



Barry Stowe
Chief Executive
Prudential Corporation Asia

INSURANCE OPERATIONS ASIA

Asia is home to 60 per cent of the world's population and, given its impressive economic transformation over the last few years, the region now has an increasingly significant role in the global economy. This is translating into the rapid emergence of an increasingly urbanised and wealthy mass affluent sector that generates outstanding growth potential in retail financial services as people look to protect their financial well being and manage their savings in more sophisticated and efficient ways.

The word 'Asia' is used extensively and broadly to describe what is, in fact, a highly diverse region of the world. This diversity exhibits itself in myriad ways: culture, religion, politics, wealth and distribution of wealth and not least language. Furthermore, within the financial services sector there are complex legal and regulatory environments which vary materially by country. These are important considerations for any business with aspirations to develop businesses in Asia. While there are undoubtedly commonalities and opportunities for synergy across the region, a 'one size fits all' approach will generally produce suboptimal results. Prudential's understanding of Asian diversity, as well as our own diversity in terms of geographic presence, distribution channels and product continue to be key factors in the success of our life insurance and asset management businesses.

The concept that Asian economies are decoupling from Western economies is a point for continued debate, but external indicators suggest that Asia is recovering more quickly from the recent global financial crisis. Sound fundamentals coupled with aggressive stimuli have enabled most Asian economies to outperform the developed Western markets over the course of 2009. So long as inflation remains under control, we expect the Asian central banks are likely to resist currency appreciation and maintain low interest rates. We anticipate that capital flows into Asia should increase as Asia's GDP growth continues to outpace the rest of the world.

	AER ⁸			CER ⁸	
	2009 £m	2008 £m	Change %	2008 £m	Change %
APE sales	1,261	1,216	4	1,350	(7)
NBP	713	634	12	711	–
NBP margin (% APE)	57%	52%		53%	
NBP margin (% PVNBP)	11.4%	9.7%		9.7%	
Total EEV basis operating profit*	1,105	1,213	(9)	1,379	(20)
Total IFRS operating profit*	416	257	62	290	43

*Operating profit from long-term operations excluding asset management operations, development costs, Asia regional head office expenses and the sold Taiwan agency business.

Market overview

Asia's life insurance industry saw a sharp decline in new business premiums during the first half of 2009 with investment linked and single premium products particularly impacted. However, balance sheets have generally remained robust and there have been no significant failures of insurance companies in the region.

Overall the competitive landscape for the life sector in Asia has remained fairly static, except for Taiwan where issues regarding the valuation of back books with high guaranteed interest rates have caused some European players to re-evaluate their strategies. Prudential ceased the distribution of life insurance through tied agents in Taiwan in 2009 with the transfer of its agents and sale of their associated back book to China Life (Taiwan). A number of smaller regional players with subscale operations are also reported to be considering exits. Prudential acquired UOB Life in Singapore and entered into a long-term strategic partnership with UOB. Through this partnership Prudential's life insurance products will be distributed through UOB's 414 bank branches across Singapore, Indonesia and Thailand. On 15 February 2010 Prudential suspended writing new business in Japan but will continue to manage its existing in-force book. This suspension does not affect the Prudential Group's asset management business in Japan.

The region's life insurance regulators are generally inherently conservative and have watched the collapse of purportedly sophisticated Western models of risk and capital management in the banking sector with interest. They are under pressure to ensure these 'mis-steps' are not replicated in their markets and so although regulators have been raising standards for quality of sales advice, product transparency and service for several years, this emphasis has generally increased post-crisis. Prudential views any measures taken to improve standards and enhance the reputation of the industry positively as we believe we already manage our businesses to a market-leading standard.

Initiatives in 2009

The over-arching objective for Prudential in Asia is to continue building profitable scale. The strategic priorities articulated in December 2006 were expanding distribution and improving productivity together with continuing product innovation with a focus on retirement, health and protection segments. These remain relevant in the current environment and are being actively pursued. While a key measure of success is market out performance in terms of new business growth, we have continued our disciplined approach to growth and do not pursue volume for its own sake. Profitability and return on capital are fundamental to this discipline.

The key components of our strategy include agency distribution scale and productivity. During 2009 total agent numbers at 410,000 remained roughly in line with 2008's 413,000. Underlying this small decrease is a reduction of 41,000 non-productive agents in India as that agency force undergoes a period of consolidation and focus on productivity following the rapid branch expansion of prior years. Elsewhere in the region we added a total of 38,000 agents representing growth of 30 per cent over 2008. Throughout 2009 agent activity remained around 2008 levels, a testament to the resilience of this distribution channel in a difficult environment. However, average premiums per policy declined as the proportion of sales derived from health and protection products increased (while these products have high new business margins, they tend to have lower average premiums). More recently the trend for average premiums per case reflects a return to 2008's pre-crisis levels.

