# Business unit review
## Insurance operations

### United Kingdom

#### 1. Market review and summary of strategy

The UK retirement market continues to remain attractive with an ageing population driving demand for pre and post-retirement products.

While many UK consumers remain overly indebted and are not saving enough for retirement, with a backdrop of reduced state and employer provision, they increasingly need to take control of their financial affairs. This positive demographic trend, together with an increasing concentration of wealth in the hands of those approaching retirement or already retired, will continue to fuel the opportunity for financial provision in, and preparing for, retirement.

The impact of A-Day, the implementation of pensions simplification legislation in April 2006, initially dampened new business in certain areas, particularly in the retail annuities market, but subsequently led to considerable market growth in individual pensions, Self Invested Personal Pensions (SIPPs) and annuities. Much of the market growth in pensions savings reflected recycling of money as consumers consolidated existing pensions arrangements to one provider.

The wholesale annuity and risk management market experienced increased competition over 2006, as short-term demand slowed and several new entrants started to participate. However, the long-term potential in this market remains considerable, with approximately £900 billion of funds held across a number of market segments.

During 2006, Prudential UK Insurance Operations (Prudential UK) has continued to target capital efficient returns through selective participation within its chosen markets, Retirement Income, Wealth and Health and Wholesale. Going forward, Prudential UK will specifically focus on maximising value for shareholders through taking a leadership position in the retirement income and savings market. This will be achieved by building on its longevity and asset allocation strengths, as well as utilising its brand strength with older customers, targeting their specific retirement needs. This focus on maximising value will be achieved alongside a programme of cost cutting initiatives for both new business and Prudential UK's back book to ensure that greater operating efficiencies are achieved.

Prudential will not participate directly in healthcare and protection but will instead expand its joint venture with Discovery Holding Limited (Discovery), the leading South African insurance company. It is expected that the Flexible Protection Plan (FPP) will be incorporated into the 50:50 Discovery joint venture during 2007. Both PruHealth and the FPP will utilise the successful 'Vitality' philosophy of a healthier lifestyle leading to lower protection premiums and have a dedicated sales force creating a more focused business model. In addition, FPP will continue to benefit from distribution to financial intermediaries through Prudential UK's intermediary sales force.

As of February 2007, PruHealth had 450 employees and over 100,000 customers, and its customer base, in contrast to the rest of the industry, has been growing at a rate of 15 per cent per month during 2006. Product leadership through strong innovation and multi-channel distribution strategy is expected to continue to deliver a significant market presence with 200,000 customers by the end of the year. PruHealth's aim is to achieve breakeven in 2008 and to be profitable thereafter.

Following the transfer of the protection business to the joint venture, the UK operations will be structured into three business units: Wholesale, Retail Retirement and Mature Life and Pensions.

The strategy in Wholesale Retirement income is to participate selectively in bulk and back book buyouts, where Prudential UK is able to win business based on its financial strength, operational capability and superior track record as well as its extensive annuitant mortality risk assessment capabilities. Prudential UK will maintain a strict focus on value, only participating in transactions that generate an acceptable rate of return. In addition, Prudential UK provides pension management services (including full or partial buyouts) to corporate clients looking to manage or close pension deficits in cost-efficient ways. While there is currently limited activity in this market, Prudential UK believes opportunities will arise to help corporate clients manage significant amounts of pension assets, which are non-core to their operations.

Retail Retirement will focus on savings and income for those customers nearing or in retirement. Retirement income will drive profitable growth in the core annuities business, building on the significant pipeline of vestings business over the next 30 years from maturing policies in its individual and corporate pensions books. This is enhanced by a number of strategic partnerships with third parties, where Prudential UK is the default annuity provider for customers vesting their pension at the point of retirement. The portfolio of retirement products also includes equity release products to provide more flexibility to customers with assets invested in property.

Prudential UK has exited the unprofitable front end commission markets for individual pensions and will transition from front end commission unit-linked bonds, particularly moving away from those areas of low persistency. Instead, Prudential UK will focus on new low risk multi-asset products which utilise Prudential UK's strengths in asset allocation and use 'factory gate pricing' (negotiated between customer and adviser with separate advice costs). These products will target the significant number of retail

| | | CER | | RER | |
|---|---|---|---|---|---|
| **United Kingdom** | **2006 £m** | 2005 £m | Percentage change | 2005 £m | Percentage change |
| APE sales | **900** | 892 | 1% | 892 | 1% |
| NBP | **266** | 243 | 9% | 243 | 9% |
| NBP margin (% APE) | **30%** | 27% | | 27% | |
| NBP margin (% PVNBP) | **3.4%** | 3.1% | | 3.1% | |
| Total EEV basis operating profit* | **686** | 426 | 61% | 426 | 61% |
| Total IFRS operating profit* | **500** | 400 | 25% | 400 | 25% |

*Based on longer-term investment returns.

investors approaching retirement who have substantial assets outside personal or corporate pension plans, or have investments in poorly performing funds, and require inflation protection.

Prudential UK remains committed to the corporate pensions market but will move to a tighter focus on larger schemes with better than average persistency and undertake a cost reduction programme. Together these are expected to deliver an IRR of 14 per cent by 2009. The corporate pensions book is an important source of vestings for the retail annuity business.

Prudential UK will continue to deliver embedded value through the Mature Life and Pensions Business. It has an aggressive target to reduce per policy unit processing costs and is evaluating the best route for achieving this which will include one or all of internal cost cutting, further off-shoring or outsourcing.

Prudential UK distributes products through both direct and intermediated channels. The direct channel will focus on capturing internal pension vesting business and Prudential UK's equity release product via a specialist face-to-face direct sales force. The indirect channel will distribute products through retail intermediaries, strategic partners and through Employee Benefit Consultants (EBCs) and consulting actuaries. Participation within the intermediary market will be selective, targeting those advisers who focus on value and building client relationships.

Prudential UK continues to investigate the opportunity for wrap platform development and views this as an integral component to ensure future access to distribution. Any involvement is likely to be in partnership with a third party.

### 2. Current year initiatives

Over the course of 2006, Prudential UK has continued to deliver innovative new solutions to the market, building on the award-winning launches of PruHealth and the Property Value Release Plan, Prudential's equity release product, in previous years.

The new Flexible Protection Plan was launched in July 2006 to the Direct channel and to a limited group of intermediaries specialising in the protection market. This innovative protection product is designed to pay critical serious illness claimants earlier and more often than traditional protection products with, on average, four times as many serious illnesses covered. Payments are based on severity levels and multiple claims for the same illness or new illnesses are possible. Early results have been encouraging and as a result the product was rolled out nationally in February 2007 and is expected to be incorporated into the Discovery joint venture during 2007.

Towards the end of 2006, Prudential UK received four stars in both the Life & Pension Providers category and the Investment Providers & Packages category at the FT Financial Adviser Practiv Services Awards. In addition, Prudential UK was ranked number one for service in the Life & Pension Annuities sector. These awards are widely recognised throughout the industry as independent recognition of a provider's proposition, as they are voted on by intermediary financial advisers, who base the ratings on the level of service they receive from providers for new business processing, central processing, product support and commission payment.

Prudential UK's strength in retirement provision continued to be well recognised as it won the Moneywise Best Annuity Provider Award for the third year running and was awarded the best lifetime mortgage provider at the 2006 Equity Release Awards for the Property Value Release Plan, together with awards from Moneyfacts and Mortgage Strategy.

In relation to its externally sourced annuity business, Prudential UK has signed further partnership agreements in 2006, including with Royal London which came into effect in September. This agreement allows Prudential UK to provide annuity quotes to all Royal London customers with maturing pensions which were originally written under various brands within the Royal London Group. In addition, Prudential UK signed an exclusive five-year agreement with Threadneedle as their supplier of annuities for their Stakeholder scheme, along with any future defined contribution schemes that Threadneedle acquires. This is a new area for Prudential UK that builds on its experience in providing annuities to the customers of life insurance companies. With the future growth in defined contribution schemes within the UK, Prudential UK expects more agreements of this type.

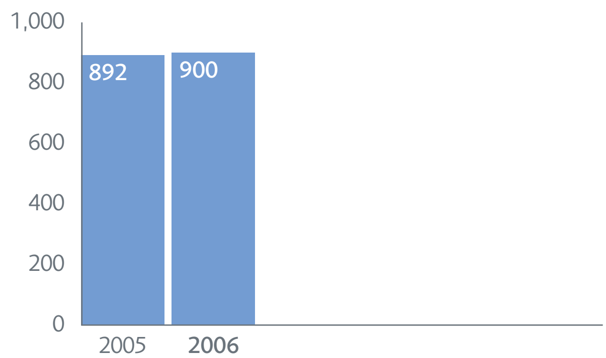
Prudential UK and Save & Prosper have also signed a direct marketing agreement under which Save & Prosper will offer Prudential's conventional annuity product on an exclusive basis to customers with maturing Save & Prosper pensions. The agreement is expected to take effect from mid-2007 and will run for five years.

Prudential UK's financial strength and continuing outstanding life fund investment returns have been well received by both customers and advisers, having a positive impact on with-profits product sales. Prudential UK has also signed new distribution agreements with National Australia Bank Group and Openwork for PruFund, Prudential UK's unitised and smoothed investment plan.

### 3. Financial results and performance

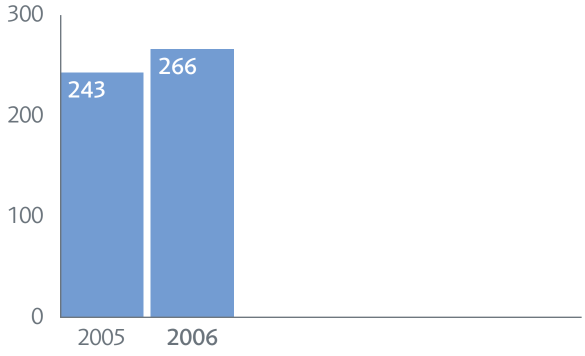
Prudential UK delivered a strong retail performance in 2006. Total APE sales of £900 million increased one per cent on 2005 and there was a nine per cent increase in NBP to £266 million, reflecting the significant increase in new business margin from 27 per cent to 30 per cent. This demonstrated the benefits of the selective participation strategy focusing on value pursued throughout 2006.

