as a proportion of inflows compared to the rest of the industry. During the fourth quarter, Jackson's quarterly VA sales declined by 6 per cent from the third quarter (at CER) due to the severe equity market disruption, compared to an industry decline of 12 per cent.

Fixed annuity APE sales of £172 million were up 202 per cent over 2007, reflecting our ability to meet changing customer demands through the company's diversified product portfolio. We ranked sixth in sales of traditional deferred fixed annuities during the first three quarters of 2008, with a market share of five per cent, up from tenth as at year-end 2007.

Fixed index annuity (FIA) APE sales of £50 million in 2008 were up 11 per cent over 2007. In late 2007, we introduced a new FIA product for the independent broker-dealer channel and, in April 2008, launched a new FIA for the bank channel. Our new FIA products have been very well received by advisers and helped drive the year-on-year increase in FIA sales.

Our retail annuity net flows increased by six per cent, reflecting continued low levels of surrender activity.

Institutional APE sales of £120 million in 2008 were up 28 per cent on 2007, as we continued to participate in this market on an opportunistic basis.

EEV basis new business profits of £293 million were three per cent higher than in 2007, reflecting a seven per cent increase in APE sales, offset to some extent by a shift in the mix of business away from variable annuities. Total new business margin was 41 per cent, slightly below the 42 per cent achieved in 2007.

The variable annuity new business margin increased from 42 per cent in 2007 to 43 per cent in 2008, with the negative impact of reduced 10-year Treasury rates on expected return and the risk discount rate being offset by the effect of a number of positive operating changes.

The fixed index annuity new business margin increased from 26 per cent in 2007 to 53 per cent in 2008, primarily as a result of an increased spread assumption and changes in economic assumptions. The spread assumptions increased from 190 basis points for 2007 issues to 220 basis points for 2008 issues, with an associated risk margin of 17 per cent. The FIA margin increased by nine per cent as a result of the 180 basis point reduction in the risk discount rate and the combined impact of declining interest rates and widening spreads in 2008.

The fixed annuity new business margin increased from 28 per cent to 37 per cent, primarily as a result of a decrease in the risk discount rate, partially offset by our refinement of assumptions about policyholder behaviour.

The new business margin on institutional business declined from 58 per cent in 2007 to 26 per cent in 2008, due to the combined effects of shorter average maturity and a lower discount rate.

Total EEV basis operating profit for the long-term business in 2008 was £586 million, compared to £627 million in 2007. In-force EEV profits of £293 million were 14 per cent below the 2007 profit of £342 million. Experience variances were £40 million lower in 2008 at AER, due primarily to a smaller spread variance.

IFRS operating profit for the long-term business was £406 million in 2008, down by nine per cent from £444 million in 2007. This decline was primarily due to accelerated DAC amortisation in the declining equity market, which was partially offset by equity hedging gains.

The aggregate IRR in new business at 18 per cent declined slightly due to a shift in product mix with variable annuities accounting for 50 per cent of total sales in 2008 against 70 per cent in 2007.

At 31 December 2008, Jackson had more than £52 billion in US GAAP assets, including £15 billion in separate account assets. Through the first eight months of 2008, our separate account assets were an average of £112 million higher than during the same period of 2007, reflecting continued sales and limited fund value losses. As a result, our earnings from fee-based products increased during 2008.

Jackson recorded impairment write-downs and credit related losses of £624 million in 2008. Gross unrealised losses moved from £439 million at 31 December 2007 to £3,178 million at 31 December 2008.

United Kingdom

	AER ^{4/8}			CER ^{4/8}		
	2008	2007	Change	2007	Change	
United Kingdom	£m	£m	%	£m		%
APE sales	947	910	4%	910		4%
NBP	273	277	(1%)	277		(1%)
NBP margin (% APE)	29%	30%		30%		
NBP margin (% PVNBP)	3.4%	3.6%		3.6%		
Total EEV basis operating profit*	1,081	859	26%	859		26%
Total IFRS operating profit*	589	528	12%	528		12%

*Based on longer-term investment returns.

Prudential UK continues to focus on realising value from the opportunities created by rapid growth in the need for retirement solutions. Our UK business targets and competes in selected areas of the UK pre and in-retirement markets, and during 2008 it demonstrated considerable resilience and discipline in a very challenging environment. We remain confident about the long-term growth prospects for the UK retirement market.

In 2008, Prudential UK performed strongly against a challenging background of volatile capital and equity markets, a declining housing market, and widespread economic uncertainty. In this environment and with ABI data showing a market decline in retail sales of 10 per cent during the year, our achievement in growing retail sales by 10 per cent was a particularly strong performance.

The UK is characterised by an ageing population and the concentration of wealth in the mass affluent and high net worth sectors – a combination that positions the retirement and near-retirement segment as the fastest-growing in the marketplace. Low savings rates and high levels of consumer debt, coupled with an increasing shift in responsibility for providing retirement income away from Government and employers towards individuals, have resulted in individuals in the UK being inadequately provided for during increasingly long periods of retirement.

Prudential UK has a unique combination of competitive advantages including its longevity experience, multi-asset investment capabilities, brand and financial strength. These put us in a strong position to pursue a value driven strategy that generates attractive returns across our Retail and Wholesale businesses.

Prudential UK has a significant pipeline of internal vestings annuity business from maturing individual and corporate pension policies, which is expected to remain at least at the current level until 2025. It is the largest annuity provider in the UK market, with approximately 1.5 million annuities in payment. Looking forward, the UK annuities market is expected to grow in the near-term, and we expect to maintain a significant share of this market.

Prudential UK's with-profits business performed particularly strongly during 2008. With-profits, when invested in an actively managed, and financially strong fund like Prudential's, continues to be an attractive medium to long-term investment, offering annualised returns which compare favourably with other investment options. Our UK with-profits fund has delivered investment returns of 67.2 per cent over ten years compared with the FTSE All-share index (total return) of 12.4 per cent over the same period.