The over-arching objective for Prudential in Asia is to continue building profitable scale.

Prudential is one of the pioneers in partnership distribution in Asia. Our unique model includes locating Prudential employed and managed sales people, known as Financial Service Consultants (FSC), in key branches of our bank distribution partners. Despite challenging market conditions, FSC sales for 2009 totalled £181 million, representing an increase of 26 per cent over 2008. Prudential has distribution relationships with over 75 institutions across Asia including Standard Chartered Bank, E.Sun Bank and our joint venture partners ICICI in India and CITIC in China. On 6 January 2010 we announced an important distribution agreement with UOB Group covering Singapore, Indonesia and Thailand.

Note
See page 25.

Our focus on health and protection products has been particularly successful in a number of respects. Health and protection products are important for the customers who buy them and the distributors who sell them. The proportion of health and protection products in our total APE mix increased to 29 per cent in 2009, up from 24 per cent in 2008. Higher average new business margins for health business translated into solid returns for shareholders, and health products accounted for over 50 per cent of the total new business profit generated in 2009. Prudential was honoured as Asia Pacific's Health Insurer of Year in 2009 by Frost and Sullivan.

Health and protection products are important for the customers who buy them and the distributors who sell them.

Prudential currently insures over 10 million life insurance customers in Asia. While we continue to focus aggressively on the acquisition of new customers given the generally low penetration rates, we are equally focused on strengthening and deepening our relationships with our existing customers. We are developing advanced data mining and profiling capabilities which provide us with a better understanding of which customers need which products and when. Around 40 per cent of new business came from existing customers in 2009 (excluding India), up from 25 per cent in 2008. Our customer retention rate was 90 per cent in 2009, a one per cent improvement over 2008.

Financial performance

Although some challenges remain in the Asian economies, there are encouraging signs that the recovery is well underway. Importantly, consumer confidence is returning to the retail financial services sector. Prudential had its highest ever quarter in terms of new business volumes during the fourth quarter of 2009 at £415 million up 42 per cent and 45 per cent from the third quarter of 2009 and the equivalent quarter in 2008 respectively, driven by a continued improvement in sentiment. Full year new business results of £1,261 million represent a growth rate of 4 per cent over 2008.

Agency remains our largest distribution channel, accounting for 63 per cent of new business, in line with 2008. Distribution through bank partnerships account for 24 per cent of new business, up from 22 per cent in 2008. The proportion of higher margin regular premium business in the mix grew to 93 per cent compared to 89 per cent in 2008. It is important to note that while market conditions did drive down single premium volumes in 2009 the single premiums sales total for 2008 included exceptional volumes of Central Provident Fund (CPF) related business in Singapore. Volumes of unit-linked business in 2009 were suppressed due to consumer concerns over capital markets, but nevertheless these products remain the single largest element of our product mix at 41 per cent of total APE for full year 2009 compared to 55 per cent in 2008. As noted earlier, the proportion of higher margin health and protection products has increased to 29 per cent for 2009, up from 24 per cent in 2008.

We have maintained strict pricing and value disciplines and have not succumbed to the temptation to drive sales results with low margin products. New business market share statistics for full year 2009 are not yet available but based on our estimates and market intelligence we expect to have retained our top three positions in seven out of our 11 life markets.

Average new business profit margins have increased from 52 per cent for 2008 to 57 per cent for 2009. The major drivers of this increase are a shift in average country mix where we have seen lower proportions of new business from the lower margin markets of Korea and India and the positive impact of the shift in product mix towards higher margin health and protection products. Total new business profits of £713 million are up 12 per cent over 2008. Despite the unforeseen and very challenging environment, we have exceeded the target we set in December 2006 of doubling 2005 new business profits by 2009 by £39 million.

As reported at the interims, during the first half of 2009 we did see a deterioration of persistency, principally in Korea, and we reported adverse assumption changes and experience variances to reflect this. During the second half of 2009, the situation has improved as a result of management actions and an improvement in market conditions. During the second half only an additional £47 million of assumption changes and experience variances relating to persistency were incurred, resulting in a full year charge of £154 million. Overall assumption changes and experience variances for 2009 netted out at a charge of £97 million, representing an improvement from the charge of £124 million reported at the half year. Given the scale of the EV shareholder funds of the long-term business at £5.8 billion, these experience variances and assumption changes remain small. The contribution to in-force earnings arising from the unwind of the discount rate and other operating investment returns amounted to £489 million, up 20 per cent on prior year, reflecting the growing scale of the business.