**APE new business premiums £m**



# **Business unit review** continued
## Insurance operations

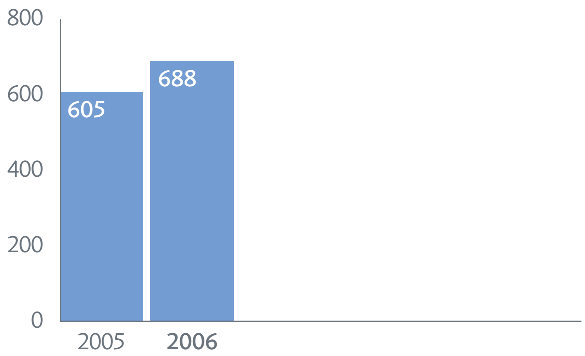
### EEV basis new business profits £m



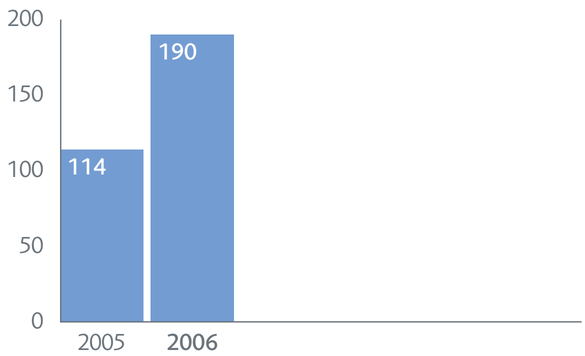

This performance was driven by underlying growth in the UK retail business (excludes credit life, bulks and back books):

- Retail APE sales of £688 million were 14 per cent higher than 2005 (£605 million);
- Retail NBP of £190 million was 67 per cent higher than 2005 (£114 million); and
- Retail New business margin has increased to 28 per cent (2005: 19 per cent).

### Retail APE new business premiums £m




### Retail EEV basis new business profits £m




The Retail life and pensions sales performance was primarily driven by strong individual annuity volumes, where Prudential UK has a 24 per cent market share (source: Association of British Insurers), together with increased sales of with-profits bonds and offshore bonds. These increases were offset by a decline in unit-linked bonds, protection and DWP rebate business.

Individual annuity sales grew by 22 per cent to £271 million as the annuity market experienced increased activity in the second half of 2006 following the removal of uncertainty around A-Day pension changes. Sales volume has been driven primarily by the continued strength of internal vestings (which contributed around 50 per cent of individual annuity sales) together with the cumulative benefit of partnership deals signed in previous years.

Individual annuity sales were also boosted by sales of with-profits annuities where sales have more than doubled to £37 million compared with 2005, and are expected to increase. From February 2007, customers are able to start using their Protected Rights Funds to buy with-profits annuities. This new feature is the first of its type and allows customers to combine 100 per cent of their pension into an asset-backed annuity without having to buy two separate annuities. Protected Rights is a term used to describe the funds held in a money purchase scheme derived from National Insurance rebates for those who contracted out of the State Earnings Related Pension Scheme (which was replaced by State Second Pension).

With-profits sales were supported by the excellent with-profits bonus announcements in 2006, in respect of 2005, which were well received by both customers and advisers. This was reflected in APE sales of with-profits bonds up 44 per cent to £26 million.

Corporate pension APE sales increased 23 per cent due in part to the continuing shift from defined benefit to defined contribution pension schemes but also due to the impact of A-Day. The sales upturn is also a reflection of Prudential UK's re-engineered and improved account management capability, where the company works in partnership with the major Employee Benefit Consultants. Individual pension APE sales increased three per cent to £35 million due to increased activity following A-Day.

PruHealth continues to grow strongly with full-year gross written premiums (GWP) up 300 per cent at £36 million (2005: £9 million). GWP from new lives (which is equivalent to new business APE) was £28 million. Contributing to this growth is the number of companies adopting PruHealth for their employee healthcare schemes, including the British Airways voluntary scheme, Smith and Nephew and Norton Rose.

In the wholesale market, bulks and back book business APE volumes of £143 million were 70 per cent of those achieved in 2005. This reflected the selective participation strategy undertaken by Prudential UK to ensure margins and profitability were maintained in a period when the market experienced increased competition.

Prudential UK completed two significant back book transactions in 2006. In January, it reached agreement with Royal London to acquire the portfolio of in-payment pension annuities that had been written primarily under the Royal London brand, but which also included some annuities written under the Refuge Assurance brand. The transaction generated premium income of £66 million on an APE basis. In June, Prudential Assurance Company (PAC) agreed to reinsure the non-profit immediate pension annuity portfolio of the Scottish Amicable Insurance Fund (SAIF) to Prudential Retirement

Income Ltd (PRIL). SAIF is a closed sub-fund established by a court-approved Scheme of Arrangement in September 1997, in which Prudential shareholders have no economic interest. It contains a large proportion of the business originally written by the Scottish Amicable Life Assurance Society that was acquired by PAC in September 1997. The reinsurance premium for this transaction was £56 million on an APE basis.

In December, Prudential UK reached agreement with Save & Prosper to acquire its portfolio of in-payment pension annuities. The book covers approximately 16,900 policies (weighted average age 72) with assets of around £135 million (£13.5 million APE). During 2007, the intention is for these annuity policies to transfer to Prudential, subject to legal and regulatory approvals, at which point Prudential will take over direct responsibility for the payment of all annuitants.

Total credit life APE sales of £69 million generated NBP of £26 million in 2006 (£83 million and £35 million respectively in 2005). Credit life sales reduced in 2006 and will continue to do so in 2007 as Prudential UK's credit life contract with Lloyds TSB, which in 2006 contributed APE sales of £63 million and NBP of £20 million, has not been renewed. Prudential UK will continue to participate in the credit life market, pricing on a case-by-case basis.

In 2002, Prudential UK transferred its UK personal lines general insurance business to Winterthur, forming a strategic alliance with Churchill to offer Prudential-branded general insurance products for which Prudential receives a commission payment that has been offset against an advance payment made by Winterthur at completion resulting in a net payment to Prudential of £4 million in 2006. From 2008, under the terms of the contractual arrangement, the advance payment will have been fully offset, therefore Prudential UK is expected to receive approximately £30 million a year from the commission payments, although this will depend on the new business volumes and persistency rates.

Prudential UK allocates shareholder capital to support new business growth across a wide range of products in the UK. The weighted average post-tax IRR on the capital allocated to new business growth in the UK in 2006 was 15 per cent, up by one percentage point from that achieved in 2005.

The NBP increased nine per cent to £266 million, primarily reflecting an increase in margin from 27 per cent in 2005 to 30 per cent in 2006. This reflects an increase in profitability within the retail business, where the margin increased significantly, driven principally by individual annuities offset by a change in business mix following the lower sales of more profitable bulk annuities, credit life business and DWP rebates.

EEV basis operating profit based on longer-term investment returns of £686 million, before restructuring costs of £34 million, were up 61 per cent on 2005. The in-force operating profit of £420 million was up 129 per cent on 2005, due to the increase in profits arising from the unwind of discount from the in-force book (reflecting an increase in the risk discount rates together with an increased opening embedded value); and because there were no operating assumption changes required in 2006, in comparison to 2005 when a charge of £148 million was made in respect of persistency.

Other charges of £110 million include £32 million of costs associated with product and distribution development and complying with regulatory requirements including Sarbanes-Oxley; £9 million negative persistency experience variance; £14 million for an annual fee paid by the shareholder business to the PAC with-profits sub-fund for the use of the Prudential and Scottish Amicable trademarks; £16 million in respect of the tariff arrangement with SAIF, which is to be renegotiated in 2007; £26 million for tax related items and £13 million in relation other items.

Prudential continues to manage actively the retention of the in-force book. During 2006, Prudential saw surrenders within its personal pension and DWP rebate business run ahead of assumptions following A-Day resulting in a small negative experience variance. All other lines of business performed in line with assumptions.

IFRS operating profit before restructuring costs of £31 million increased 25 per cent to £500 million in 2006. This reflects a 22 per cent increase in profits attributable to the with-profits business, which contributed £368 million reflecting the strong investment performance of the Life-Fund and its impact on terminal bonuses. In addition, the result benefited from a £46 million positive impact of changes in FSA reserving requirements for protection and unit-linked products.

### 4. Outlook and forthcoming objectives

While Prudential's retail APE sales volume growth may fall in the short term, as it refocuses its retirement savings products, Prudential expects the UK financial services environment to remain favourable, and expects to achieve growth in line with the market (5 to 10 per cent) over the next five years.

Prudential UK will continue to focus on profitable opportunities which deliver capital-efficient returns and will seek to maintain an aggregate 14 per cent IRR on new business. It will continue to pursue profitable opportunities in its chosen product areas and distribution channels in 2007.

As previously announced, Prudential UK has targeted £150 million of cost savings by 2008 through the integration of Egg and other shareholder cost saving initiatives at a cost of £110 million. Of these target savings and costs, £35 million and £25 million respectively were due to be realised by Egg. Following the sale, the revised target savings for Prudential is £115 million. Prudential UK has, however, identified further cost saving initiatives which result in target cost savings for the UK business being increased to £195 million, to be achieved by 2010. The savings when achieved, net of restructuring costs, will result in a small positive assumption change on an EEV basis, estimated to be around £60 million. The cost savings will be achieved through a combination of internal cost saving, further off-shoring or outsourcing. The work of approximately 3,000 people in the customer service, customer operations and information technology areas will be in the core scope of this review. Prudential will comply with its legal obligations to consult with unions and employee representatives in relation to these proposals. The total cost of achieving the £195 million of savings is expected to be up to £165 million and will depend upon the final detail of the cost reduction programme.