In Wholesale, Prudential UK's aim is to participate selectively in bulk and back book buyouts, where we are able to win business based on our financial strength, superior track record and annuitant mortality risk assessment capabilities. In the UK wholesale bulk and insurer back-

book market, we are maintaining a strict focus on value, and will only participate in transactions that meet our return on capital requirements based on our view of future longevity improvements. There continues to be a significant pipeline of potential wholesale deals but competition remains intense with a number of market participants competing for business.

Within corporate pensions, we will continue to look for growth from our existing DC schemes, refresh our contract-based DC proposition, and build our presence through new scheme wins.

Prudential UK remains on track to deliver £195 million of cost savings by the end of 2010. As announced in Prudential's 2007 full-year results, the first phase of our UK cost reduction programme delivered savings of £115 million per annum. The agreement with Capita, under which Prudential UK outsourced a large proportion of its in-force and new business policy administration, commenced in April 2008 and will ultimately deliver £60 million per annum of savings.

Initiatives in 2008

Maintaining leadership position in individual annuities

Prudential UK's strong internal annuity pipeline is supplemented by strategic partnerships with third parties, where we are the recommended annuity provider for customers vesting their pensions at retirement.

In the key area of with-profits annuities, we can bring our core manufacturing strengths to bear while also capitalising on people's need for protection from inflation through increasingly long periods of retirement. We have been operating in the UK with-profits annuity market since 1991 and are now the market leader with a market share of over 85 per cent.

In the second half of 2008, Prudential UK introduced lifestyle rating using postcodes for pricing non-profit individual annuities. The introduction of lifestyle pricing allows us to price in a manner more reflective of risks associated with the business we are writing.

In the final quarter of 2008, Prudential UK – working in conjunction with Hannover Re – launched an enhanced annuity, for which the longevity risk is shared, and which uses Hannover Re's efficient market underwriting model. The current market for enhanced annuities is estimated to exceed £1 billion.

Given the UK's compulsory annuitisation age of 75, an increasingly sophisticated consumer population, and the rising incidence of second careers and semi-retirement as a result of increasing longevity, the market has seen good growth in the 'bridge' between pensions and annuities through income drawdown products. We launched our new income drawdown product in late 2007 and achieved sales of £8 million APE in 2008 compared to £3 million in the previous year. This product helps customers manage their pension through the various stages of retirement, and also offers flexibility while providing potential for capital growth.

Building share of the equity release market

Prudential UK entered the equity release market three years ago, and grew its share of this market to 23 per cent by the end of 2008. Investing in property has been an increasingly important component for many people saving for their retirement. With around £700 billion owned by pensioners in property in the UK, pensioners can consider options such as equity release to help deliver an adequate income in retirement. This is likely to become increasingly important as people live longer and the cost of living continues to rise. In an environment of falling house prices and the associated risk of negative equity, we reduced our maximum loan-

to-value ratio, which impacted sales in the latter part of 2008. We will continue to maintain a disciplined approach to lending in this market.

Growing the volume of products that use Prudential's multi-asset management expertise

Prudential UK's total retail with-profits business has performed very strongly across a range of products. The strong sales growth for with-profits bonds reflects the strength of our with-profits offering and an increasing demand for this type of product as consumers increasingly look to protect themselves from market downturns, especially in an actively managed, well-run and financially strong fund.

Sales of PruFund, Prudential UK's unitised and smoothed investment plan, were particularly strong during the year. Since October 2008 PruFund has been available across Prudential UK's range of tax wrappers, including individual pensions, income drawdown and onshore and offshore bonds. We also launched the new PruSelect range of unit-linked funds across our UK pensions and investments products, more than doubling the number of funds available.

The sales growth across Prudential UK's with-profits range has been achieved on the back of sustained strong investment performance in its Life Fund over a number of years, reflecting the benefits of its diversified investment policy. We believe this market will continue to see further growth as investors turn to trusted and financially strong brands and products offering an element of capital protection.

Growing other income streams

The PruHealth joint venture uses the Prudential brand and Discovery's expertise to build branded distribution in private healthcare. Since its launch, PruHealth has established itself in the marketplace, and it now has 187,000 lives insured. The focus for PruHealth going into 2009 is to continue to increase sales volumes, grow the in-force book and manage its loss ratio.

PruProtect, which was launched in the third quarter of 2007, follows the success of PruHealth by applying the Vitality points system. PruProtect's product is focused around a core philosophy of helping people become healthier while protecting and improving the quality of their lives.

Strengthening relationships with intermediaries

Prudential UK's intermediaries distribution channel saw significant growth in 2008. The business increased its field sales-force with an additional 10 regional sales units, and the focus is to continue developing deeper and better relationships with key accounts and through partnership arrangements. We have been successful in gaining over 40 new panel positions in 2008, meaning that our products are now more widely available to intermediaries than before. In addition, PruFund is now panelled across almost all the major UK retail banks.

Maintaining strict focus on value in the bulk annuity and back-book markets

Prudential UK maintained its strict focus on value in the bulk annuity and back-book markets in 2008, completing transactions totalling APE £142 million. These included the bulk annuity buy-in agreements with Goldman Sachs for the reinsurance of APE £30 million of Rothesay Life's non-profit annuity business and with the Trustee of the Cable & Wireless Superannuation Fund for the reinsurance of APE £106 million of liabilities relating to the scheme's pensioners in payment. The latter represented the largest ever bulk annuity buy-in deal in the UK and the biggest bulk annuity deal to be announced in 2008, demonstrating our ability to complete complex and innovative transactions.

In the Wholesale market, we are maintaining a strict focus on value and will only participate in transactions that meet our return on capital requirements.

Cost management

Prudential UK has continued to make good progress against its cost reduction plans. As announced in Prudential's 2007 full-year results, the first phase of our UK cost reduction programme delivered savings of £115 million per annum. The agreement with Capita, which commenced in April 2008, will ultimately deliver a further £60 million per annum of savings and will enable our UK business to achieve its total cost savings target of £195 million by the end of 2010.

The Capita contract also provides a significant reduction in long-term expense risk, by providing Prudential UK with certainty on per-policy costs as the number of policies in the mature life and pensions book decreases over the coming years.