Prudential Asia Life reported record IFRS profits of £416 million for 2009, an increase of 62 per cent over 2008. This includes the impact of reserve releases in Malaysia following the introduction of RBC of £63 million. Excluding this one-off, the growth rate for IFRS profit was 37 per cent. Aside from Japan and Taiwan where we are working through fundamental changes in our business models and except for Thailand that made a small loss, all our life operations are generating IFRS profits. Our life insurance joint venture with ICICI in India generated its first IFRS profit since the inception of the business in 2001.

Prudential Asia Life reported record IFRS profits of £416 million for 2009, an increase of 62 per cent over 2008.

New business strain on the IFRS basis is 6.2 per cent of APE compared to 8.0 per cent reported in 2008. The main driver is change in country mix with lower proportions of new business from India and Korea. IFRS profits from the in-force book of £494 million are 22 per cent ahead of 2008 excluding the impact of the reserve release in Malaysia.

We continue to manage our investment in new business, focusing on value creation. New business written in the period has an average internal rate of return (IRR) in excess of 20 per cent and an average pay back period of three years.

The Asian Life Businesses remain net remitters of cash to the Group at £80 million.

Asia: our extensive agency network

The scale and reach of our Asia franchise is unparalleled, with top three market share positions in seven fast-growing markets.

Our growth across Asia is fuelled by our extensive tied agency force of 410,000 sales professionals.

Many of our agents today are young female graduates and successful entrepreneurs in their own right. Dedicated and highly trained, our agents have the knowledge and commitment to help our customers meet their savings, protection and investment needs at every life stage.



Looking at individual countries

In China, new business volumes for 2009 of £45 million are up 18 per cent on 2008 principally driven by bancassurance. CITIC-Prudential remains one of the leading foreign joint ventures and we continue to pursue our strategy of quality sales and sustainable value creation rather than chasing short-term volumes. China is a critically important strategic market for Prudential.

Hong Kong delivered an exceptionally strong fourth quarter of £91 million of new business volumes, up 65 per cent on the third quarter of 2009 and up 98 per cent on the equivalent quarter of last year. This was driven by continuing improvements in agency productivity along with strong recovery of the bank channel. Full year new business for Hong Kong was £241 million, up 18 per cent over 2008. Prudential remains amongst the top three positions in Hong Kong based on new business premium market share and is the only top player with distribution channel diversity.

Following a slow start to 2009, given the impacts of the market turbulence on customer confidence in India, ICICI-Prudential has seen an encouraging resurgence in new business volumes during the fourth quarter. Prudential's fourth quarter new business volumes of £52 million (reflecting our 26 per cent ownership) is up 30 per cent on the third quarter. Agency recruitment has slowed as our branch expansion programme has now been successfully completed. The proportion of business derived from bank distribution continues to increase and now stands at 30 per cent for 2009 compared to 25 per cent for 2008. The operation remains India's leading private sector life insurer.

Growth in Indonesia remains on track with the fourth quarter of £64 million of new business volumes up 49 per cent on the third quarter of 2009 and up 36 per cent on the equivalent quarter of last year. Full year new business in Indonesia of £190 million represented an increase of 8 per cent on 2008. Agency manpower continues to be the main driver of growth with over 20,000 new agents added during the year. Takaful linked products remain a significant contributor at 25 per cent of the new business mix. Prudential is the market leader in Indonesia in the life insurance industry.

As seen earlier during 2009, the market in Korea remains very challenging and although the crisis has impacted results, a key contributor to the 44 per cent decline in new business volumes in the year to £122 million is our unwillingness to compete in the low margin, high capital guaranteed products sector.

Our traditional and takaful businesses in Malaysia had a record 2009 with fourth quarter volumes of £62 million, nearly double the third quarter and 72 per cent higher than the equivalent quarter of 2008. Agency momentum in terms of recruitment and productivity are key drivers of the results, but there was also a significant uptake due to a recovery in the local capital markets during the fourth quarter. Full year new business volumes for 2009 of £146 million is an impressive 43 per cent increase over 2008. Although comprehensive market statistics are unavailable we believe we are one of the leading life insurers in Malaysia.