In connection with the sale of Egg, outline terms of a distribution agreement have been agreed in principle with Citi through which Prudential UK will provide life and pension products to Egg's customers for a five-year period. Prudential UK sees Egg's direct distribution capacity and access to its three million customers as powerful strategic assets, and this agreement enables it to preserve these benefits while reducing the risk to its balance sheet.

# Business unit review continued
## Insurance operations

### United States

#### 1. Market review and summary of strategy

The United States is the largest retirement savings market in the world, with 67 per cent, or US$12.9 trillion, of the world's retirement assets concentrated in the US at the end of 2005 (Source: Cerulli Associates). As 78 million baby boomers (Source: US Census Bureau), born between 1946 and 1964, approach retirement age, the ageing demographics of the US are expected to increase annual retirement distributions to more than US$1 trillion per year by 2012. The combination of increasing average life expectancy and decreasing average retirement age in the US is leading to an increase in the average time individuals will spend in retirement. At the same time, the responsibility for providing income during retirement continues to shift away from institutions, such as government and employers, toward individuals. These changes, coupled with historically low savings rates in the US, have resulted in an increasing risk that individuals' finances will be insufficient to cover the cost of living through retirement. These consumers will have a growing need for independent financial advice and increasingly seek guarantees and longevity protections from the financial products they purchase.

Despite favourable demographics, US life insurers face challenges from both within and outside the industry. The US life insurance industry remains highly fragmented – the combination of all annuity companies ranked below the top 20 annuity sellers have more than twice the market share of the top annuity provider (Source: LIMRA) and competition for market share is expected to intensify. In addition to competing against each other, life insurers are increasingly competing with other financial services providers, in particular mutual fund companies and banks, for a share of retirement savings assets in the US. Sales of annuities in the career agency distribution channel continue to decline to the benefit of independent agents/broker-dealers due to increasing costs and regulatory burdens, as well as a growing pool of sophisticated investors increasingly seeking more independent investment advice.

The US insurance industry faces continued regulatory scrutiny, particularly with respect to index and variable annuity products. The National Association of Securities Dealers Inc. (NASD) has issued guidelines requesting that its member firms provide stricter supervision of the marketing and sales of index annuities. In the variable annuity market, regulators continue to focus on product suitability in an effort to ensure that the products are sold appropriately to customers. There has also been regulatory pressure to reduce fees and costs associated with variable annuities, which has increased advisor demand for providers to manufacture low-cost variable annuity options.

Companies with quality distribution relationships, strong product manufacturing and below-industry-average cost structures are well positioned to compete effectively and continue to grow profitably. Significant convergence in the US financial services industry has yet to occur. As noted, the market remains fragmented with more business being consolidated organically among market participants with significant scale and sophisticated risk management functions.

During 2006 and 2005, the S&P index increased 13.6 per cent and 3.0 per cent, respectively, increasing the attractiveness of products providing access to equity-based returns. During the same periods, interest rates trended upward. However, the short end of the yield curve rose more dramatically than the long end of the curve, resulting in a flat to inverted yield curve. This, combined with low spreads over Treasury bonds, created a difficult environment for the sale of properly priced fixed annuities.

Jackson National Life Insurance Company (Jackson) provides retirement income and savings solutions in the mass and mass-affluent segments of the US market, primarily to near and post-retirees. It offers tools that help people plan for their retirement, and manufactures products with specialised features and guarantees to meet customers' needs. By seeking to add value to both the representatives who sell Jackson products, and to their customers, Jackson has built a strong position in the US retirement savings and income market with the fastest growing variable annuity franchise measured by new sales growth during the past four years (Source: VARDS) and top-10 sales rankings in fixed index annuities and individual traditional deferred fixed annuities (Source: LIMRA).

Jackson's primary focus is manufacturing high-margin, capital-efficient products, such as variable annuities, and marketing these products to advice-based channels through its relationship-based distribution model. In developing new product offerings, Jackson leverages a low-cost, flexible technology platform to manufacture innovative, customisable products that can be brought to the market quickly. In 2006, 81 per cent of Jackson's retail sales were from products and features developed and launched in 2006 and 2005.

Jackson's product offerings include variable, fixed and fixed index annuities, as well as life insurance and institutional products. Jackson's annuity products are long-term personal retirement products, which offer tax-deferred accumulation on the funds invested until proceeds are withdrawn from the policy. Fixed annuities offer

| | CER | | | RER | |
|---|---|---|---|---|---|
| **United States** | **2006 £m** | 2005 £m | Percentage change | 2005 £m | Percentage change |
| APE sales | **614** | 508 | 21% | 515 | 19% |
| NBP | **259** | 208 | 25% | 211 | 23% |
| NBP margin (% APE) | **42%** | 41% | | 41% | |
| NBP margin (% PVNBP) | **4.2%** | 4.1% | | 4.1% | |
| Total EEV basis operating profit* | **718** | 745 | (4)% | 755 | (5)% |
| Total IFRS operating profit* | **408** | 358 | 14% | 362 | 13% |

*Based on longer-term investment returns and including broker-dealer and fund management and Curian.

customers a guarantee of principal and a minimum guaranteed rate of return on their deposits. Fixed index annuities also offer these features, but vary from fixed annuities in that they offer the potential for additional interest to be credited based upon the performance of an equity index over a specified period. Variable annuity products differ from the fixed annuity products in that the returns to the customer will depend upon the performance of the underlying fund portfolio. Jackson's variable annuity products offer a range of protection options, such as death, income and withdrawal benefits, which are priced separately by the company and can be elected by customers according to their individual needs. Jackson manages its exposure to equity market movements through a comprehensive hedging programme.

Due to the increasing complexity of the retirement savings and income market and broad array of financial products being brought to market, professional advice is vital for customers to understand the choices available and to determine which products are best for their particular financial situation. Therefore, Jackson primarily markets its retail products through advice-based distribution channels, including independent agents, independent broker-dealer firms, regional broker-dealers, banks and registered investment advisors. Beginning in 2005, Jackson also began marketing products through its captive insurance agency, acquired through the purchase of Life of Georgia (LOG).

Jackson supports its network of independent agents and advisors with award-winning marketing support and award-winning customer service. In 2006, the Service Quality Measurement Group recognised Jackson with a World Class Customer Satisfaction Award, and Jackson's marketing campaigns won awards for achievement in graphic design, editorial content and overall communications excellence. Jackson complements its award-winning marketing and customer service with value-added services such as the Seminar Systems Unit, which helps advisors host educational seminars for clients on a variety of financial planning topics. In addition, Jackson recently launched the Retirement and Wealth Strategies Group, a unit dedicated to helping advisors better address their clients' evolving retirement planning needs.

By manufacturing and distributing a broad suite of platform-based products that can be tailored to an individual customer's needs, Jackson has positioned itself to compete effectively in all phases of the business cycle based upon the quality and value of the products and services it provides, rather than price alone.

Jackson's institutional products division markets institutional products such as traditional Guaranteed Investment Contracts (GICs), Funding Agreements and Medium Term Note (MTN) funding agreements. Jackson distributes its institutional products directly to investors, through investment banks or through funding agreement brokers. This is a market in which Jackson continues to participate on an opportunistic basis.

In early 2003, Jackson entered the registered investment advisor channel with the launch of Curian Capital. Curian provides innovative fee-based separately managed accounts and investment products to advisors through a sophisticated technology platform.

In 1998, Jackson launched the National Planning Holdings (NPH) independent broker-dealer network with the formation of National Planning Corporation. Since its formation, NPH has grown through acquisitions to comprise four broker-dealer firms: INVEST Financial, Investment Centers of America, National Planning Corporation and SII Investments. By leveraging technology, NPH provides its advisors with the tools they need to operate their practices more efficiently. Through its relationship with NPH, Jackson has gained an important distribution outlet, plus invaluable insight into the needs of financial advisors and their clients.

Jackson's focus on current retirees and those approaching retirement age is not unique among US financial institutions. As a result, competition in this segment is expected to continue as the baby boomer generation retires and their retirement savings assets are moved from pre-retirement accumulation accounts into post-retirement income accounts. Jackson believes that its specialised product offerings, advice-based distribution model, sophisticated risk management function and low cost structure will offer a significant competitive advantage.

As competition and regulatory challenges intensify, Jackson expects consolidation within the industry to continue at a measured pace. Further consolidation will provide an excellent opportunity for Jackson to leverage its efficient information technology platform and cost effective business model as an aggregator of annuity and life portfolios, as demonstrated with Jackson's acquisition and integration of LOG in 2005.

### 2. Current year initiatives

Jackson's focus on maximising its opportunities in the evolving US market is embedded in the development of current and future strategic initiatives. These goals include a continued expansion of Jackson's share of the US annuities and retail asset management markets.

Expansion of Jackson's share of the US annuities market will be largely contingent on continued expansion of existing product offerings, additional growth in new and existing distribution channels and opportunistic acquisition activity.

Innovation in product design and speed to market continue to be key drivers of Jackson's competitiveness. In January, Jackson added a five per cent annual benefit increase option to its popular lifetime guaranteed minimum withdrawal benefits (GMWBs). In February 2006, the company launched two new fixed index annuity contracts, Elite Choice and Elite Choice Rewards, which expanded the number of FIA products Jackson offers to five. In May, Jackson added five new GMWB options that provide contract holders with a guaranteed return of premium and lifetime income. Additionally, Jackson expanded its variable annuity fund offering during the year.

