Notes on the unaudited European Embedded Value (EEV) basis results

1. Basis of preparation of results

The EEV basis results have been prepared in accordance with the EEV Principles issued by the CFO Forum of European Insurance Companies in May 2004. Where appropriate, the EEV basis results include the effects of adoption of International Financial Reporting Standards (IFRS).

The EEV results for the Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Group's long-term insurance business for which the value of new and in-force contracts is attributable to shareholders. The EEV basis results for the Group's covered business are then combined with the IFRS basis results of the Group's other operations.

The definition of long-term business operations is consistent with previous practice and comprises those contracts falling under the definition of long-term insurance business for regulatory purposes together with, for US operations, contracts that are in substance the same as guaranteed investment contracts (GICs) but do not fall within the technical definition. Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal fund management.

With two exceptions, covered business comprises the Group's long-term business operations. The exceptions are for the closed Scottish Amicable Insurance Fund (SAIF) and for the presentational treatment of the financial position of two of the Group's defined benefit pension schemes.

SAIF is a ring-fenced sub-fund of the Prudential Assurance Company (PAC) long-term fund, established by a Court approved Scheme of Arrangement in October 1997. SAIF is closed to new business and the assets and liabilities of the fund are wholly attributable to the policyholders of the fund. In 2006, a bulk annuity arrangement between SAIF and Prudential Retirement Income Limited (PRIL), a shareholder-owned subsidiary took place, as explained in note 5. Reflecting the altered economic interest for SAIF policyholders and Prudential shareholders, this arrangement represents a transfer from business of the Group that is not 'covered' to business that is 'covered' with consequential effect on the EEV basis results.

As regards the Group's defined benefit pension schemes, the surplus and deficit attaching to the Prudential Staff Pension Scheme (PSPS) and Scottish Amicable Pension scheme are excluded from the value of UK operations and included in the total for other operations. The surplus and deficit amounts are partially attributable to the PAC with-profits fund and shareholder-backed long-term business and partially to other parts of the Group. In addition to the IFRS surplus or deficit, the shareholders' 10 per cent share of the PAC with-profits sub-fund's interest in the movement on the financial position of the schemes is recognised for EEV reporting purposes.

The directors are responsible for the preparation of the supplementary information in accordance with the EEV Principles.

2. Economic assumptions

Deterministic

In most countries, the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on fixed interest securities. This 'active' basis of assumption setting has been applied in preparing the results of all the Group's UK and US long-term business operations. For the Group's Asian operations, the active basis is appropriate for business written in Japan, Korea and US dollar denominated business written in Hong Kong.

An exception to this general rule is that for countries where long-term fixed interest markets are less established, investment return assumptions and risk discount rates are based on an assessment of longer-term economic conditions. Except for the countries listed above, this basis is appropriate for the Group's Asian operations.

Expected returns on equity and property asset classes are derived by adding a risk premium, based on the long-term view of Prudential's economists in respect of each territory, to the risk-free rate. In the UK, the equity risk premium is 4.0 per cent (half year 2005: 3.0 per cent; full year 2005: 4.0 per cent) above risk-free rates. The equity risk premium in the US is 4.0 per cent (half year 2005: 3.0 per cent, full year 2005: 4.0 per cent). In Asia, equity risk premiums range from 3.0 per cent to 5.75 per cent (half year 2005: 2.75 per cent to 5.25 per cent, full year 2005: 3.0 per cent to 5.75 per cent). Assumptions for other asset classes, such as corporate bond spreads, are set consistently as best estimate assumptions.

The investment return assumptions as derived above are applied to the actual assets held at the valuation date to derive the overall fund-earned rate.

2. Economic assumptions continued

Deterministic continued

The table below summarises the principal financial assumptions:

	Half year 2006 %	Half year 2005 %	Full year 2005 %
UK insurance operations			
Risk discount rate:			
New business	**8.0**	7.4	7.55
In force	**8.2**	6.9	7.7
Pre-tax expected long-term nominal rates of investment return:			
UK equities	**8.7**	7.2	8.1
Overseas equities	**8.7 to 9.4**	7.0 to 7.9	8.1 to 8.75
Property	**7.2**	6.5	6.4
Gilts	**4.7**	4.2	4.1
Corporate bonds	**5.4**	5.1	4.9
Expected long-term rate of inflation	**3.0**	2.8	2.9
Post-tax expected long-term nominal rate of return:			
Pension business (where no tax applies)	**7.7**	6.6	7.1
Life business	**6.85**	5.8	6.3
US operations (Jackson National Life)			
Risk discount rate:			
New business	**8.0**	5.8	6.9
In force	**7.1**	5.3	6.1
Expected long-term spread between earned rate and rate credited to policyholders for single premium deferred annuity business	**1.75**	1.75	1.75
US 10-year treasury bond rate at end of period	**5.2**	4.0	4.4
Pre-tax expected long-term nominal rate of return for US equities	**9.2**	7.0	8.4
Expected long-term rate of inflation	**2.7**	2.2	2.4