Singapore also had a very strong finish to 2009 closing the year with new business volumes up 14 per cent at £128 million. Fourth quarter new business sales of £48 million were up 66 per cent on the third quarter and 85 per cent higher than the equivalent quarter of last year. Improved sentiment, plus increases in agency productivity and new non-participating products drove this very strong result. We anticipate holding our market leading position in Singapore.

Following our exit from the agency channel in 2009, Taiwan is now successfully focused on bank distribution principally with partners E. Sun and Standard Chartered Bank. New business volumes of £107 million for the year are up a significant 84 per cent on prior year from this channel and Taiwan remains a material contributor to Asia's results.

Vietnam delivered a very strong result in 2009, up 36 per cent on prior year, driven by improvements in agency productivity. Although small, both Philippines and Thailand delivered reasonable results given the challenging market conditions. As announced on 15 January, PCA Life Japan has suspended writing new business.



Clark Manning
President and Chief Executive Officer
Jackson National Life Insurance Company

INSURANCE OPERATIONS UNITED STATES

The United States is the world's largest retirement savings market, and is continuing to grow rapidly. As 78 million baby boomers¹ reach retirement age, their retirement assets will shift from asset accumulation to income distribution. There are already US\$2 trillion of assets generating retirement income in the US - and this amount is forecast to rise to some US\$7 trillion by 2029.²

During 2009, the US financial services industry continued to face an array of challenges. After the S&P 500 index fell to a 12-year low in March, it rebounded and ended the year up 23.5 per cent (compared to a 38.5 per cent decline in 2008). Governmental interest rates increased but remained at historic lows, and rating agencies downgraded the financial strength ratings of many of the largest US insurance companies.

Further uncertainty arose early in the year as several companies scaled back their product offerings due to capital constraints which, combined with the financial strength downgrades, caused consumers to question the long-term financial stability of product providers. At the same time, tightening credit spreads and the rally in equity markets throughout the last nine months of the year created more favourable market conditions for the sale of variable annuities. These developments in the annuity market provided a competitive advantage to companies with strong financial strength ratings and a relatively consistent product set.

Prudential's US business, Jackson, benefited significantly from this flight to quality in the US annuity market. Our strategy continues to target increasing volumes in variable annuities in line with the goal of capital preservation. As Jackson focused on optimising the balance between new business profits and capital consumption, no institutional sales were made during the full year of 2009.

Notes

- 1 Source: US Census Bureau
- 2 Source: Tiburon Strategic Advisers, LLC

	AER ⁸			CER ⁸	
	2009 £m	2008 £m	Change %	2008 £m	Change %
APE sales	912	716	27	846	8
NBP	664	293	127	347	91
NBP margin (% APE)	73%	41%		41%	
NBP margin (% PVNBP)	7.3%	4.1%		4.1%	
Total EEV basis operating profit*	1,233	586	110	693	78
Total IFRS operating profit*	459	406	13	480	(4)

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

Initiatives in 2009

Distribution

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

The success in the marketplace of Prudential's US business, Jackson, continues to be driven by our industry-leading distribution organisation and product innovation, coupled with our sound evaluation of product economics.

The annuity industry is consolidating to the strongest players, and this consolidation has contributed to a substantial increase in Jackson's distribution relationships. We have experienced a large influx of new advisers this year, increasing our licensed agent and registered representative count by more than 30,000 to 117,453, which has driven significant increases in market share for Jackson, particularly in variable annuities. Jackson signed a distribution agreement with Merrill Lynch, which began selling Jackson products in late 2009.

Many baby boomers are increasingly seeking advice to help them recover the losses suffered during the crisis. With strong growth in our distribution relationships in advice-based channels, Jackson is well positioned to benefit from this trend.

Innovation

Innovation in product design and speed to market continue to be key drivers of Jackson's competitiveness in the variable annuity market. High-quality and cost-effective technology has allowed Jackson to offer a comprehensive product portfolio that can be customised to meet the needs of individual customers. We offer products on an unbundled basis, enabling customers to select those benefits that meet their unique financial requirements and to pay only for those benefits they truly desire. In our view, leveraging this advantage is a more sustainable long-term strategy than competing on price – Jackson will not sacrifice product economics for a short-term increase in market share.

During 2009, Jackson maintained its track record of continued product innovation by enhancing our variable annuity product line by offering a bonus variable annuity and six new portfolio investment options. We also continued to modify our Guaranteed Minimum Withdrawal Benefits (GMWBs).