In the near term, Jackson's product development strategy includes further enhancement of its variable annuity offerings and the introduction of new guarantees, including a Guaranteed Minimum Accumulation Benefit (GMAB). In early 2007, Jackson launched a simplified retirement annuity that will serve as a low-cost option for financial advisors who are currently not participating in the variable annuity market. Additionally, Jackson launched its first set of retail

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## Insurance operations

mutual funds for distribution by existing wholesalers. Jackson's new mutual funds are marketed as an additional option for financial advisors currently selling variable annuity products.

Jackson will continue to build its relationship-based distribution advantage in the advice-based channels and explore additional distribution opportunities, including expansion into the wirehouse channel, as evidenced by the company's recently announced distribution agreement with UBS.

Jackson's organisational flexibility and excellence in execution, coupled with its product innovation, successful distribution model and strong service offering, increased Jackson's share of the US variable annuity market to 4.6 per cent in 2006 (VARDS), up from 3.6 per cent in 2005. Jackson also increased its share of variable annuity sales through the independent broker-dealer channel to 10.8 per cent at the end of 2006, up from 9.2 per cent at the end of 2005.

Jackson continues to seek opportunities to deploy capital through opportunistic, value-creating acquisitions. Jackson demonstrated its ability to efficiently consolidate annuity and life portfolios by meeting or exceeding performance targets during the completion of its acquisition of LOG. Jackson integrated more than 1.5 million policies onto its platform within eight months of the acquisition date. The IRR on the acquisition of LOG exceeded 13 per cent and the purchase resulted in a gain of US$8.9 million (£4.8 million) as the net assets acquired exceeded the purchase price paid.

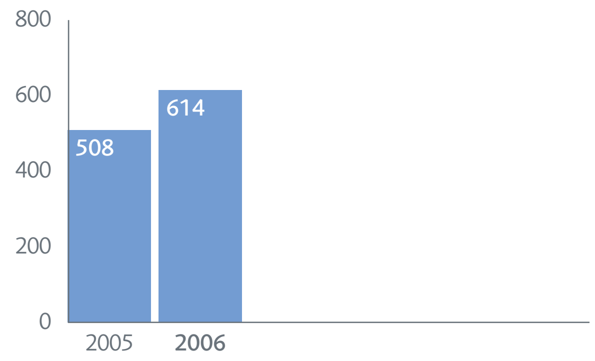
Jackson's continued expansion in the US retail asset management market will be led by the efforts of its independent broker-dealer network, NPH and Curian. NPH was ranked the seventh largest independent broker-dealer network in the US (source: Investment News magazine) and generated nearly US$12 billion in gross product sales and nearly US$500 million in revenues in 2006. Curian continues to be one of the fastest growing third-party separately managed account platforms in the US, with assets under management of US$2.4 billion at the end of 2006. Curian is expected to continue expansion of its product offerings and further improve efficiencies through planned improvements to its core technology system. Curian also continues to expand its distribution relationships with key financial institutions, as evidenced in recently announced agreements with AIG and Commonwealth Financial Group.

### 3. Financial results and performance

Jackson has a diversified earnings base derived from spread, fee and underwriting income. Through strong growth in its variable annuity business during 2006, Jackson increased the share of revenue received from fee income and further diversified its revenue streams. Underwriting revenue from life insurance provides Jackson with stable cash flows to balance the volatility of cash flows from fixed annuities, thereby providing the company with a more stable earnings base and greater flexibility in how assets are invested.

Jackson achieved record APE sales of £614 million in 2006, representing a 21 per cent increase on 2005, driven by strong growth in sales of variable annuities. On a PVNBP basis, new business sales were £6.1 billion. Retail APE sales in 2006 of £524 million were up 27 per cent. APE sales in the fourth quarter of 2006 were £147 million, up 43 per cent compared to the fourth quarter of 2005.

**APE new business premiums £m**




Jackson delivered record variable annuity sales in 2006 of £3.8 billion, up 48 per cent on last year. This reflects its distinct competitive advantages of an innovative product offering, an efficient and flexible technology platform, a relationship-driven distribution model and award-winning service. Jackson's sales result was achieved in a market that grew 18 per cent year-on-year in 2006.

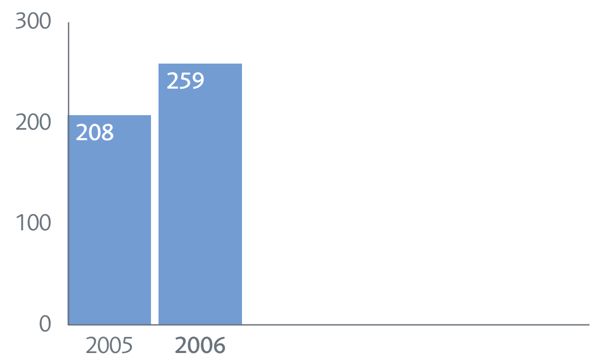
Entry spreads for fixed annuities continued to be challenging during 2006, which limited the attractiveness of the market to Jackson. APE sales of £69 million were down 12 per cent on the same period in 2005.

Fixed index annuity sales continued to be affected by the uncertain regulatory environment in the US. APE sales of £55 million were 10 per cent down on 2005. Jackson's market share in 2006 was 3.7 per cent, compared to 3.8 per cent in the prior year.

Institutional APE sales of £90 million were down eight per cent from 2005. Jackson participates in this market on an opportunistic basis.

EEV basis NBP of £259 million was 25 per cent above the prior year, reflecting both a 21 per cent increase in APE sales and an increase in margin from 41 per cent to 42 per cent year-on-year. The increase in margin reflects a favourable business mix, economic assumption changes, and positive effects from the increase in election of high-margin guaranteed benefit options on variable annuity contracts, offset by more prudent operating assumptions.

**EEV basis new business profits £m**



The variable annuity new business margin decreased slightly from 50 per cent in 2005 to 49 per cent in 2006. The fall in margin primarily reflects changes in assumptions for expenses and utilisation of lifetime guaranteed minimum withdrawal benefits, offset by economic assumption changes and a more favourable mix due to the increased election of guaranteed minimum withdrawal benefits.

The fixed annuity new business margin fell from 23 per cent to 16 per cent reflecting changes to expense and cash withdrawal assumptions partly offset by economic assumption changes.

The new business margin on institutional business improved due to the larger average duration contracts written during 2006.

The average IRR on new business was 18 per cent compared to 15 per cent in 2005.

While product IRRs are generally in line with returns reported for 2005 new business, the aggregate returns are higher due to a larger proportion of variable annuity sales in 2006 (64 per cent) as compared to 2005 (52 per cent). For variable annuities, the IRR has increased to 25 per cent in 2006 from 24 per cent last year due to higher interest rates and therefore a higher separate account return assumption.

Total EEV basis operating profit for Jackson for 2006 was £708 million compared to £731 million in the prior year. In-force EEV profits of £449 million were 14 per cent below prior year profit of £523 million, primarily reflecting the inclusion in 2005 of an operating assumption change relating to price increases introduced on two older books of term life business representing £140 million. This was partially offset by an increase in the unwind of the in-force business during 2006 as a result of a higher opening embedded value and a higher risk discount rate as long-term interest rates increased. On a normalised basis, the EEV basis operating profit was up by 19 per cent. One-off items affecting the spread income variance totalled £46 million.

The growth in IFRS operating profit for total US operations of 14 per cent from the prior year to £408 million primarily reflects an increase in fee and spread income over 2005. The improved spread income primarily reflects higher net average invested assets. Higher fee income was primarily driven by higher separate account assets given the growth in variable annuity sales, and an improvement in the average fees generated from those assets given the increase in election of high-margin guaranteed optional benefits. In 2006, spread income included a number of non-recurring items including mortgage prepayment fees, make-whole payments and total return swap income which together represent £33 million of spread, compared to £44 million in 2005, both net of DAC amortisation.

At 31 December 2006, Jackson had more than US$74 billion (£38 billion) in GAAP assets. Of this total, US$22 billion related to separate account assets, an increase of more than US$7 billion compared to 2005 year end, further diversifying Jackson's earnings toward fee-based income.

NPH had a strong year with pre-tax profits up 51 per cent to £6 million. NPH, which is a network of four independent broker-dealers, increased gross product sales through the network to US$11.9 billion (£6.5 million) in 2006, an increase of 26 per cent over the prior year. NPH has also increased the number of registered advisors in its network to more than 2,600 at year end, further extending Jackson's footprint in broker-dealer distribution.

Curian recorded improved results with pre-tax losses of £8 million in 2006, improving from losses of £10 million in the prior year, as it continues to build scale in assets under management. At 31 December 2006, Curian had US$2.4 billion (£1.2 billion) of assets under management compared with US$1.7 billion (£853 million at CER) at the same point in the prior year.

Jackson continues to maintain a strong capital position through capital conservation and strong earnings. At 31 December 2006, Jackson's capital was well in excess of regulatory requirements with sufficient available capital to fund future bolt-on acquisitions. During 2006, Jackson increased the capital remittance to the Group to US$200 million, with future increases expected with continued growth.

### 4. Outlook and forthcoming objectives

Jackson continues to deliver growth in the attractive US market and has further enhanced its competitive advantage in the variable annuity market, offering the product and service solutions that both customers and advisors desire. With its continued focus on product innovation, a proven relationship-based distribution model, award-winning service and excellence in execution, Jackson is well positioned to take advantage of the changing demographics and resulting opportunities in the US market.