Over time, the Capita contract will result in the migration of approximately seven million in-force policies from a number of Prudential legacy IT systems to two Capita proprietary platforms, significantly enhancing operational performance.

Financial performance

In an environment of unprecedented volatility in capital and equity markets, a declining housing market and general economic uncertainty, Prudential UK performed strongly in 2008.

Our total UK APE sales of £947 million represented a rise of four per cent on 2007. Retail sales of £803 million were 10 per cent higher than 2007. Individual annuity and corporate pension sales were substantial and in line with 2007, despite volatile market conditions. Sales growth was driven by strong growth in with-profits bonds supplemented by growth in lifetime mortgages, offshore products and PruHealth.

There was a slight decrease in EEV new business profits to £273 million in 2008 from £277 million in 2007, reflecting a decline in new business margin to 29 per cent from 30 per cent. The lower new business margin largely reflects allowances for higher credit risk on individual annuity business, and a lower level of wholesale bulk annuity and insurer back book sales in 2008. New business profits relating to the Retail business increased slightly to £226 million from £223 million.

Our UK business maintained its strict focus on value in the wholesale bulk annuity and insurer back book markets in 2008, with new business profits of £46 million in 2008, reflecting a margin of 32 per cent and a 14 per cent IRR.

EEV basis total operating profit based on longer-term investment returns of £1,081 million, before restructuring costs of £14 million, were up 26 per cent on 2007. The 2008 in-force year operating result includes £569 million relating to the unwind of discount to the value of in-force business, the release of £80 million of provisions not now required, and a £118 million benefit from rebalancing assets, including lifetime mortgage assets, that support the shareholder backed annuity portfolio.

In 2002 Prudential UK transferred its general insurance business to Churchill. We receive a commission payment for Prudential-branded general insurance products, and in 2008 this arrangement resulted in a net payment to Prudential of £44 million.

Prudential UK continues to manage actively the retention of the in-force book. During 2008, persistency experience at an aggregate level has been in line with our long-term assumptions.

IFRS total operating profit before restructuring costs increased by 12 per cent to £589 million. This reflected profits attributable to the with-profits business of £395 million and 15 per cent growth from the long-term shareholder backed business. For shareholder-backed annuity

business, the operating profit includes a charge of £413 million for strengthening the allowance for credit defaults. Partially offsetting this is £390 million for the impact of rebalancing the credit portfolio, also in the shareholder annuity fund. At the start of 2008 the portfolio was overweight in gilts with an average rating of AA versus a benchmark of A. The rebalancing has led to the fund now having an average rating of A+ thereby remaining ahead of benchmark. IFRS profit for General Insurance commission increased to £44 million as cash now begins to emerge following the 2002 sale of the business to Churchill. We expect General Insurance commission to continue to emerge around this level in the near-term.

Prudential UK writes with-profits annuity, with-profits bond and with-profits corporate pensions business in its life fund, with other products backed by shareholder capital. The weighted average post-tax IRR on the shareholder capital allocated to new business growth in the UK was 14 per cent.

Asset Management

Global

The Prudential Group's asset management operations add value to our various insurance businesses by delivering sustained out-performance for our life and pension funds. They are also important profit generators in their own right, having low capital requirements and generating significant cash flow for the Group.

Our asset management businesses are well-placed to capitalise on their leading market positions and strong track records in investment performance. These advantages enable us to deliver positive net flows and profit growth, as well as strategically diversifying the Group's investment propositions in retail financial services (RFS) markets worldwide. The fact that these markets are increasingly favouring greater product transparency, greater cross-border opportunities and more open-architecture investment platforms also plays to our strengths.

Prudential's various asset management businesses operate using different models and under different brands, all tailored to their particular markets and unique strengths. However, they continue to work together by managing money for each other with clear regional specialisation, distributing each others' products, and sharing vital knowledge and expertise in areas such as credit research.

Each business and its performance in 2008 is summarised below.

M&G

M&G is comprised of the M&G asset management business and Prudential Capital.

	AER ⁴			CER ⁴	
	2008	2007	Change	2007	Change
M&G	£m	£m	%	£m	%
Net investment flows	3,407	4,958	(31%)	4,958	(31%)
Revenue	455	482	(6%)	482	(6%)
Other income	25	30	(17%)	30	(17%)
Staff Costs	(184)	(224)	18%	(224)	18%
Other Costs	(111)	(113)	2%	(113)	2%
Underlying profit before Performance-related Fees	185	175	6%	175	6%
Performance-related fees	43	28	54%	28	54%
Operating profit from asset management operations	228	203	12%	203	12%
Operating profit from Prudential Capital	58	51	14%	51	14%
Total IFRS operating profit	286	254	13%	254	13%

M&G's asset management business

M&G is our UK and European fund manager, responsible for £141 billion of investments as at 31 December 2008 on behalf of both internal and external clients.

M&G is an investment-led business which aims to deliver superior investment performance and maximise risk-adjusted returns in a variety of macro-economic environments. Through M&G we seek to add value to our Group by generating attractive returns on internal funds as well as growing profits from the management of third party assets. Such external funds now represent a third of M&G's total funds under management (FUM).

Our overall strategy at M&G is to focus first and foremost on investment performance, by recruiting, developing and retaining market-leading investment talent, and by providing the environment and infrastructure this talent needs to perform to its full potential.

In the retail market, our strategy is to maximise the value of our centralised investment function through a multi-channel, multi-geography distribution approach. Key themes in recent years have included the growing proportion of business sourced from intermediated channels and the growth of cross-border products. Our diverse product portfolio has proved its worth during the recent turmoil as, for example, bond funds have become more popular than equity based products.

M&G's institutional strategy centres on leveraging capabilities developed primarily for internal funds into higher margin external business opportunities. In recent years this has allowed us to operate at the forefront of a number of specialist fixed income strategies, including leveraged finance and infrastructure investment. The recent chaos in capital markets has resulted in a renewed focus on more traditional credit and equity mandates, again drawing on our core research and investment expertise.