Asian operations

	China 30 Jun 2006 %	**Hong Kong (note i) 30 Jun 2006 %**	**India 30 Jun 2006 %**	**Indonesia 30 Jun 2006 %**	**Japan 30 Jun 2006 %**	**Korea 30 Jun 2006 %**	**Malaysia 30 Jun 2006 %**	**Philippines 30 Jun 2006 %**	**Singapore 30 Jun 2006 %**	**Taiwan (note ii) 30 Jun 2006 %**	**Thailand 30 Jun 2006 %**	**Vietnam 30 Jun 2006 %**
Risk discount rate:												
New business	**12.0**	**6.6**	**16.5**	**17.5**	**5.3**	**9.7**	**9.5**	**16.5**	**6.7**	**8.9**	**13.75**	**16.5**
In force	**12.0**	**6.9**	**16.5**	**17.5**	**5.3**	**9.7**	**9.1**	**16.5**	**6.8**	**9.5**	**13.75**	**16.5**
Expected long-term rate of inflation	**4.0**	**2.25**	**5.5**	**6.5**	**0.0**	**2.75**	**3.0**	**5.5**	**1.75**	**2.25**	**3.75**	**5.5**
Government bond yield	**9.0**	**5.3**	**10.5**	**11.5**	**2.1**	**5.2**	**7.0**	**10.5**	**4.5**	**5.5**	**7.75**	**10.5**

	China 30 Jun 2005 %	Hong Kong (note i) 30 Jun 2005 %	India 30 Jun 2005 %	Indonesia 30 Jun 2005 %	Japan 30 Jun 2005 %	Korea 30 Jun 2005 %	Malaysia 30 Jun 2005 %	Philippines 30 Jun 2005 %	Singapore 30 Jun 2005 %	Taiwan (note ii) 30 Jun 2005 %	Thailand 30 Jun 2005 %	Vietnam 30 Jun 2005 %
Risk discount rate:												
New business	10.0	4.7	16.0	18.75	4.9	7.5	9.15	16.25	6.4	9.7	13.5	15.5
In force	10.0	5.1	16.0	18.75	4.9	7.5	8.7	16.25	6.65	9.5	13.5	15.5
Expected long-term rate of inflation	3.0	2.25	5.25	7.75	0.0	2.75	3.0	5.25	2.25	2.25	3.75	4.5
Government bond yield	7.25	4.9	10.25	13.0	1.7	4.4	7.0	10.5	5.0	5.5	7.75	9.75

	China 31 Dec 2005 %	Hong Kong (note i) 31 Dec 2005 %	India 31 Dec 2005 %	Indonesia 31 Dec 2005 %	Japan 31 Dec 2005 %	Korea 31 Dec 2005 %	Malaysia 31 Dec 2005 %	Philippines 31 Dec 2005 %	Singapore 31 Dec 2005 %	Taiwan (note ii) 31 Dec 2005 %	Thailand 31 Dec 2005 %	Vietnam 31 Dec 2005 %
Risk discount rate:												
New business	12.0	5.9	16.5	17.5	5.0	10.3	9.4	16.5	6.7	9.0	13.75	16.5
In force	12.0	6.15	16.5	17.5	5.0	10.3	9.0	16.5	6.8	9.4	13.75	16.5
Expected long-term rate of inflation	4.0	2.25	5.5	6.5	0.0	2.75	3.0	5.5	1.75	2.25	3.75	5.5
Government bond yield	9.0	4.8	10.5	11.5	1.8	5.8	7.0	10.5	4.5	5.5	7.75	10.5

2. Economic assumptions continued

Deterministic continued

	Asia total 30 Jun 2006 %	Asia total 30 Jun 2005 %	Asia total 31 Dec 2005 %
Weighted risk discount rate (note iii):			
New business	9.9	9.4	9.8
In force	8.9	7.2	8.4

Notes

(i) The assumptions shown are for US dollar denominated business which comprises the largest proportion of the in-force Hong Kong business.

(ii) For traditional business in Taiwan, the economic scenarios used to calculate the half year 2006 EEV basis results reflect the assumption of a phased progression of the bond yields from the current rates applying to the assets held to the long-term expected rates.