## Asia

### 1.The Asian opportunity

Asia remains a very attractive region for growth opportunities due to its high levels of economic activity translating into higher levels of personal wealth, greater disposable incomes and a growing appetite for good quality protection and savings products. Within this environment, ageing demographics are also beginning to drive increased household savings rates and an emerging need for retirement solutions.

| | | CER | | RER | |
|---|---|---|---|---|---|
| **Asia** | **2006 £m** | 2005 £m | Percentage change | 2005 £m | Percentage change |
| APE sales | **956** | 734 | 30% | 731 | 31% |
| NBP | **514** | 418 | 23% | 413 | 24% |
| NBP margin (% APE) | **54%** | 57% | | 56% | |
| NBP margin (% PVNBP) | **10.0%** | 10.3% | | 10.2% | |
| Total EEV basis operating profit* | **829** | 585 | 42% | 576 | 44% |
| Total IFRS operating profit* | **189** | 201 | (6)% | 195 | (3)% |

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

## Business unit review continued
## Insurance operations

Within Asia, each country typically has incumbent life insurers and asset managers and the majority of market share is concentrated in the top five players. For many years, these incumbents have used predominantly lower quality tied agency distribution and life products have tended to be simple, often with some form of guarantee that may be based on higher interest rates than the current prevailing ones.

The country markets within Asia are extremely diverse and a 'one size fits all' business model does not work. Regional players must accommodate different stages of economic development, varying cultures, multiple languages, differing legal and regulatory regimes and competitors with different objectives and standards. Joint venture with local companies is also mandated in some markets and there is a limited pool of attractive partners. Regional players such as Prudential Corporation Asia have had considerable success across multiple Asian markets but, to date, this has been the exception rather than the rule with local players tending to stay within their markets and other international players, whilst successful in one or two markets, have not developed their businesses across the region.

Opportunities for foreign players to access the Asia protection and savings markets have been increasing steadily and regulators in the region are becoming more accommodating regarding product and distribution innovation. These include unit-linked products, more professional non-agency channels and mandatory licensing of agents. Most notably, the significant markets of China and India have greatly opened up within the last few years.

Despite the increasing opportunities in Asia, there are also challenges to expansion. Experienced staff and agents are very much in demand, particularly in markets such as China and India where the rapid growth of the industry has resulted in limited pools of resources. There is also the potential for mis-selling where there can often be a difference between the customer's perception of product features and the reality which may take several years to become apparent. These challenges can be exacerbated by a media that is becoming more consumer focused as deregulation continues.

During 2006, economic activity in the region remained strong and equity market performance was robust. We anticipate the Asian economic outlook will remain strong with domestic demand and foreign investment and capital inflow expected to increase, resulting in average GDP growth across Asia being around seven per cent for the next few years.

### 2. Prudential's Asian strategy

Since 1994 Prudential has implemented a strategy designed to build an Asian platform with the breadth and depth to deliver material shareholder value that is sustainable over the long term. This strategy has been executed by securing early access to countries with high potential customer bases, building and professionalising core tied agency distribution that is complemented by alternative channels such as bank partnerships, launching capital efficient consumer orientated products and supporting the entire structure with a sharp focus on excellent customer service.

Underpinning the strategy is an investment in recruiting and training with the objective of retaining the best people in the industry. Prudential also continues to leverage the significant advantages from its well respected UK heritage including a powerful brand, embodied by the Prudence icon, over 150 years experience as a market leader, and the governance and compliance infrastructure associated with a leading international business.

Today, Prudential has life operations in 12 countries, including joint ventures with CITIC in China and ICICI in India. Prudential is a regional force in the life insurance and fund management business, and, at 31 December 2006 had 7.2 million customers in Asia and 14,000 staff. Brand recognition is high and Prudential's customer centric delivery has been acknowledged through a number of awards, including second most trusted life insurance and asset management brand in India. Life insurance new business APE has grown at a compound annual growth rate (CAGR) of 22 per cent since 2001 and funds under management, including Prudential's market leading retail mutual fund business has grown at a CAGR of 25 per cent over the same period. For the first time this year, Asia also became a net contributor of cash to the Group, demonstrating the growing scale of the business.

### 3. Business priorities

An ongoing priority for Prudential is to continue building distribution to drive growth. The agency strategy is tailored to each market, with the more developed markets typically focused on enhancing agency productivity and the newer markets emphasising increased distribution reach through growth in agent numbers. In China and India particularly, this means increasing geographic coverage through entering new cities and opening more branches.

2006 was a very successful year for the agency distribution channel with year-end 2006 agent numbers increasing by 114,000 in India, 11,000 in Indonesia and 5,000 in China compared to 2005. Agency productivity measured by APE per average agent also improved strongly during the year with Prudential's more developed markets of Singapore, Hong Kong and Malaysia all showing double-digit improvement over 2005 of 23 per cent, 30 per cent and 32 per cent, respectively.

Distribution from non-agency channels also grew strongly in 2006. Strong growth from bank distribution included record new business volumes from Standard Chartered Bank (SCB) in Hong Kong, an increasing proportion of new business from ICICI Bank in India and encouraging growth from Maybank and Singpost in Singapore. In addition, a new direct distribution initiative, PRUcall, was launched in Thailand during 2006, posting strong results to date.

Prudential's product strategy has been a key driver of its success. From the outset, the focus has been on predominantly regular premium products designed and targeted to meet customer needs. In the more emerging markets this is illustrated by the success of products that focus on providing for children and their education such as PRUkid in Vietnam. However, in an older and more developed market such as Korea, retirement-orientated unit-linked products such as PRUretire are proving popular.

Prudential has led product innovation in a number of markets often working closely with the regulators. As a result, Prudential has been first to market with unit-linked products in Singapore, Malaysia, Taiwan, Indonesia, India, the Philippines and Korea. Unit-linked products are now a well established part of the overall portfolio generating 61 per cent of total new business APE in 2006 and, within the regulatory driven investment guidelines in each market, Prudential continues to expand the choice of investment funds available to customers, including third-party funds in markets where it makes sense.

During 2006, Prudential launched a new universal life product in Malaysia to give customers more choice and in India, ICICI Prudential launched a ground-breaking new diabetes care product. Prudential has also made its first move into the takaful market by forming a joint venture with Bank Simpanan Nasional (BSN) in Malaysia and successfully launching its first linked product in November.

As a result of this strategic focus on regular premium policies, capital efficient linked products and the high proportion of A&H riders, new business profit margins as a percentage of weighted sales tend to be higher in Asia than are seen elsewhere.

The focus on effective distribution and profitable life products has proven more difficult to deliver in Japan. Neither tied agency nor general agency distribution were found to be economically viable and, whilst a profitable variable annuity product has been approved by the regulators, it has not been commercially attractive when compared to some competitor products. The business remains subscale and we continue to look for profitable growth opportunities in the market.

Further demonstrating the benefits of scale that Prudential is beginning to realise in Asia, costs as a proportion of gross written premiums have been decreasing steadily from 16 per cent in 2002 to 11 per cent in 2006. However, continuing to increase efficiencies through greater use of common systems, platforms and processes across the region and the Group remains a priority.

Prudential is committed to delivering material shareholder value from its Asian business and, during 2006, a number of steps were taken to strengthen the Asia regional management team with Barry Stowe becoming the new CEO in November 2006.

## Major market overviews

### *China*

Prudential, with its joint venture partner CITIC, continues to be very well placed amongst the foreign players establishing themselves in this very attractive market. In 2006, CITIC-Prudential retained its position as the number two foreign player with new business APE growth of 56 per cent to £39 million and continued to successfully implement its strategy of geographic expansion receiving six new city licence awards from the regulators.

New business profit margins of 43 per cent remain attractive but as would be expected, the business is currently making IFRS losses and consuming capital as it invests in new cities. The reduction in margin from 51 per cent in 2005 is primarily due to product mix and persistency assumption changes in 2006.

### *Hong Kong*

The Hong Kong market grew strongly between 2000 and 2005 with a CAGR of 18 per cent and Prudential has consistently outperformed the market with a CAGR of 22 per cent over the same period. One reason for this is Prudential's successful multi-channel model while most of the top five players in the market choose to focus on only one distribution channel. In 2006, 55 per cent of distribution came from agency and 45 per cent from bank distribution with SCB.

During 2006, Hong Kong successfully focused on recruiting and training agents with average agent numbers and productivity up seven per cent and 15 per cent, respectively. Another priority for the business is to continue leveraging its strong partnership with SCB, and new business APE from this channel increased by 32 per cent in 2006.

NBP margins on APE increased from 60 per cent to 69 per cent during 2006 reflecting improving experience. Hong Kong also generates material IFRS profits and is a net remitter of capital to the Group.

As in Singapore and Korea, there are significant opportunities in the retirement sector in Hong Kong and Prudential is well placed with a marketing campaign already underway.

### *India*

Prudential's strategy of working with top quality joint venture partners has been very successful in India, where ICICI-Prudential Life is the clear leader amongst the private sector insurers and, with its nine per cent market share, is really making headway. This is a remarkable achievement given it has only been operating for six years.

As reflected by the over 280 new branches opened during the year and the 165 per cent increase in agent numbers, the strategy in India has been to build scale rapidly. Bancassurance is also well established in India and generated 27 per cent of ICICI-Prudential's new business in 2006. At 31 December 2006, ICICI-Prudential had 2.6 million policies in force.

Whilst 96 per cent of India's 2006 new business is made up of unit-linked products, margins are lower than in other Asian markets. This is driven primarily by relatively higher discount rates and more aggressive pricing. The margin of 23 per cent in 2006 is lower than the 29 per cent reported for 2005 primarily due to product mix and expense assumption changes.

Prudential's ownership of this venture is capped at 26 per cent by law and, although there is much speculation that this limit may be increased to 49 per cent in the future, there is no firm timetable in place. Prudential will consider an increase in its stake as and when this becomes a feasible option. Resulting from the fast pace of expansion, the business currently makes a loss under the IFRS basis and requires net capital injections.

### *Indonesia*

Indonesia is a very attractive market with a population of 240 million and an increasingly stable and productive economy. Prudential is already a well established market leader and during 2006 has continued to aggressively expand its agency distribution with numbers up 49 per cent in the year. In addition to continuing to expand the agency force, Indonesia is expected to begin working with Citi in 2007 as announced at the time of the Egg sale.