Customer service

The significant increase in new business in 2009, following the difficult market conditions in 2008, resulted in higher call volume to our service centres. Despite this increased workload, we continued to demonstrate the ability to service investors' and advisers' needs accurately and efficiently, by once again earning recognition as a World Class service provider in the Service Quality Measurement Group's (SQM) latest benchmarking study of North American service centres. Historically, only 5 per cent of service centres receive World Class designation, but 2009 marked the fifth year that Jackson has achieved World Class status. We also earned SQM's 'Highest Customer Satisfaction by Industry' award for having the highest rate of customer satisfaction in the financial services industry. During 2009, Jackson created a series of educational presentations and materials designed to address the concerns that advisers were facing in such a challenging economic environment. In Financial Research Corporation's 2009 Advisor Insight study, Jackson ranked number one in overall adviser satisfaction with marketing effectiveness.

Financial performance

Jackson delivered record APE sales in 2009 of £912 million, representing a 27 per cent increase over 2008 at actual exchange rates. It was also the highest level of total sales in the company's history even though we sold no institutional products. The strong momentum seen in the first half of the year continued, as second half sales of £5.1 billion were 34 per cent higher than the first half of 2009 and 64 per cent higher than the second half of 2008. We have maintained our pricing discipline and continued to write business at very attractive Internal Rates on Return in excess of 20 per cent and with payback periods of two years.

Jackson ranked 4th in total annuity sales with a market share of 5.3 per cent in the first nine months of 2009, up from 11th and a market share of 4.0 per cent for 2008³.

Variable annuity APE sales of £639 million in 2009 were 83 per cent higher than 2008 at actual exchange rates and the highest level of variable annuity sales in the company's history. Jackson's strong variable annuity sales performance was due primarily to the equity market rally that began in the second quarter of 2009, the relative consistency of Jackson's product offering and continued disruptions among some of our major competitors. Jackson ranked 4th nationally in new variable annuity sales during the first three quarters of 2009, with a market share of 7.3 per cent, up from 12th with a market share of 4.3 per cent at the end of 2008⁴. During the first nine months of 2009, the latest period for which statistics are available, Jackson ranked second in variable annuity net flows and experienced the lowest level of outflows, as a percentage of variable annuity inflows, in the industry⁴.

Fixed index annuity (FIA) APE sales of £143 million in 2009 were up 186 per cent over 2008. Sales in the fourth quarter of £378 million were 111 per cent higher than the same quarter in 2008. Industry FIA sales have increased due to higher customer demand for products which offer guaranteed rates of return with additional upside potential linked to stock market index performance. Additionally, Jackson's FIA sales have benefited from the company's consistent financial strength ratings and further disruptions among some of the top FIA sellers. Jackson ranked fifth in sales of FIAs during the first three quarters of 2009, with a market share of 7.1 per cent, up from 9th with a market share of 3.5 per cent at the end of 2008⁵.

Jackson's strategy of containing fixed annuity volumes to achieve capital preservation resulted in APE sales of £105 million, 39 per cent lower than 2008. Sales in the fourth quarter of £212 million were 51 per cent higher than the third quarter of 2009 and 64 per cent lower than the fourth quarter of 2008.

Total retail annuity net flows of £5.0 billion for 2009 represent a 115 per cent increase on the same period in 2008 at actual exchange rates, reflecting the impacts of record sales and continued low levels of surrender activity.

EEV basis new business profits of £664 million were 127 per cent higher than in 2008, reflecting a 27 per cent increase in APE sales and a significant shift in the mix of business toward variable annuities. Total new business margin was 73 per cent, significantly higher than the 41 per cent achieved in 2008.

New business spread assumptions have increased for some products as a result of decreases in crediting rates on new business, which were lowered in an effort to reduce sales and conserve capital. Such high spreads are unusual and tied to the unique economic environment.

The variable annuity new business margin increased from 43 per cent in 2008 to 81 per cent in 2009, arising from updated assumptions, revised benefits and higher take-up rates on the higher margin guaranteed withdrawal benefits.

The FIA new business margin decreased slightly from 53 per cent in 2008 to 51 per cent in 2009, as a result of the increased risk discount rate more than offsetting increased assumptions.

The fixed annuity new business margin increased from 37 per cent to 57 per cent, as a result of wider spread assumptions offset to some extent by an increase in the risk discount rate.

Total EEV basis operating profit for the long-term business in 2009 was £1,233 million, compared to £586 million in 2008.

There was no new institutional business as Jackson restricted sales in this business line in order to conserve and direct capital to higher margin variable annuity business.