In preparing the half year 2006 EEV basis results the same approach has been applied as was used for the full year 2005 results. The 2005 year end basis was that, in the average scenario, bond yields trend from the then current levels of around 2 per cent towards 5.5 per cent at 31 December 2012. In the first six months of 2006 bond yields increased in a manner consistent with the assumed phased progression. However, these increases in bond yields consequently reduced the values of bonds held and, also consistent with the assumed phased progression, the Fund Earned Rate for half year 2006 was 0.2 per cent.

In projecting forward the Fund Earned Rate allowance is made for the mix of assets in the fund, future investment strategy, and further market value depreciation of bonds held as a result of assumed future yield increases. These factors, together with the assumption of the phased progression in bond yield give rise to an average assumed Fund Earned Rate that trends to 5.4 per cent in 2013. Thereafter, the assumed Fund Earned Rate fluctuates around a target of 5.9 per cent. Consistent with the EEV methodology applied, a constant discount rate has been applied to the projected cash flows.

(iii) The weighted discount rates for the Asian operations shown above have been determined by weighting each country's discount rates by reference to the EEV basis operating result for new business and the closing value of in-force business.

(iv) Assumed equity returns
The most significant equity holdings in the Asian operations are in Hong Kong, Singapore and Malaysia. The mean equity return assumptions for those territories at 30 June 2006 were 9.2 per cent (30 June 2005: 7.3 per cent, 31 December 2005: 8.6 per cent), 9.3 per cent (30 June 2005: 9.75 per cent, 31 December 2005: 9.3 per cent) and 12.8 per cent (30 June 2005: 12.25 per cent, 31 December 2005: 12.8 per cent) respectively. To obtain the mean, an average over all simulations of the accumulated return at the end of the projection period is calculated. The annual average return is then calculated by taking the root of the average accumulated return minus 1.

Stochastic

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations described above. Assumptions specific to the stochastic calculations such as the volatilities of asset returns reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of longer-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with allowance for correlation between the various asset classes.

Details are given below of the key characteristics and calibrations of each model.

UK insurance operations

- Interest rates are projected using a two-factor model calibrated to actual market data;
- the risk premium on equity assets is assumed to follow a log-normal distribution;
- the corporate bond return is calculated as the return on a zero-coupon bond plus a spread. The spread process is a mean reverting stochastic process; and
- property returns are modelled in a similar fashion to corporate bonds, namely as the return on a riskless bond, plus a risk premium, plus a process representative of the change in residual values and the change in value of the call option on rents.

The rates to which the model has been calibrated are set out below.

Mean returns have been derived as the annualised arithmetic average return across all simulations and durations.

Standard deviations have been calculated by taking the annualised variance of the returns over all the simulations, taking the square root and averaging over all durations in the projection. For bonds the standard deviations relate to the yields on bonds of the average portfolio duration. For equity and property, they relate to the total return on these assets. The standard deviations applied to all periods presented in these statements are as follows:

	%
Government bond yield	2.0
Corporate bond yield	5.5
Equities:	
UK	18.0
Overseas	16.0
Property	15.0

Notes on the unaudited European Embedded Value (EEV) basis results

continued

2. Economic assumptions continued

Stochastic continued

Jackson National Life

- Interest rates are projected using a log-normal generator calibrated to actual market data;
- corporate bond returns are based on Treasury securities plus a spread that has been calibrated to current market conditions and varies by credit quality; and
- variable annuity equity and bond returns have been stochastically generated using a regime-switching log-normal model with parameters determined by reference to historical data. The volatility of equity fund returns ranges from 18.6 per cent to 28.1 per cent, depending on risk class, and the volatility of bond funds ranges from 1.4 per cent to 2.0 per cent.

Asian operations

The same asset return model, as used in the UK, appropriately calibrated, has been used for the Asian operations. The principal asset classes are government and corporate bonds. Equity holdings are much lower than in the UK whilst property is not held as an investment asset.

The stochastic cost of guarantees are only of significance for the Hong Kong, Singapore, Malaysia and Taiwan operations.

The mean stochastic returns are consistent with the mean deterministic returns for each country. The volatility of equity returns ranges from 18 per cent to 26 per cent, and the volatility of government bond returns ranges from 1.6 per cent to 8.9 per cent.

3. Level of encumbered capital

In adopting the EEV Principles, Prudential has based encumbered capital on its internal targets for economic capital subject to it being at least the local statutory minimum requirements. Economic capital is assessed using internal models, but when applying EEV Prudential does not take credit for the significant diversification benefits that exist within the Group. For with-profits business written in a segregated life fund, as is the case in the UK and Asia, the capital available in the fund is sufficient to meet the encumbered capital requirements.

The table below summarises the level of encumbered capital as a percentage of the relevant statutory requirement.