In 1997, Prudential successfully introduced unit-linked products in Indonesia, which now account for virtually all new business sold. The business is profitable under the IFRS basis and remitted surplus capital to the Group in 2006.

### *Japan*

Prudential's Japanese life insurance operation remains subscale, although 2006 saw new business double. A review of opportunities in Japan is underway.

# **Business unit review** continued
## Insurance operations

### *Korea*
Prudential's Korean life operation has an impressive growth track record with a CAGR of 82 per cent since its acquisition in 2001 and is the fastest growing company in the industry. This has resulted primarily from successful implementation of a multi-channel distribution and product innovation strategy that has differentiated Prudential from the market.

New business APE in 2006 of £218 million was driven principally by the tied financial consultant channel (49 per cent) and the GA (broker) channel (38 per cent). Bancassurance volumes are limited by regulatory constraints which prescribe a maximum 25 per cent of banks' sales volume from any one life insurer. This has negatively impacted bank distribution in Korea as Prudential reached this limit early on in the year with all its major bank partners. Direct distribution accounted for five per cent in 2006 and this reflects the more competitive environment at present. In 2007 Prudential will continue building on its advantaged distribution model, including new bank partnerships with Korea Bank and Shinhan Bank.

Prudential Korea has benefited significantly from its innovative stance in the retirement space; and has been hugely successful with its 'What's your number' campaign.

Whilst lower than some other markets, new business profit margins in Korea remain attractive at 35 per cent and are driven by the high proportion of unit-linked products at 84 per cent of APE.

As a result of its rapid growth, investment in building scale and the comparatively small size of the acquired in-force book, the business currently makes a loss under the IFRS basis and receives capital injections from the Group.

### *Malaysia*
Prudential Malaysia had a challenging year in 2006 in part due to regulatory driven changes on illustrations which unsettled the industry. Against this backdrop Prudential Malaysia was able to grow by six per cent. Distribution in Malaysia is predominately tied agency as the current bank distribution regulations limit insurers to one bank partner. In 2007 the focus in Malaysia will be to continue expanding the agency force and further broaden the product range with a universal life product.

For some time Prudential has seen the potential for takaful products in Malaysia and in 2006 formed a takaful joint venture with BSN, Prudential BSN Takaful. This launched in November and has started selling Shariah compliant linked life products through Prudential Malaysia's tied agency force.

Malaysia generates significant IFRS profits and makes material contributions of surplus capital to the Group.

### *The Philippines*
Although it is a top 5 player in the Philippines, Prudential's operation is small; during 2007 a major revamp of the agency channel and product portfolio will begin.

### *Singapore*
Prudential is a leading player in Singapore and, over the five-year period 2001 to 2005, consistently outgrew the market.

During 2006, Prudential Singapore delivered strong APE growth of 23 per cent driven by its strategy of growing and rejuvenating the agency force against the industry trend and implementing a number of agency productivity initiatives, including the operationalisation of a sophisticated sales force automation tool to simplify the application process. Third-party distribution through Maybank and Singpost is also beginning to make meaningful contributions to new business.

Prudential Singapore continues to sell a higher proportion of unit-linked business than the market supported by the strategy of enhancing the fund range.

Given the size, longevity and quality of its in-force book, Singapore is a major contributor to Prudential Corporation Asia's IFRS profits and generates material surplus operating cash which is remitted back to the Group.

Looking ahead, growth opportunities in Singapore remain promising, particularly in the retirement space (both accumulation and drawn down).

### *Taiwan*
Taiwan now has the highest life insurance penetration rate in the world measured by premiums as a percentage of GDP. To a large extent, however, this has been driven by competitors launching low-margin tactical products which capitalise on the current low interest rate environment. Prudential has deliberately avoided this tactic and its strategic priority continues to be to position the business for the long-term with quality, multi-channel distribution and profitable products.

2006 new business volumes decreased slightly compared to 2005 with agent numbers reducing by nine per cent reflecting the focus on quality as non-performers were terminated. There are also good opportunities for bancassurance in Taiwan and Prudential has five agreements in place with the intention to expand these further.

Prudential continues to sell a higher proportion of unit-linked business than the market and for 2006 this was 58 per cent compared to 39 per cent. NBP margins at 55 per cent, are up from 51 per cent in 2005, at RER, primarily due to product mix changes.

The Taiwan business continues to receive capital support from the Group to maintain solvency resulting from current negative spread on the back book acquired in 1999.

During 2006, interest rates did not increase from their current low levels as expected, although the long-term assumption remains that these will rise.

Looking ahead, priorities for the Taiwan life business include driving greater rider attachments and direct marketing with A&H products.

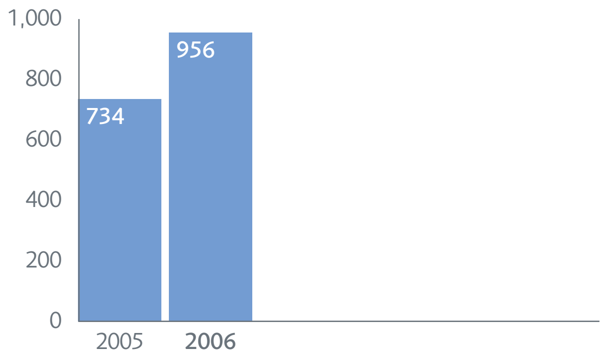
### *Thailand*
For many years, Prudential has struggled to make headway with agency distribution in Thailand; however, during 2006 it launched a call centre in support of its direct marketing operation. Although still small, the results to date have been very encouraging contributing to new business APE growing 81 per cent in 2006.

### *Vietnam*
In Vietnam, Prudential has retained its market leading position but the market continues to be depressed following the initial post-liberalisation boom. The longer-term potential remains excellent and Prudential continues to develop and build its agency distribution.

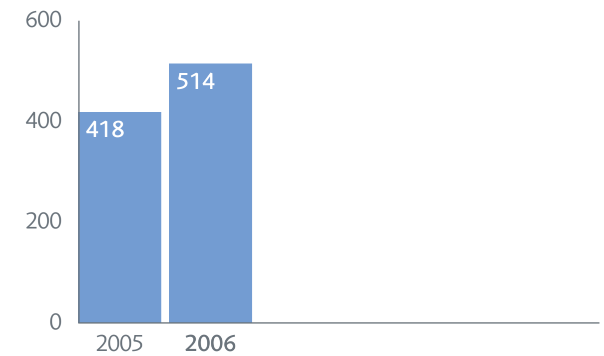
## 4. Financial results and performance

In financial terms, 2006 was another strong year. Prudential Corporation Asia's new business APE grew by 30 per cent to £956 million. New business profit margins remain robust at 54 per cent with the net two per cent change from 56 per cent in 2005 at RER, principally attributed to higher proportion of new business in the mix from lower margin geographies. The percentage of unit-linked products, which are more capital efficient, remained high at 64 per cent compared to 63 per cent in 2005.

**APE new business premiums £m**




**EEV basis new business profit £m**




Long-term EEV operating profits of £829 million are up 42 per cent over 2005 and are principally driven by new business profits of £514 million and an 89 per cent increase in in-force profits, from £167 million in 2005 to £315 million in 2006. This includes the increase in unwind across all countries, positive operating assumption changes of £45 million together with positive experience and other variances of £16 million.

Operating assumption changes include positive mortality and persistency assumption changes which are the net result of a number of small movements in countries across the region. In addition, there are positive expense assumption changes, primarily the result of uplifting the Prudential Asset Management (PAM) profit assumptions across Asia.

Within experience variances, there is a positive persistency experience variance which is the net result of a number of small variances in countries across the region. There is negative expense experience in China and India, as expected, as these operations expand rapidly.

Total EEV shareholders' funds at 31 December 2006 were £2.5 billion, up 28 per cent on 31 December 2005.

IFRS operating profits increased 11 per cent to £189 million, compared to 2005, excluding 2005 net exceptional items of positive £30 million. This reflects the steady increase in profits from the established markets of Singapore, Malaysia and Hong Kong with total IFRS operating profits of £139 million, and the emergence of profits on the IFRS basis from some of the newer operations as they build scale. Total shareholders' funds on the IFRS basis, of £1.29 billion, increased by 12 per cent compared to 2005.

IRRs for Asia were in excess of 20 per cent for 2006. In Asia, Prudential has target IRRs on new business at a country level of 10 percentage points over the country risk discount rate. Risk discount rates vary from five per cent to 18 per cent depending upon the risks in each country market. These target rates of return are average rates and the marginal return on capital on a particular product could be above or below the target.

As expected, overall Prudential Asia became a net contributor of cash to the Group with a net remittance of surplus capital of £28 million during 2006.

## 5. Outlook for 2007

The opportunities for profitable growth in Asia remain compelling and Prudential is very well placed with an excellent platform.

The focus going forward will be continuing to focus on developing its existing strengths in terms of growing agency scale and productivity, improving and expanding partnership distribution and continuing product innovation.

There is also the opportunity to deepen and strengthen relationships with the over nine million customers already on the books with a disciplined and systematic approach. The retirement opportunity is clear and Prudential is developing a comprehensive approach to this in terms of accumulation, drawn down and associated protection needs. Prudential Asia will be leveraging its very successful Korean media campaign 'What's your number' to other markets during 2007.

Prudential has not leveraged its strengths to building scale direct distribution as yet and this will be a priority in the future.

Prudential will also be re-examining its approach to health products as there are significant opportunities to create value for shareholders and customer above and beyond what is already being done.

Prudential remains committed to the target of at least doubling its 2005 new business profit by 2009, and expect to generate increasing levels of cash from the region.

In summary, the outlook for the life insurance business in 2007 remains very positive.