Total EEV basis operating profit for the long-term business in 2009 was £1,233 million, compared to £586 million in 2008. In-force EEV profits of £569 million were 94 per cent higher than the 2008 profit of £293 million, reflecting both the greater contribution to earnings from the unwind of the discount rate and the beneficial impact of updating the assumption relating to GMWB utilisation rates to reflect recent experience studies.

Notes

³ Source: LIMRA

⁴ Source: Morningstar

⁵ Source: Advantage Group Associates, Inc

Jackson becomes a top five annuity provider

Our outstanding performance in the US is driven by our success in meeting the needs of the baby-boomer generation - the 78 million Americans now approaching retirement and looking to turn their retirement savings into income.

During 2009, a period of unprecedented financial turmoil, savers began to seek greater certainty. Jackson was quick to respond through offering a comprehensive product portfolio that could be customised to meet the needs of individual customers.

As a result, Jackson moved from eleventh in total annuity sales to become a top-five provider, while simultaneously achieving a dramatic increase in margins.



IFRS operating profit for the long-term business was £459 million in 2009, up 13 per cent over the £406 million in 2008. The expected charge from the negative accounting effect of rising equity markets and interest rates on derivative instruments supporting Jackson's variable annuity business has been more than offset by the absence of the accelerated DAC amortisation experienced in 2008 and the effect of movements in exchange rates. Since Jackson hedges the economics of the product rather than the accounting result, there will naturally be some volatility in the reported results due to equity market and interest rate movements. As evidence of the effectiveness of Jackson's hedging programme, over the cumulative 24 month period of 2008 and 2009, which included a historic decline and partial recovery of equity markets as well as significant interest rate movements, Jackson's variable annuity guaranteed benefits and related hedges resulted in a net operating loss of £7 million.

At 31 December 2009, Jackson had more than £55 billion in total assets, including £21 billion in separate account assets.

In 2009 Jackson recorded impairment write-downs and credit related losses on debt securities net of recoveries of £631 million (2008: £624 million), of which £499 million (2008: £167 million) arose on residential mortgage-backed securities.

Gross unrealised losses moved from £3,178 million at 31 December 2008 to £966 million at 31 December 2009 as the markets rebounded from the historically wide spreads at the end of 2008. The net unrealised position moved from an unrealised loss of £2,897 million at 31 December 2008 to a net unrealised gain of £4 million at 31 December 2009.

Jackson's statutory basis total adjusted capital of £2.5 billion is more than eight times the regulatory required risk-based capital at the authorised control level. This equates to a RBC percentage in excess of 400 per cent. The Michigan Insurance Commissioner granted Jackson a permitted practice that allowed Jackson to carry interest rate swaps at book value, as if statutory hedge accounting were in place, instead of at fair value as would have been otherwise required. The effect of this permitted practice was to increase statutory total adjusted capital by £117 million at 31 December 2009.



Rob Devey
Chief Executive
Prudential UK and Europe

INSURANCE OPERATIONS **UNITED KINGDOM**

Prudential UK continues to focus on realising value from the opportunities created by the increasing need for retirement solutions. Prudential UK competes in selected areas of the UK's retirement savings and income markets where it believes that it can generate attractive returns from capital employed. In line with the Group's strategy, the business continues to place great emphasis on the disciplined deployment of capital to seize opportunities that play to the core strengths of the business and this focus enabled us to deliver a strong relative performance in 2009.

In 2009, Prudential UK performed strongly against a challenging background of difficult capital and equity markets and widespread economic uncertainty which led to consumers looking for greater certainty and security through trusted and financially strong brands. We believe that the business has a unique combination of competitive advantages including our longevity experience, multi-asset investment capabilities, strong brand and financial strength, which help put Prudential UK in a strong position to generate attractive returns across its businesses.

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

	AER ⁸			CER ⁸	
	2009 £m	2008 £m	Change %	2008 £m	Change %
APE sales	723	947	(24)	947	(24)
NBP	230	273	(16)	273	(16)
NBP margin (% APE)	32%	29%		29%	
NBP margin (% PVNBP)	3.9%	3.4%		3.4%	
Total EEV basis operating profit	921	1,081	(15)	1,081	(15)
Total IFRS operating profit	657	589	12	589	12

Initiatives in 2009

Maintaining leadership position in individual annuities

Prudential UK has a significant pipeline of internal vestings into its annuity business from maturing individual and corporate pension policies, which is expected to remain strong at least over the next ten years. This is supplemented by strategic partnerships with third parties where Prudential UK is the recommended annuity provider for customers vesting their pensions at retirement. Prudential UK is one of the largest annuity providers in the UK market, with approximately 1.5 million annuities in payment. Looking ahead, the UK annuities market is expected to grow in the near-term, and Prudential UK believes it is well-positioned to maintain a significant share of this market.