Initiatives in 2008

The global financial crisis has had a negative impact on asset values across classes and geographies. At M&G, this has a direct impact on our FUM as well as important consequences for new business sales and existing client persistency. In this challenging environment investment performance is more critical than ever, further illustrating the value of our core strategy.

In the three years to December 2008, 35 per cent of M&G's retail funds delivered top-quartile investment performance.

In Europe, the asset management industry has seen net outflows of €334 billion in 2008, while the IMA reported £2.1 billion of net outflows from UK asset managers across Retail and Institutional funds.

Against this background M&G performed extremely well in 2008, with record gross inflows from external customers of £16.2 billion, up from £14.7 billion in 2007. Higher redemption rates resulted in somewhat lower net inflows of £3.4 billion, compared to £4.9 billion in 2007 and £6.1 billion in 2006, which was M&G's record year to date.

Our strategy of maximising diversity across the business proved its worth in 2008, as demonstrated by increased net inflows to retail bond funds of £1.4 billion, up from £0.2 billion in 2007. These helped to offset a decline in equity fund net inflows, which fell to £0.7 billion, down from £1.7 billion in 2007.

M&G's net retail inflows in the UK were up 62 per cent on 2007 at £1.9 billion, while the more challenging European market resulted in net flows of zero, compared to £0.8 billion of inflow in 2007. A significant achievement for our retail distribution team has been the development of the discretionary manager channel (including stockbrokers, family offices and fund of funds managers), with net sales of £0.7 billion in 2008, up from £0.4 billion in 2007.

Among M&G's institutional businesses, a difficult year for our Macro Investment Business (net outflows of £0.9 billion) was more than offset by strong net inflows of £0.3 billion to our infrastructure fund and £0.8 billion to segregated equity funds. Our high quality of client servicing and diverse product offering enabled us to maintain positive inflows of £1.3 billion during a period that saw net institutional outflows for asset managers of £6.3 billion according to the IMA.

A key cost management initiative in 2008 was the outsourcing of M&G Retail's direct customer servicing. As well as generating immediate annual savings of around £3 million, this will allow us to move from a fixed to a variable cost base for this channel.

Financial performance

In the face of a very challenging economic environment, M&G recorded record profits in 2008, with an operating result of £228 million, up from £203 million in 2007. This means our profit has grown by 21 per cent compounded annually since 2004. Our underlying profit growth, which excludes volatile performance related fees (PRFs) and carried interest earned on private equity investments, has grown by 23 per cent compounded annually over the same period to reach £185 million in 2008, up from £175 million in 2007.

In 2008 M&G benefited from – and continued to promote – greater diversity in terms of profit-generating activities and our profitability is well spread across internal (30 per cent), retail (47 per cent) and institutional markets (23 per cent).

We achieved net investment inflows for the year in both the retail (£2.1 billion, down from £2.7 billion in 2007) and institutional (£1.3 billion, down from £2.2 billion in 2007) markets, while our overall external FUM was negatively impacted by falls in the value of underlying assets.

M&G's total FUM at the end of 2008 was £141 billion, down 15 per cent from the start of the year.

During 2008, M&G continued to focus on effective cost management to limit the impact of falling FUM on bottom-line results. Our overall overhead costs fell 16 per cent in 2008. However it is important to note that this partially reflects a one-off reduction in long term incentive costs.

Our cost/income ratio was 60 per cent in 2008, down from 66 per cent in 2007, having improved from 75 per cent in 2004.

M&G continues to provide capital efficient profits and cash generation for the Prudential Group, as well as strong investment returns on our long-term business funds. Return on capital of 91 per cent and cash remittances of £106 million in 2008 provided strong support for the Group's corporate objectives.

Prudential Capital

Prudential Capital — re-branded from Prudential Finance in 2007 — manages Prudential's balance sheet for profit by leveraging Prudential's market position. This business has three strategic objectives: to operate a first-class wholesale and capital markets interface; to realise profitable proprietary opportunities within a tightly-controlled risk framework; and to provide professional treasury services to Prudential. Prudential Capital generates revenue by structuring transactions, providing bridging finance, and operating a securities lending and cash management business for our Group and its clients.

The business has continued to grow in terms of investment, infrastructure and personnel in a controlled way, while maintaining the dynamism and flexibility necessary to identify and realise opportunities for profit. Prudential Capital is committed to working more closely with other business units across the Group to exploit opportunities and improve value creation for Prudential as a whole. At Prudential Capital, we are also taking a more holistic view on hedging strategy, liquidity and capital management for the Group.

Prudential Capital has a diversified earnings base derived from bridging, structured finance and wholesale markets. We delivered a good financial result from this business in 2008, driven by increased investment activity and a strong securities lending performance. As a result of increased revenue and maintaining a low cost/income ratio, operating profits increased by 14 per cent to £58 million, resulting in a cash remittance to the holding company of £61 million.

Asia

	AER ⁴			CER ⁴	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
Net investment flows	855	2,961	(71%)	3,455	(75%)
Total IFRS operating profit*	52	72	(28%)	78	(33%)

*Based on longer-term investment returns.

In order to capitalise on the exciting and sizeable opportunities in Asia's retail financial services market, Prudential's Asian asset management business maintained its focus in 2008 on building a strong third-party customer retail franchise. Prudential now has retail operations in 10 Asian markets and its growth strategy is targeted at meeting specific market needs. The customer proposition is driven by Prudential's strong investment capabilities that enable it to develop innovative product suites, and distribute them through diverse channels including regional banks, local banks, private banks, and securities houses and an internal sales force. Over the last ten years, Prudential has become one of the largest and most successful domestic asset management companies in the region.

In addition to retail funds, Prudential's Asian asset management business manages funds for Prudential's Asian and UK Life businesses. It further supports the Asian Life Business with the design of funds for investment linked products. Prudential is also growing its third party institutional and pension fund management business.