# **Business unit review** continued
## Asset management

### Global

The Prudential Group's asset management businesses are very successful. Not only do they provide value to the insurance businesses within the Group, but also are important profit generators in their own right, with low capital requirements and generating significant cash flow for the Group.

The asset management businesses are well placed to capitalise on their leading market positions and strong track records in investment performance to deliver net flows and profit growth as well as strategically diversifying the Group's investment propositions in retail financial services (RFS) markets that are increasingly favouring greater product transparency, greater cross-border opportunities and more open-architecture investment platforms. Wholesale profit streams are also growing.

The Group's asset management businesses operate different models and under different brands tailored to their markets and strengths, but are increasingly working together by managing money for each other with clear regional specialism, distributing each others' products and sharing knowledge and expertise, such as credit research.

Each business and its performance in 2006 is summarised below.

### M&G

#### 1. Market review and summary of strategy

M&G is Prudential's UK and European fund management business and has £164 billion of funds under management, of which £119 billion relates to Prudential's long-term business funds. M&G aims to maximise profitable growth by operating in markets where it has a leading position and competitive advantage, including retail fund management, institutional fixed income, pooled life and pension funds, property and private finance. M&G also manages Prudential's balance sheet for profit.

M&G is an investment-led business with a demonstrable focus on performance delivery and aims to offer attractive products in a variety of macro-economic environments. M&G has scale in all key asset classes: it is one of the largest active managers in the UK stock market, one of the largest bond investors in the UK and one of the UK's largest property investors.

M&G is made up of three distinct and autonomous businesses – Retail, Wholesale and Prudential Finance – each with its own strategy for the markets in which it operates.

The UK and European retail asset management industry has grown strongly during 2006 as rising stock markets have increased the value of existing funds under management and attracted investors back into the market. M&G's retail strategy is to maximise the leverage of its strong investment performance, multi-channel distribution and efficient operating platform.

The asset management sector has continued to benefit from the increasing shift by retail investors from opaque to transparent investment products, such as unit trusts, and M&G's range of market leading funds has positioned it well to benefit from this trend. European cross-border distribution has accelerated and the trend in favour of 'Open Architecture' in both the UK and Europe has continued to open up significant bank and life company distribution opportunities. Parallel to this, distribution of mutual funds has become increasingly intermediated and has been accompanied by the rise of professional buyers who demand higher levels of service and investment information, areas in which M&G has considerable expertise.

Institutional markets are demanding increasingly sophisticated and tailored products and 2006 saw a rising awareness of asset/liability matching and a continued shift from balanced to specialist mandates. These trends, plus the increased role of fixed income within portfolios, continue to play to the strength and scale of M&G's wholesale business.

M&G's wholesale strategy is twofold: to add value to its internal clients through investment performance, liability matching and investment in innovative and attractive areas of capital markets and to utilise the skills developed primarily for internal funds to build new business streams and diversify revenues. Examples of new business streams include leveraged loans, collateralised debt obligations (CDOs), infrastructure finance and the Episode global macro hedge fund. Demand has increased for alternative investments and structured credit expertise, meaning that managers who offer value-adding skills, such as M&G, are able to command attractive margins. With its strong track record and market leading reputation, M&G remains well placed to continue to benefit from this trend.

| | | CER | | RER | |
|---|---|---|---|---|---|
| **M&G** | **2006 £m** | 2005 £m | Percentage change | 2005 £m | Percentage change |
| Gross investment flows | **13,486** | 7,916 | 70% | 7,916 | 70% |
| Net investment flows | **6,101** | 3,862 | 58% | 3,862 | 58% |
| Underlying profit before PRF performance-related fees | **177** | 138 | 28% | 138 | 28% |
| Total IFRS operating profit* | **204** | 163 | 25% | 163 | 25% |

* Based on longer-term investment returns.

Prudential Finance was set up to manage Prudential's balance sheet for profit. In addition to acting as the internal banker to the Prudential Group and its subsidiaries, Prudential Finance's strategy is to leverage Prudential's and M&G's positioning and skills for profit. Its activities include bridging transactions, property financing and securities lending with a focus on deals which have high profitability and capital velocity but low capital usage.

### 2. Current year initiatives

M&G maintained its reputation for strong fund performance and product innovation during 2006 and continued to expand its multi-channel distribution model.

In the retail market, the excellent fund performance of M&G's fund range was recognised by M&G being named Best Equity Group (Large) and Best Non UK Equity Group (Large) at the Lipper Fund Awards 2006. M&G continued to innovate during the year by extending its fixed income and property fund ranges with the launch of two new funds, the M&G Optimal Income Fund and the M&G European Property Fund. M&G expanded its retail distribution in 2006 by adding Spain to the European countries in which it operates and in the UK significantly expanded its links with life company platforms.

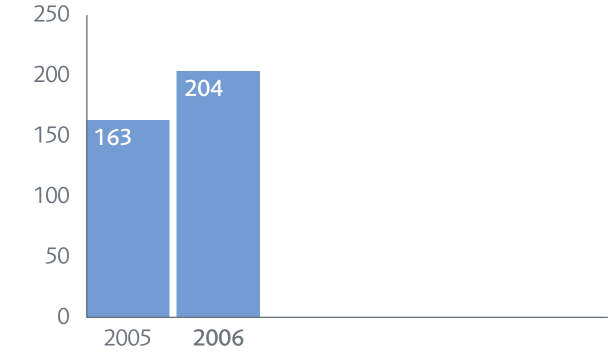
In the wholesale marketplace, M&G benefited from increasing demand from clients for specialist mandates and liability matching, both of which are core areas of expertise for M&G. Strong fund performance was maintained with 86 per cent of segregated funds beating their benchmark over one year and 90 per cent over three years. M&G continued to develop its market leading positions in structured credit and leveraged loans and also its position in infrastructure finance. Utilising skills developed for the internal funds, M&G has built significant new business streams with external third parties over the past five years. In structured credit, seven new CDOs were launched in 2006 and M&G was named CDO manager of the year by the International Securitisation Report. M&G's infrastructure fund, InfraCapital, made its first purchase as part of a consortium which made a successful bid for Associated British Ports plc.

Following a soft launch in August 2005, M&G rolled out its Episode global macro hedge fund in February last year, a fund which again uses investment expertise originally developed for internal funds. Episode has been a notable success with external clients and by year end had reached assets under management of US$1.5 billion.

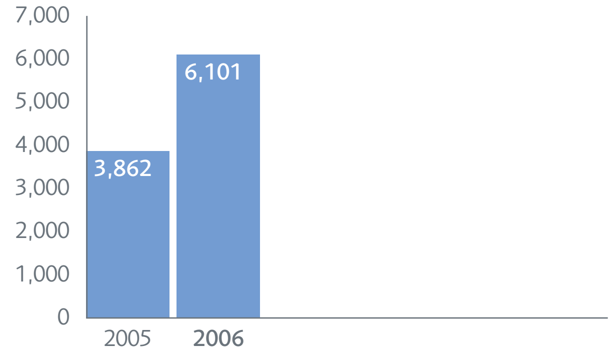
### 3. Financial results and performance

M&G delivered significant profit growth during 2006 on the back of rising market levels, strong net inflows and continued business diversification. Operating profits, which include performance related fees (PRF), increased 25 per cent to £204 million. Underlying profits, excluding PRF, were £177 million, an increase of 28 per cent compared to the previous year. PRF increased by 11 per cent over 2005, totalling £27 million for 2006. As a result, M&G's cost income ratio improved from 66 per cent to 64 per cent in 2006.

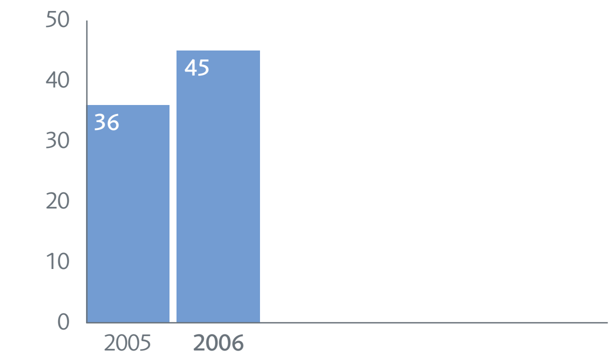
**IFRS basis operating profit based on longer-term investment returns £m**




**Net investment flows £m**




**External FUM £bn**




In addition to adding significant value via the management of Prudential's internal funds, M&G remains an important generator of earnings and cash for the Prudential Group. Since 2002, M&G has delivered strong profit growth which has seen underlying profits more than triple.

# Business unit review continued
## Asset management

Outstanding fund performance led to record fund inflows into M&G's retail and wholesale businesses during 2006. Gross fund inflows were £13.5 billion, an increase of 70 per cent on the previous year. Net fund inflows were their highest ever, increasing by 58 per cent to £6.1 billion. External funds under management grew significantly, up 24 per cent to £45 billion, and at this level represent over a quarter of M&G's total funds under management.

In the retail marketplace, demand remained strong for M&G's high alpha equity and competitive fixed income and property offerings, with gross fund inflows increasing by 75 per cent to £6.7 billion and net fund inflows more than doubling to £3.1 billion. Product innovation has remained key for opening up new markets for M&G and 66 per cent of gross mutual fund inflows in 2006 through UK and European distribution channels were into funds launched or re-engineered within the past six years.

Sales were strong across all retail markets. Excellent progress was made in the UK and across the European markets of Germany, Austria, Switzerland, Luxembourg, Italy and Spain. In Germany, the first European market entered (in 2002), M&G is now the number three foreign provider and in just four years has risen to number nine in net sales against all providers in the German marketplace. In an official FERI ranking of the best selling funds by UK fund managers across the UK and Europe in 2006, M&G had three funds represented in the top 20. In South Africa, M&G's business was last year ranked number one by net inflows in the market only five years on from launch.