Sales of individual annuities of APE £219 million were 22 per cent lower than 2008. Sales of external annuities of £83 million were down 31 per cent year-on-year as Prudential UK continued to actively manage the flow of external business to reduce capital consumption. For internal vestings, although rates remained robust, sales were impacted by a reduction of eight per cent in average case sizes as a result of depressed asset values and by customers choosing to delay their retirement to allow asset values to recover. As a result, internal vestings sales fell by 15 per cent. However, the year-on-year decline is also explained by the fact that vestings were stronger than usual in the last quarter of 2008.

In the first quarter of 2009, Prudential UK launched a new Income Choice Annuity which allows customers to choose an income between a defined maximum and minimum level, with the option of re-setting this every two years. It also provides an opportunity for pension income to grow because the product is backed by Prudential's strong with-profits fund.

Building on our multi-asset capabilities and expertise

Prudential UK's with-profits business performed particularly strongly during 2009, showing once again that with-profits, when invested in an actively managed, and financially strong fund like Prudential's, continues to be an attractive medium to long-term investment, offering strong annualised returns compared with other investment options. Prudential UK with-profits fund has delivered investment returns of 66.3 per cent over ten years compared with the FTSE All-Share Index (total return) of 17.7 per cent over the same period.

Sales of with-profits bonds of APE £132 million were up 35 per cent on 2008. This strong sales growth reflects the attractiveness of Prudential's with-profits offering, including in particular PruFund, in which over £1.3 billion has been invested across Prudential UK retail savings' product range in the last 12 months. In 2009, Prudential UK extended further the PruFund range of investments with the launch of the PruFund Cautious series to sit alongside the PruFund Growth series within the on-shore bond wrapper. Approximately £300 million has been invested in PruFund Cautious since it was launched in the second half of the year.

Customers have invested over £1.3 billion in PruFund across Prudential UK's retail savings product range in the last 12 months.

Individual pensions sales (including income drawdown) of APE £55 million were 20 per cent higher than 2008. Sales of the Flexible Retirement Plan, Prudential UK's individual pension product with customer agreed remuneration, continued to grow with sales in 2009 of APE £21 million up 90 per cent. Sales of the income drawdown product of APE £9 million were 13 per cent higher than 2008. Sales were boosted by the launch of PruFund and PruSelect as fund options in the second half of 2008.

Note
See page 25.

Growing other income streams

Prudential UK has a joint venture with Discovery which uses the Prudential brand and Discovery's expertise to build branded distribution and innovative product offerings in the private healthcare and protection markets. Since its launch, PruHealth has established itself in the marketplace, and it now has more than 200,000 customers insured. PruProtect continues to grow sales strongly following the re-launch of its product range and improved distribution model in November 2008. APE Sales of £14 million were achieved in 2009, an increase of 311 per cent over 2008.

Strengthening our distribution capabilities

The business increased its field sales-force with an additional 13 regional sales units and the focus is to continue developing deeper and better relationships with key accounts and through partnership arrangements. Prudential UK was successful in gaining over 50 new panel positions across our 24 key accounts in 2009, meaning that its products are now even more widely available to intermediaries than before.

A strong focus on delivering improvements in customer service

Prudential UK's focus on delivering improved levels of customer service was recognised in 2009 through the award of two Five-Star awards at the Financial Adviser Service Awards in the Life & Pensions and Investments categories. These awards were achieved shortly before Prudential was named 'Best Annuity Provider' at the 2010 Professional Adviser Awards.

Maintaining our disciplined approach to pricing and capital usage

In the Wholesale markets, Prudential UK's aim is to participate selectively in bulk and back-book buyouts using the Group's financial strength, superior investment track record and annuitant mortality risk assessment capabilities. There continues to be a pipeline of potential wholesale deals, but maintaining a strict focus on value means that Prudential UK will only participate in transactions that meet its strict return on capital requirements. As a result, 2009 APE sales of £4 million were significantly lower than 2008.

Within corporate pensions, Prudential UK intends to continue to focus principally on the opportunities from the substantial existing Defined Contribution book of business as well as providing Additional Voluntary Contribution arrangements to the public sector. During an extremely challenging 2009 for Prudential UK's corporate clients and the whole industry, Prudential UK's revenues from existing schemes and underlying sales were broadly in line with 2008 after excluding one-off items in both 2008 and 2009. With the inclusion of one-off items sales of £210 million were 16 per cent lower than in 2008.