Initiatives in 2008

In Taiwan, PCA Securities Investment Trust successfully introduced the PCA Green Solution Fund, the third-largest IPO launched in the country. On the institutional client front, we secured a domestic equity mandate from Taiwan's New Labour Pension Fund, for £63 million (TWD 3 billion) of assets. Similarly, in China, the Triple Benefit Bond Fund and Blue Chip Equity Fund launched in 2008 by, CITIC-Prudential Fund Management Company Limited, raised over £253 million despite the bearish market conditions. In Korea, the focus on providing innovative variable annuities, variable unit linked and corporate pension products to third-party insurance institutions succeeded in building a more persistent customer base. The Japanese business is now the largest India funds provider in Japan, following the successful launch of the fourth India-themed fund (India Consumer Fund). Additionally, the Employees Provident Fund Organisation in India approved ICICI-Prudential Fund Management as one of the three private sector asset management companies to manage incremental flows into its fund.

Prudential continues to explore opportunities in Islamic funds, and the UAE it signed a Memorandum of Understanding to expand marketing co-operation and distribution of Shariah funds in Malaysia and the Middle East. Prudential's property fund management business PRUPIM, delivered solid performance that included raising £97 million for a new Fund Vietnam Property Fund launched in 2008.

Financial Performance

Prudential's Asian asset management business's total FUM as at 31 December 2008 was £36.8 billion. This included £4.9 billion of assets from the Group, £16.7 billion from Prudential Corporation Asia's life funds, and £15.2 billion from third-party customers. Compared to 2007, the overall FUM dropped by 27 per cent at CER, primarily as a result of negative market movements. In comparison, the MSCI Asia ex-Japan Index fell by 52 per cent in 2008.

Despite volatile market conditions, our net inflows remained positive at £0.86 billion, led by the good performance in Taiwan and Japan. Of the £0.86 billion in net inflows, 66 per cent was from Equity/Bond funds and 34 per cent from Money Market Funds.

IFRS profit from fund management was £52 million, a fall of 28 per cent, driven by decreasing funds under management and performance related fees as a result of the current market situation.

The asset management business requires very little capital to support its growth, and in 2008 it remitted a net £36 million to the Group.

United States

US Asset Management

	AER ⁴			CER ⁴	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
PPM America					
Total IFRS operating profit*	2	4	(50%)	4	(54%)

*Based on longer-term investment returns.

PPM America (PPMA) manages assets for Prudential's US, UK and Asian affiliates. We also provide other affiliated and unaffiliated institutional clients with investment services including collateralised debt obligations (CDOs), private equity funds, institutional accounts, and mutual funds. At PPMA, our strategy is focused on managing existing assets effectively, maximising the benefits gleaned from synergies with our international asset management affiliates, and leveraging investment management capabilities across the Prudential Group. We also pursue third-party mandates on an opportunistic basis.

Financial performance

IFRS operating profit in 2008 was £2 million, down from £4 million in 2007, primarily due to lower investment income and performance-related fees.

Year-end 2008 funds under management of £46 billion were as follows:

PPMA funds under management £bn

	Asia	US	UK	Total	
Insurance		0	30	11	41
Unitised		3	0	1	4
Institutional		0	0	0	0
CDOs		0	1	0	1
Total	3	31	12	46	

US Broker dealer

	AER ⁴			CER ⁴	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
Broker dealer					
Revenue	328	300	9%	324	1%
Costs	(320)	(291)	10%	(315)	2%
Total IFRS operating profit*	8	9	(11%)	9	(11%)

*Based on longer-term investment returns.

National Planning Holdings (NPH) is Jackson's affiliated independent broker-dealer network. The business is comprised of four broker-dealer firms, including INVEST Financial Corporation, Investment Centers of America, National Planning Corporation, and SII Investments.

We continue to grow NPH's business through strong recruiting efforts. By utilising our high-quality, state-of-the-art technology, we provide NPH's advisers with the tools they need to operate their practices more efficiently. At the same time, through its relationship with NPH, Jackson continues to benefit from an important retail distribution outlet, as well as receive valuable insights into the needs of financial advisers and their clients.

Financial performance

NPH generated record revenues of £328 million during the year, up from £300 million in 2007, on gross 2008 product sales of £8 billion. Our network continues to experience profitable results, with 2008 IFRS operating profit of £8 million, an 11 per cent decrease at AER from £9 million in 2007. We also increased the number of registered advisers in our network to approximately 3,165 at the end of 2008.

Curian

	AER ⁴			CER ⁴	
	2008	2007	Change	2007	Change
	£m	£m	%	£m	%
Curian					
Gross investment flows	591	663	(11%)	717	(18%)
Revenue	24	20	20%	22	9%
Costs	(27)	(25)	8%	(27)	(0%)
Total IFRS operating profit*	(3)	(5)	(35%)	(5)	(40%)

*Based on longer-term investment returns.

Curian Capital, Jackson's registered investment advisor, provides innovative fee-based separately-managed accounts and investment products to advisers through a sophisticated technology platform. Curian expands Jackson's access to advisers while also providing a complement to Jackson's core annuity product lines.

Financial performance

Curian's results during 2008 improved, despite the significant impact of falling equity markets on its assets under management. Our effective management of costs and an eight per cent increase in average assets under management contributed to this result. At the end of 2008, we had total assets under management of £1.8 billion, compared to £1.7 billion at the end of 2007 (£2.4 billion at CER). We generated deposits of £591 million in 2008, down 11 per cent on 2007. The decline in both deposits and assets under management at CER were mainly due to difficult conditions in the equity markets, with the S&P 500 index falling 38.5 per cent during 2008.

OTHER CORPORATE INFORMATION

Financial instruments

Our Group is exposed to financial risk through our financial assets, financial liabilities, and policyholder liabilities. The key financial risk factors that affect us include market risk, credit risk and liquidity risk. Information on our Group's exposure to financial risk factors, and our financial risk management objectives and policies, is provided both in the Risk and Capital Management section of this Business Review and the financial statements.

Further information on the sensitivity of our Group's financial instruments to market risk and our use of derivatives is also provided in the financial statements.