M&G's wholesale business also saw substantial growth, with gross fund inflows increasing by 66 per cent to £6.8 billion and net inflows rising 19 per cent to £3 billion. M&G's scale and market reputation in fixed income continued to position it very favourably in both traditional areas of the market, such as segregated funds, and alternative areas such as structured credit.

### 4. Outlook and forthcoming objectives

M&G's priorities for the year ahead are to:

- deliver investment outperformance to its clients;
- distribute through existing channels and exploit new opportunities;
- leverage its scale and capabilities to develop innovative products for the retail and wholesale marketplaces; and
- deliver attractive returns to Prudential.

## Asia Fund Management

### 1. Market review

The mutual fund market in Asia[2] has grown at a CAGR of 22 per cent from end 2003 to end 2006 with £720 billion of assets under management at 31 December 2006 with Japan and Korea accounting for over three quarters of the total FUM. China and India have been the fastest growing markets over this period with annual growth rates of 57 per cent and 31 per cent respectively.

Over the past few years, appetite for risk-based products has gradually been increasing and during 2006, Asian investors have shown increased interest in equity-focused funds. Regulatory change has also continued to drive demand for Luxembourg based offshore products.

### 2. Prudential's strategy

Prudential's fund management business serves both the life companies in Asia by managing the life funds and by designing and managing the funds underlying the investment linked products and third-party customers through a growing mutual fund business.

Given that the majority of individuals' personal financial assets currently reside in bank deposits in Asia (Source: Citi Asia Pacific Household Balance Sheets 2005), Prudential continues to grow its third-party mutual fund business by developing strong customer propositions to cater to an estimated potential 450 million customers for mutual fund products in Asia. Prudential's strategy is underpinned by building local operating entities with local market knowledge and expertise and supporting these with strong regional capabilities.

Given the significance of bank distribution, broadening distribution reach involves developing strong relationships with regional and local bank distributors and providing better servicing.

Continued delivery of strong and consistent fund performance is essential in maintaining the credibility of the Prudential brand in this market.

Today, Prudential's fund management business in Asia is the second largest retail fund management company in terms of Asia (ex Japan) sourced retail FUM as of June 2006 (Source: Asia Asset Management Sept 2006 for survey participants). Including institutional and insurance assets, Prudential's fund management business was ranked in June 2006 as the third largest asset manager in terms of overall assets sourced in Asia ex Japan, compared with its fifth ranking in 2005.

| | CER | | | RER | |
|---|---|---|---|---|---|
| **Asia** | **2006 £m** | 2005 £m | Percentage change | 2005 £m | Percentage change |
| Net investment flows | **2,532** | 1,321 | 92% | 1,328 | 91% |
| Total IFRS operating profit* | **50** | 11 | 355% | 12 | 317% |

*Based on longer-term investment results.

2. Asia here refers to the eight countries of China, India, Korea, Japan, Taiwan, Singapore, Malaysia (Private Funds) and Hong Kong (Local retail funds) Sources: Cerulli Associates, Monetary Authority of Singapore, Association of Mututal Fund in India, Securities Inv Trust Association, KITCA.

### 3. Progress in 2006

In 2006, Prudential entered three new markets: China, Vietnam and the United Arab Emirates (UAE). In China, Prudential's joint venture with CITIC launched two retail mutual funds during the year and raised £414 million (Prudential share at £137 million). In Vietnam, Prudential launched its first mutual fund and an offshore fund investing in Vietnam, together raising £163 million. A licence was obtained for doing business in the UAE, with an office in Dubai.

Prudential continued to build on its existing platform in Asia with specific focus on the markets of India, Korea and Japan. In India, Prudential's joint venture with ICICI Bank grew assets under management by 53 per cent; in Korea, Prudential's business grew assets by 33 per cent and in Japan – the region's largest market – assets grew by 20 per cent.

PRUPIM Singapore – a joint venture with PRUPIM in the UK – was established with its first core fund with a gross asset value of US$616 million. This gives the business an entry into the real estate space which is a fast growing and attractive segment of the business.

### 4. Financial results and performance

Prudential's fund management business achieved record net inflows for 2006, with £2.5 billion being almost twice that of 2005. This reflects the strengths of the Asian Fund Management's geographic and product diversification.

Prudential's total FUM as at 31 December were £29.2 billion and included £6.2 billion of assets from the Group, £10.6 billion from Prudential Corporation Asia's life funds and £12.3 billion from the retail operations. This is an increase of 22 per cent from 31 December 2005, though mutual funds through the retail operations grew by 33 per cent.

IFRS profits from fund management operations were £50 million, up 85 per cent on 2005, excluding 2005 exceptional items.

### 5. Outlook for 2007

The main focus for 2007 will be to continue to pursue profitable opportunities in all markets but more specifically in the key growth markets of China and India and the large Japanese and Korean markets. The fund range will continue to be expanded through expanding both onshore and offshore funds and developing real estate and Islamic funds. Distribution will be broadened and deepened through relationships with channel partners in the individual countries and regionally.

## PPM America

### 1. Market review and summary of strategy

PPM America (PPMA) manages assets for Prudential's US, UK and Asian affiliates. PPMA also provides investment services to other affiliated and unaffiliated institutional clients including CDOs, private investment funds, institutional accounts and mutual funds.

PPMA's strategy is focused on effectively managing existing assets, maximising synergies with international asset management affiliates and leveraging investment management capabilities across the Prudential Group.

A summary of PPMA's year end 2006 assets under management follows:

#### PPMA funds under management

| (US$ billions) | US | UK | Asia | Total |
|---|---|---|---|---|
| Insurance | 45.5 | 16.3 | 0.5 | 62.3 |
| Retail | 0.0 | 2.5 | 5.0 | 7.5 |
| Institutional | 0.2 | 0.0 | 0.0 | 0.2 |
| CDOs | 3.6 | 0.0 | 0.0 | 3.6 |
| Total | 49.3 | 18.8 | 5.5 | 73.6 |

### 2. Current year initiatives

During 2006, PPMA executed several initiatives to improve operational effectiveness and scalability, including the enhancement of fixed income analytical capabilities. Initiatives designed to maximise synergies within the Group included leveraging PPMA's capabilities to manufacture financial products distributed by affiliates.

### 3. Financial results and performance

Investment performance was favourable in 2006, particularly across US affiliate portfolios, the US public equity and fixed income components of the portfolios managed for UK affiliates and CDOs.

IFRS operating profit in 2006 was £12 million versus £20 million in 2005. The 2005 results benefited from a £5 million positive non-recurring item related to revaluation of a CDO.

### 4. Outlook and forthcoming objectives

The 2007 outlook is positive driven by current momentum, favourable economic and market conditions, and the growth prospects of internal clients.

# **Business unit review** continued
# Banking

## Egg

### 1. Market review and summary of strategy

The high level of consumer indebtedness has led to a sharp increase in the number of individuals seeking to restructure their credit obligations. This has been observed through higher levels of personal bankruptcies and individual voluntary arrangements: the number of personal insolvencies has risen at an annual rate of over 50 per cent. These factors have given rise to increased bad debt provisions across the UK banking industry.

In January 2007, Prudential concluded that its current banking business does not represent the best opportunity for it to drive profitable growth in the future and it announced the sale of Egg to Citi for £575 million, with the transaction expected to complete later in 2007, subject to regulatory approvals. Citi is the largest credit card issuer in the world and a group that is well placed to develop and grow Egg's franchise. As part of the transaction, Prudential has agreed in principle outline terms of a five-year agreement to distribute life and pension products through Egg. Prudential has also been selected as a strategic provider to Citi for the distribution of life insurance products to Citi's consumer banking customers in Thailand, Indonesia and the Philippines. The transaction will improve Prudential's capital position and is expected to increase Prudential's solvency surplus under FCD by an estimated £300 million.

### 2. Financial results and performance

Egg's total operating loss in 2006 was £145 million, compared with a profit of £44 million in 2005. This result reflects a marked deterioration in industry-wide consumer behaviour. This has resulted in a reduction of net borrowing on credit cards as consumers reduce their spending and borrowing. In addition, bad debt experience is considerably worse than expected, particularly in relation to personal loans.

During 2006, Egg made a number of changes to its lending approach. On unsecured loans, Egg's strategy was to tactically reduce its exposure and it tightened the acceptance criteria throughout the year. This resulted in a significantly reduced level of sales, and associated insurance income. Egg also changed its approach to the management of the credit card book, and it adopted the standard industry policy of charging variable interest rates in relation to a customer's expected risk profile.

Throughout the industry, 2006 saw an increase in the application of balance transfer fees, therefore reducing the levels of balance transfer activity.

Egg's net interest income of £330 million increased six per cent in 2006. Slightly lower customer balances were offset by the effects of a higher interest rate environment.

Non-interest income reduced by 36 per cent to £138 million following a significant reduction in personal loan insurance income as Egg reduced its exposure to the unsecured loans business. Total new loan sales reduced to 83,000, which is approximately 50 per cent of the new volumes achieved in 2005. In addition, payment protection insurance (PPI) penetration rates were far lower than that experienced in 2005. Other non-interest card income is lower than 2005, reflecting consumer spend patterns and continuing regulatory focus on the creditor insurance market, resulting in reductions in commission revenue earned.

Egg's loan book performance reflects the industry-wide increase in consumers using individual voluntary arrangements, debt management companies and in some cases bankruptcy to alleviate their debt burden. Within the Egg personal loan portfolio, the number of customers employing debt management companies in the last quarter increased 18 per cent on the prior quarter. These arrangements typically result in lower recoveries from customers than have historically been achieved via Egg's collection strategies. The overall deterioration in credit led to the total charge for bad debts increasing by £143 million to £382 million.

Restructuring costs of £12 million were incurred during 2006.