In November, Prudential UK announced the decision to close its equity release operation to new business. For this product, a significant cash expense is incurred up front in acquiring new business and the payback period on capital employed is long. Prudential UK management concluded that this is not sustainable and that cash and capital can be deployed more effectively across other parts of the business. Prudential UK's existing lifetime mortgage customers are unaffected by this decision.

Financial performance

Market conditions remained challenging in 2009, with ABI statistics data showing a 23 per cent fall in the retail sales market in the twelve months to September. As explained above, Prudential UK continued to maintain a strict focus on the disciplined use of capital and pricing to achieve its return on capital targets. Against this background, Retail APE sales of £717 million were down 11 per cent on 2008. Total UK APE sales of £723 million were down 24 per cent on last year, although the 2008 figure included a large bulk annuity transaction which has not been repeated in 2009, due to the unavailability of transactions which met Prudential's return criteria.

The UK business continues to focus rigorously on balancing writing new business with cash and capital preservation while generating attractive returns on capital employed.

This disciplined pricing approach led to lower sales of individual annuities and corporate pensions. In addition, sales of other product lines, such as offshore bonds, were impacted by the continued market volatility. These reductions in sales were partially offset by the continued strength of Prudential UK's with-profits offering, in particular PruFund.

Lower sales resulted in total EEV new business profits falling by 16 per cent to £230 million, but the underlying new business margin improved from 29 per cent to 32 per cent. This improvement was mainly due to the strong margins achieved on shareholder-backed annuity business. The £43 million reduction in the total EEV new business profit compared with 2008 was mainly due to the large bulk deals written in 2008 which were not repeated in 2009. Retail EEV new business profits at £223 million were in line with 2008 (£226 million).

UK: a trusted retirement brand

In the UK, our 162-year heritage, financial strength and trusted retirement brand provide a robust platform for outperformance, generating capital and cash for investment in growth opportunities worldwide.

These core strengths have made us one of the UK's largest providers of individual annuities, with approximately 1.5 million annuities in payment. With the UK annuities market set for near-term growth, we are well-placed to maintain a substantial share of this market, supported by ongoing innovation such as the new Income Choice Annuity we launched in 2009.



EEV total operating profit based on longer-term investment returns of £921 million was down 15 per cent on 2008. This was mainly due to the £118 million benefit arising in 2008 from rebalancing the credit portfolio that supports the shareholder-backed annuity business compared with £22 million in 2009. The 2009 in-force operating result includes £588 million from the unwind of the discount rate on the value in-force business which is three per cent higher than 2008.

Prudential UK continues to manage actively the retention of the in-force book. During 2009, the experience at an aggregate level has been in line with long-term assumptions.

IFRS total operating profits were up 12 per cent at £657 million. The increase was mainly due to the superior returns achieved on shareholder-backed annuity business, which were £194 million higher than 2008, partly offset by a £114 million reduction in IFRS profits attributable to the with-profits business. This decrease was primarily due to bonus rate reductions in the February 2009 bonus declaration. Commission received on Prudential-branded General Insurance products contributed £51 million to IFRS operating profits in 2009, 16 per cent higher than 2008. This increase was due to the substantial advance commissions received on the transfer of the business to Churchill in 2002 being fully amortised in March 2008, so that commissions earned are now received in full.

Prudential UK writes with-profits annuity, with-profits bond and with-profits corporate pensions business in its life fund, with other products backed by shareholder capital. The weighted average post-tax IRR on the shareholder capital allocated to new business growth in the UK was in excess of 15 per cent. The average free surplus undiscounted payback period for shareholder-backed business written in 2009 was five years.

The business has also continued to make good progress against its cost reduction plans. As previously announced, the first phase of the Prudential UK cost reduction programme delivered savings of £115 million per annum, with a further £60 million per annum of savings expected to be delivered by the end of 2010 through the agreement with Capita, which commenced in April 2008. The remaining £20 million per annum is expected to be generated from across the rest of the UK business by the end of 2010. By the end of 2009, a total of £156 million per annum of savings had been delivered and Prudential UK expects that it will have achieved its total cost savings target of £195 million per annum by the end of 2010.

Over time, the Capita contract is expected to result in the migration of approximately seven million in-force policies from a number of Prudential legacy IT systems to two Capita proprietary platforms, significantly enhancing operational performance and efficiencies. The first migration from a legacy system to a Capita platform was completed during 2009.