Treasury policy

The Group operates a central treasury function, which has overall responsibility for managing our capital funding programme as well as our central cash and liquidity positions.

The aim of our capital funding programme, which includes the £5,000 million MTN programme together with the unlimited commercial paper programme, is to maintain a strong and flexible funding capacity.

Prudential UK and Prudential Corporation Asia use derivatives to reduce equity risk, interest rate and currency exposures, and to facilitate efficient investment management. In the US, Jackson uses derivatives to reduce interest rate risk, to facilitate efficient portfolio management and to match liabilities under fixed index policies.

It is Prudential's policy that derivatives are only used to hedge exposures or facilitate efficient portfolio management.

Amounts at risk are covered by cash or by corresponding assets.

Due to the geographical diversity of our businesses, we are subject to the risk of exchange rate fluctuations. Our international operations in the US and Asia generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements upon conversion of results into pounds sterling. The currency exposure relating to the conversion of reported earnings is not separately managed, as it is not in the economic interests of the Group to do so. The impact of gains or losses on currency conversions is recorded as a component of shareholders' funds within the statement of recognised income and expense. The impact of exchange rate fluctuations in 2008 is discussed elsewhere in this financial review.

Unallocated surplus of with-profits

During 2008, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Group's with-profits funds on a statutory basis, decreased from £14.0 billion at 1 January to £8.4 billion at 31 December.

Inherited estate of Prudential Assurance

The assets of the with-profits sub-fund (WPSF) within the long-term fund of The Prudential Assurance Company Limited (PAC) are comprised of the amounts that it expects to pay out to meet its obligations to existing policyholders and an additional amount used as working capital. The amount payable over time to policyholders from the WPSF is equal to the policyholders' accumulated asset shares plus any additional payments that may be required by way of smoothing or to meet guarantees. The balance of the assets of the WPSF is called the 'inherited estate' and has accumulated over many years from various sources.

The inherited estate, as working capital, enables PAC to support with-profits business by providing the benefits associated with smoothing and guarantees, by providing investment flexibility for the fund's assets, by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus and investment policies. The size of the inherited estate fluctuates from year to year depending on the investment return and the extent to which it has been required to meet smoothing costs, guarantees and other events.

Our overriding priority is to maintain the long-term financial security of the WPSF and to continue delivering strong performance for the benefit of its policyholders.

Defined benefit pension schemes

The Group operates four defined benefit schemes, three in the UK, of which by far the largest is the Prudential Staff Pension Scheme (PSPS), and a small scheme in Taiwan. The level of surplus or deficit of assets over liabilities for defined benefit schemes is currently measured in three ways: the actuarial valuation, FRS 17 (for parent company and subsidiary accounting in the UK), and IAS 19 for the Group financial statements.

Defined benefit schemes in the UK are generally required to be subject to full actuarial valuation every three years to assess the appropriate level of funding for schemes having regard to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. PSPS was last actuarially valued as at 5 April 2005 and this valuation demonstrated PSPS to be 94 per cent funded, with a shortfall of actuarially determined assets to liabilities of six per cent, representing a deficit of £243 million.

As a result, changes were made to the basis of funding for PSPS with effect from that date. Deficit funding amounts designed to eliminate the actuarial deficit over a 10-year period have been and are being made. Following these changes, total contributions to PSPS for deficit funding and employer's contributions for ongoing service for current employees were expected to be of the order of £70-75 million per annum, subject to a reassessment when the subsequent valuation is completed.

In 2008 our total contributions for the year including expenses and augmentations were £79 million. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the PAC life fund and shareholder-backed operations following detailed consideration in 2005 of the sourcing of previous contributions. Employer contributions for the ongoing service of current employees are apportioned in the ratio relevant to current activity. The PSPS valuation as at 5 April 2008 is currently being finalised.

In 2008, the Group adopted IFRIC 14, 'IAS 19-The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' (IFRIC 14). IFRIC 14 provides guidance on the recognition of IAS 19 surpluses in, and funding obligations for, defined benefit pension schemes. As a result of the adoption of IFRIC 14, in respect of the position at 31 December 2008, the Group has not recognised its interest in the underlying PSPS pension surplus of £615 million net of related tax relief, reflecting the difference between the market value of the

scheme assets and the discounted value of the liabilities, which would have otherwise been recognised as an asset on its balance sheet under the previous policy. In addition, the Group has recognised a provision for deficit funding to 5 April 2010 of £55 million net of related tax relief in respect of PSPS. The underlying assets and liabilities of PSPS are unaffected by the adoption of IFRIC 14.

As at 31 December 2008, after the effect of the adoption of IFRIC 14, the shareholders' share of the pension liability for PSPS' deficit funding obligation and the other schemes' deficits amounted to a £61 million liability net of related tax relief. The total share attributable to the PAC with-profits fund amounted to a liability of £60 million net of related tax relief in respect of the PAC with-profits fund's share of the liability for deficit funding to 5 April 2010 on PSPS and the deficit on the smaller Scottish Amicable scheme.

Products and drivers of insurance operations' profits

Asia

The life insurance products offered by Prudential Corporation Asia include with-profits (participating) and non-participating term, whole life and endowment and unit-linked policies. To supplement our core life products we also offer health, disablement, critical illness and accident cover.

The primary focus in Asia is regular premium products that provide both savings and protection benefits.

In 2008, the new business profit mix in our Asian insurance business was derived 50 per cent from accident and health products, 40 per cent from unit-linked and 10 per cent from non-linked.

Unit-linked products combine savings with protection, with the cash value of the policy depending on the value of the underlying unitised funds. Participating products provide savings with protection where the basic sum assured can be enhanced by a profit share (or bonus) from the underlying fund as determined at the discretion of the insurer. Non-participating products offer savings with protection where the benefits are guaranteed or determined by a set of defined market-related parameters. Accident and health products provide mortality or morbidity benefits and include health, disablement, critical illness and accident cover. These products are commonly offered as supplements to main life policies, but can also be sold separately.