	Capital as a percentage of relevant statutory requirement
UK business (excluding annuities)	100% of EU minimum
UK annuity business	100% of EU minimum
Jackson National Life	235% of Company Action Level
Asian operations	100% of Financial Conglomerates Directive requirement

4. Margins on new business premiums

Half year 2006

	New business premiums		Annual premium equivalent (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution	New business margin	
	Single £m	**Regular £m**	**£m**	**£m**	**£m**	**(APE) %**	**(PVNBP) %**
UK insurance operations	**3,890**	**95**	**484**	**4,224**	**138**	**29**	**3.3**
Jackson National Life	**3,146**	**8**	**323**	**3,209**	**134**	**41**	**4.2**
Asian operations	**519**	**396**	**448**	**2,328**	**232**	**52**	**10.0**
Total	**7,555**	**499**	**1,255**	**9,761**	**504**	**40**	**5.2**

Half year 2005

	New business premiums		Annual premium equivalent (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution	New business margin	
	Single £m	Regular £m	£m	£m	£m	(APE) %	(PVNBP) %
UK insurance operations	4,430	90	533	4,797	159	30	3.3
Jackson National Life	2,700	5	275	2,749	95	35	3.5
Asian operations	401	273	313	1,734	162	52	9.3
Total	7,531	368	1,121	9,280	416	37	4.5

4. Margins on new business premiums continued

Full year 2005

	New business premiums		Annual premium equivalent (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution	New business margin	
	Single £m	Regular £m	£m	£m	£m	(APE) %	(PVNBP) %
UK insurance operations	7,002	191	892	7,593	243	27	3.2
Jackson National Life	5,009	14	515	5,135	211	41	4.1
Asian operations	837	648	731	4,039	413	56	10.2
Total	12,848	853	2,138	16,767	867	41	5.2

New business margins are shown on two bases, namely the margins by reference to annual premium equivalents (APE) and the present value of new business premiums (PVNBP). APEs are calculated as the aggregate of regular new business premiums and one-tenth of single new business premiums. PVNBPs are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business. In determining the present value, allowance is made for lapses and other assumptions applied in determining the EEV new business new profit.

The table of new business premiums and margins above excludes SAIF DWP rebate premiums. Comparatives for premiums for this business, which were previously included in the totals have been restated.

In determining the EEV basis value of new business written in the year the policies incept, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.

New business contributions are determined by applying the economic and non-economic assumptions applying at the end of the reporting period. The contributions represent profits at the end of the reporting period.

5. Bulk annuity reinsurance from the Scottish Amicable Insurance Fund (SAIF) to Prudential Retirement Income Limited (PRIL)

In June 2006 PRIL, a shareholder-backed subsidiary of the Company, entered into a bulk annuity reinsurance arrangement with the SAIF for the reinsurance of non-profit immediate pension annuity liabilities with a premium of £592 million. SAIF is a closed ring-fenced sub-fund of the PAC long-term fund, which is solely for the benefit of SAIF policyholders. Shareholders have no interest in the profits of this sub-fund and, accordingly, it is not part of covered business for EEV reporting purposes.

Consistent with the transfer from uncovered to covered business and reflecting the transfer of longevity risk, requirement for capital support, and entitlement to profits on this block of business from SAIF to Prudential shareholders, the transaction has been accounted for as new business for EEV basis reporting purposes.

6. UK restructuring costs

The charge of £18 million for restructuring costs comprises £17 million recognised on the IFRS basis and an additional £1 million recognised on the EEV basis for the shareholders' share of costs incurred by the PAC with-profits sub-fund. The costs relate to the initiative announced on 1 December 2005 for UK insurance operations to work more closely with Egg and M&G.

7. UK insurance operations expense assumptions

The full year 2005 EEV basis financial statements included note disclosure that explained that in determining the appropriate expense assumptions for 2005 account had been taken of the cost synergies that were expected to arise with some certainty from the initiative announced on 1 December 2005 from UK insurance operations working more closely with Egg and M&G. Without this factor there would have been a charge for altered expense assumptions of approximately £55 million. The half year 2006 EEV basis results have been prepared on the same basis.

The initiative is expected to provide annual savings to the cost base of UK operations in aggregate of £40 million. In addition, an end-to-end review of the UK business, with the aim of reducing the overall cost base is under way. Total UK annual savings, including the £40 million mentioned above, are expected to be £150 million per annum comprising £100 million for Egg and shareholder-backed business of UK insurance operations and £50 million attaching to the with-profits sub-fund. The savings for the UK insurance operations cover both acquisition and renewal activity. Reflecting the underlying trend in unit costs, the element of the additional savings of £110 million that relates to long-term business is currently expected to be neutral in its effect on EEV basis results.