Policyholder and insurer share the profits from participating policies (typically in a 90:10 ratio) in the same way as with-profits business in the UK. With unit-linked products, shareholders receive the profits arising from managing the policy, its investments and the insurance risk. Policyholders within the underlying unitised fund receive investment gains. The profits from accident and health and non-participating products come from any surplus remaining after paying policy benefits.

Unit-linked products tend to have higher profits on the EEV basis of reporting than traditional non-linked products, as expenses and charges are better matched and solvency capital requirements are lower. At the end of 2008, we were offering unit-linked products in 11 of the 12 countries in Asia in which we operate, with the only exception being Thailand.

In addition to the life products described above, we offer mutual fund investment products in India, Taiwan, Japan, Singapore, Malaysia, Hong Kong, Korea, Vietnam and China, thus enabling customers to participate in debt, equity and money market investments. We are also licensed in the United Arab Emirates. Prudential Corporation Asia earns a fee based on assets under management.

United States

Jackson's product offerings include variable, fixed and fixed index annuities, as well as life insurance, retail mutual funds and institutional products.

Annuities

Annuity products are long-term individual retirement products, which offer tax-deferred accumulation on the funds invested until proceeds are withdrawn from the policy.

Interest-sensitive fixed annuities are used for asset accumulation in retirement planning and for providing income in retirement and offer flexible payout options. The contract holder pays us a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and administrative charges are deducted. We may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state

regulations. When the annuity matures, we either pay the contract holder the amount in the contract holder account, or begin making payments to the contract holder in the form of an immediate annuity product – similar to a UK annuity in payment.

Fixed annuity policies are subject to early surrender charges for the first six to nine years of the contract. In addition, the contract may be subject to a market value adjustment at the time of surrender. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Our profits on fixed annuities come primarily from the spread between the return we earn on investments and the interest credited to the contract holder's account (net of any surrender charges or market value adjustment) less expenses. Our fixed annuities continue to be a profitable book of business, benefiting from favourable spread income in recent years. However, the continued low interest rate environment could have an impact on the fixed annuity portfolio as lower crediting rates could result in increased surrenders and lower sales as customers seek alternative investment opportunities. That said, if the recent equity market volatility has the effect of making customers more risk averse, they may view fixed annuities as an attractive alternative to variable annuities.

Fixed index annuities (formerly referred to as equity-indexed annuities) are similar to fixed annuities, in that the contract holder pays us a premium that is credited to the contract holder's account, and also in that interest is periodically credited to the contract holder's account and administrative charges deducted, as appropriate. We guarantee an annual minimum interest rate, although actual interest credited may be higher and is linked to an equity index over its indexed option period. Our profit comes from the investment income we earn and the fees charged on the contract, less the expenses incurred, which include the costs of the guarantees, and the interest credited to the contract. Fixed index annuities are subject to early surrender charges for the first five to twelve years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Fixed index annuities continue to be a profitable product, benefiting from favourable spread and the effective management of equity risk. The fixed index book provides natural offsetting equity exposure to the guarantees issued in conjunction with our variable annuity products, which allows for efficient hedging of the net equity exposure.

Variable annuities are tax-advantaged, deferred annuities where the rate of return depends upon the performance of the underlying portfolio, similar in principle to UK unit-linked products. They are also used for asset accumulation in retirement planning and to provide income in retirement. The contract holder can allocate the premiums between a variety of variable sub-accounts with a choice of fund managers and/or guaranteed fixed-rate options. As with a unit-linked fund, the contract holder's premiums allocated to the variable accounts are held separately from Jackson's general account assets. The value of the portion of the separate account allocated to variable sub-accounts fluctuates with the underlying investments. Variable annuity policies are subject to early surrender charges for the first four to seven years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value. We offer one variable annuity that has no surrender charges and we also offer a choice of guaranteed benefit options within our variable annuity product portfolio, which customers can elect and pay for. These options include the guaranteed minimum death benefit (GMDB), which guarantees that, upon death of the annuitant, the contract holder or beneficiary receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the return of original premium, the highest past anniversary value of the contract, or as the original premium accumulated at a fixed rate of interest. In addition, there are three other types of guarantee: guaranteed minimum withdrawal benefits (GMWB), guaranteed minimum accumulation benefits (GMAB) and guaranteed minimum income benefits (GMIB).

GMWBs provide a guaranteed return of the principal invested by allowing for periodic withdrawals that are limited to a maximum percentage of the initial premium. One version of the GMWBs provides for a minimum annual withdrawal amount that is guaranteed for the

contract holder's life without annuitisation. GMABs generally provide a guarantee for a return of a certain amount of principal after a specified period. GMIBs provide for a minimum level of benefits upon annuitisation regardless of the value of the investments underlying the contract at the time of annuitisation. The GMIB is reinsured.

As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of guarantees. In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business cost effectively to manage our equity exposure. We believe that the internal management of equity risk, coupled with the use of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure. Profits in the variable annuity book of business will continue to be subject to the impact of market movements both on sales and allocations to the variable accounts and the effects of the economic hedging program. While we hedge our risk on an economic basis, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility. We continue to believe that, on a long-term economic basis, the equity exposure remains well managed.

Life insurance

Jackson also sells several types of life insurance including term life, universal life and variable universal life. Term life provides protection for a defined period of time and a benefit that is payable to a designated beneficiary upon the insured's death. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a life insurance policy that combines death benefit protection and the important tax advantages of life insurance with the long-term growth potential of professionally managed investments. Our life insurance book has also delivered consistent profitability, driven primarily by positive mortality and persistency experience.

Institutional products

Our institutional products division markets institutional products such as traditional Guaranteed Investment Contracts (GICs), Funding Agreements and Medium Term Note (MTN) funding agreements. The institutional product offerings also include Jackson's funding agreements issued to the Federal Home Loan Bank. We distribute our institutional products directly to investors, through investment banks, or through funding agreement brokers.

Mutual funds

During 2007, we launched a line of retail mutual funds as a complement to the broad product offering. In January 2008, we added two new portfolios to our existing line-up of mutual funds. The Jackson Funds now offer seven distinct strategies, each designed to address the diversification and asset growth potential of investors as they navigate the retirement planning process.

United Kingdom

In common with other UK long-term insurance companies, Prudential UK's products are structured as either with-profits (or participating) products, or non-participating products including annuities in payment and unit-linked products. Depending on the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies.

With-profits policies are supported by a with-profits sub-fund and can be single premium (for example, Prudence Bond) or regular premium (for example, certain corporate pension products).

Our primary with-profits sub-fund is part of PAC's long-term fund. The return to shareholders on virtually all our with-profits products is in the form of a statutory transfer to PAC shareholders' funds. This is analogous to a dividend from PAC's long-term fund, and is dependent upon the bonuses credited or declared on policies in that year. In this context, there are two types of bonuses — 'annual' and 'final'. Annual bonuses are declared once a year, and are determined as a prudent proportion of the long-term expected future investment return on the underlying assets. Once credited, annual bonuses are guaranteed in accordance with the terms of the particular product. In contrast, 'final' bonuses are only guaranteed until the next bonus declaration, and are primarily determined on the actual smoothed investment return achieved over the life of the policy. Prudential's with-profits policyholders currently receive 90 per cent of the distribution from the main with-profits sub-fund as bonus additions to their policies, while our shareholders receive 10 per cent as a statutory transfer.

The defined charge participating sub-fund (DCPSF) forms part of the PAC long-term fund. It is comprised of the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into PAC from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and includes the portfolio of with-profit annuity policies acquired from Equitable Life in 2007. All profits in this fund accrue to policyholders in the DCPSF.

The profits from almost all of our new non-participating business accrue solely to shareholders. Such business is written in the non-profit sub-fund within PAC's long-term fund, or in various shareholder-owned direct or indirect subsidiaries. The most significant of these is Prudential Retirement Income Limited (PRIL), which also writes all new immediate annuities arising from vesting deferred annuity policies in the with-profits sub-fund of PAC.

There is a substantial volume of in-force non-participating business in PAC's with-profits sub-fund and that fund's wholly owned subsidiary Prudential Annuities Limited (PAL), which is closed to new business. Profits from this business accrue to the with-profits sub-fund.

Description of EEV basis reporting

Prudential's results are prepared on two accounting bases — the supplementary EEV basis, and the IFRS basis for the financial statements. Over the life of any given product, the total profit recognised will be the same under either the IFRS or the EEV basis. However, the two methods recognise the emergence of that profit in different ways, with profits emerging earlier under the EEV basis than under IFRS. This section explains how EEV differs from IFRS and why it is used.

In broad terms, IFRS profits for long-term business reflect the aggregate of statutory transfers from UK-style with-profits funds and profit on a traditional accounting basis for other long-term business. By their nature, the products sold by the life insurance industry are long-term, as insurance companies commit to service these products for many years into the future. The profit on these insurance sales is generated over this long-term period. In our view, the result under IFRS does not properly reflect the inherent value of these future profits, as it focuses instead on the amounts accruing to shareholders in the current year.

In May 2004 the CFO Forum, representing the Chief Financial Officers of 19 European insurers, published the European Embedded Value Principles, which were designed to promote transparent and consistent embedded value reporting. Key features of the principles are:

- Inclusion of an explicit allowance for the impact of options and guarantees. This typically requires stochastic calculations, under which a large number of simulations are performed that provide a representation of the future behaviour of financial markets;
- An active allowance for the combined impact of risk profile and encumbered capital in the selection of discount rates. This ensures that the risks to the emergence of shareholder cash flows are properly accounted for; and
- Sufficient disclosure to enable informed investors to understand the key risks within the business and the basis of preparation of the results.

The EEV basis not only provides a good indication of the value being added by management in a given accounting period, but also demonstrates whether shareholder capital is being deployed to best effect. Indeed insurance companies in many countries use comparable bases of accounting for management purposes.

The EEV basis is a value-based method of reporting in that it reflects the change in value of the business over the accounting period. This value is called the shareholders' funds on the EEV basis which, at a given point in time, is the value of future profits expected to arise from the current book of long-term insurance business plus the net worth of the company. In determining these expected profits, we make full allowance for the risks attached to their emergence and the associated cost of capital, and take into account recent experience in assessing likely future persistency, mortality and expenses.

The change in value is typically analysed into the following components:

- the value added from new business sold during the year;
- the change in value from existing business already in place at the start of the year;
- short-term fluctuations in investment returns;
- change in the time value of cost of options and guarantees and economic assumption changes;
- other items (for example, profit from other Group operations, tax, foreign exchange, exceptional items); and
- dividends.

The value added from new business — defined as the present value of the future profits arising from new business written in the year — is a key metric that we use in the management of our business. The change in value of business in force at the start of the year demonstrates how the existing book is being managed. Together, these metrics provide our management and shareholders with valuable information about the underlying development of our business and the success or otherwise of management actions.

EEV basis results are prepared by first of all setting 'best estimate' assumptions, by product, for all relevant factors including expenses, surrender levels and mortality. Economic assumptions as to future investment returns and inflation are generally based on market data. These assumptions are used to project future cash flows. The present value of the future cash flows is then calculated using a discount rate which reflects both the time value of money and the risks associated with the cash flows. The risk discount rate is determined by adding a risk margin to the appropriate risk free rate of return. The actual outcome may differ from that projected, in which case the effect will be reflected in the experience variances for that year.

The publication of the EEV Principles represented a significant step towards the harmonisation of embedded value reporting in Europe. However, even with these principles and the accompanying guidance, a divergence of approaches between companies has emerged in practice. In June 2008, in an effort to improve still further the consistency and transparency of embedded value reporting, the CFO Forum published the Market Consistent Embedded Value (MCEV) Principles. However, the MCEV Principles were designed during a period of relatively stable market conditions and their application could, in the current turbulent markets, lead to misleading results. The CFO Forum is therefore currently conducting a review of the impact of turbulent market conditions on the MCEV Principles, and the results of this review may lead to changes to the published MCEV Principles or the issuance of new guidance.