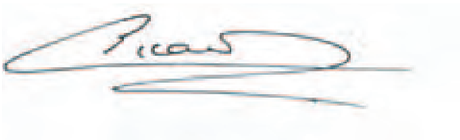
Nic Nicandrou
Chief Financial Officer



CHIEF FINANCIAL OFFICER'S OVERVIEW

In 2009 Prudential has continued to balance profitable growth, capital conservation and cash generation to both protect the Group's financial strength and preserve its long-term growth potential. We have focused on generating significant levels of sales of highly profitable and capital efficient products.

Our results, as summarised below, show that we have achieved our dual objectives of higher profitability and lower levels of investment in new business at a time when market conditions remained challenging for the insurance industry. This highlights our focus on value over volume as we manage investment in new business to meet our capital management targets. In addition we have been able to strengthen our capital position and have continued to generate a positive Group operating holding company cash flow.

The global economic environment has gradually improved through 2009, led by emerging economies, especially Asia. The Asian region appears to be more resilient than the rest of the world and we expect it is likely to return sooner to strong growth while the western world seems to be set for a prolonged period of weaker growth. Against this backdrop, and in particular in those countries in Asia where we have leading positions, our long-term growth potential remains intact, and we believe we are well positioned to take advantage of opportunities in the pre and post retirement markets in our chosen geographical markets.

In 2009, in a difficult economic and market environment, Prudential produced a strong performance across all of its key performance indicators. We believe this performance demonstrates the success of our strategy and the resilience and strength of Prudential's business model.

We have achieved our dual objectives of higher profitability and lower levels of investment in new business at a time when market conditions remained challenging for the insurance industry.

Group retail APE new business sales were £2,890 million, 11 per cent higher than for 2008. In Asia, sales were £1,261 million, up four per cent, boosted by a record fourth quarter. In the US, Jackson continued to be a beneficiary of the significant changes in the competitive landscape, with a 53 per cent increase in retail sales at £912 million. In the UK, the Group's disciplined approach to capital consumption led to retail sales of £717 million, down 11 per cent. Wholesale sales were held to a minimum as the Group continued to focus on products with higher IRRs and shorter payback periods.

Net investment flows increased by £11.2 billion to £15.4 billion, driven by strong performances in M&G's retail and institutional business, and the Asian asset management operations. With these contributions and recovering investment markets, external funds under management have increased by £27.5 billion to £89.8 billion during the year.

Performance and key metrics

	AER[8]			CER[8]	
	2009 £m	2008 £m	Change %	2008 £m	Change %
New business note 1					
Annual premium equivalent (APE) sales:					
– Retail					
– Asia	**1,261**	1,216	4	1,350	(7)
– US	**912**	596	53	705	29
– UK	**717**	803	(11)	803	(11)
– Total retail	**2,890**	2,615	11	2,858	1
– Wholesale	**6**	264	(98)	285	(98)
– Total APE sales	**2,896**	2,879	1	3,143	(8)
EEV new business profit (NBP)	**1,607**	1,200	34	1,331	21
NBP margin (% APE)	**56%**	42%		42%	
Net investment flows	**15,417**	4,266	261	4,456	246
External funds under management	**89,780**	62,279	44	60,924	47
EEV basis operating profit note 1					
On long-term business notes 2, 3	**3,202**	2,810	14	3,080	4
Total	**3,090**	2,865	8	3,138	(2)
IFRS operating profit based on longer-term investment returns notes 1, 3	**1,405**	1,283	10	1,390	1
Balance sheet and capital					
EEV basis shareholders' funds	**15.3bn**	15.0bn	2	14.1bn	9
EEV basis shareholders' funds per share	**603p**	599p	1	563p	7
Return on Embedded Value note 4	**14.9%**	14.4%			
IFRS shareholders' funds	**6.3bn**	5.1bn	24	4.8bn	31
IGD capital surplus (as adjusted) note 5	**3.4bn**	1.5bn	127	n/a	n/a
Free surplus – investment in new business note 6	**675m**	806m	(16)	885m	(24)
Operating holding company cash flow	**38m**	54m	(30)	54m	(30)
Dividend per share relating to the reporting year	**19.85p**	18.9p	5	n/a	n/a
Dividend cover note 7	**2.2**	2.1	n/a	n/a	n/a

Notes

1 New business and operating profits exclude the results of the Taiwan agency business for which the sale process was completed in June 2009.
2 Long-term business profits after deducting Asia development expenses and before restructuring costs.
3 Operating profits are determined on the basis of including longer-term investment returns. EEV and IFRS operating profits are stated after excluding the effect of short-term fluctuations in investment returns against long-term assumptions, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, and the effect of disposal and results of the Taiwan agency business, for which the sale process was completed in June 2009. In addition for EEV basis results, operating profit excludes the effect of changes in economic assumptions and the time value of cost of options and guarantees, and the market value movement on core borrowings.
4 Return on Embedded Value is based on EEV operating profit after tax and minority interest as a percentage of opening EEV basis shareholders' funds.
5 Insurance Groups Directive capital surplus (as adjusted). The surpluses shown for 2009, which is estimated, and 2008 are before allowing for the final dividends for 2009 and 2008 respectively.
6 Free surplus – investment in new business represents EEV net worth strain together with EEV required capital to support the new business acquired.
7 Dividend cover is defined as IFRS operating profit after tax and minority interests divided by the dividend declared relating to the reporting period.
8 Actual Exchange Rate (AER) and Constant Exchange Rate (CER).

In this review, comparisons of financial performance are on an actual exchange rate (AER) basis, unless otherwise stated.

In 2009, total EEV basis operating profits based on longer-term investment returns of £3,090 million were up eight per cent from 2008, primarily from an increase in the profitability from the Group's long-term business operations which was up 14 per cent to £3,202 million comprising new business profit of £1,607 million, in-force profits of £1,601 million and development expenses of £6 million. New business profit increased by £407 million to £1,607 million, driven principally by the US and Asia. Overall, there was a two per cent decrease in the contribution from in-force business (before development expenses), down by £35 million to £1,601 million. The movement reflects a growing level of unwind of discount, up by £210 million, reflecting the increased in-force business offset by a reduction in the level of contribution from changes to operating assumptions, experience variances and other items of, in aggregate, £245 million. The growth in the Group's EEV operating profit was held back by a lower contribution from the asset management businesses (down £48 million to £297 million) reflecting reduced market values in 2009. There was also a negative impact on Group EEV operating profit from other income and expenditure of £131 million due to lower returns on central funds and higher interest payable on core structural borrowings.

The total EEV profit before tax for 2009 of £1,743 million compares to a loss of £2,106 million for 2008. The increase of £3,849 million reflects the growth in operating profit of £225 million and an increase in the aggregate effect of non-operating items of £3,624 million which mostly arise from the net effects of improved financial markets. Within the non-operating items of negative £1,347 million there were positive contributions of £351 million for short-term fluctuations in investment returns and the £91 million from the profit on sale and results of the Taiwan agency business that was sold in June 2009. However, these amounts were offset by reductions of £795 million for the change in the mark-to-market value of the Group's borrowings as credit spreads normalised, a charge of £910 million for the effect of changes in economic assumptions and time value of cost of options and guarantees arising from increasing interest rates and the application of higher risk discount rates across our businesses and an £84 million charge for actuarial and other losses for the Group's defined benefit pension schemes.

Our IFRS operating profit has increased by 10 per cent to £1,405 million. This result was driven by higher profits from all of our life businesses which were up 25 per cent to £1,475 million, with a strong contribution from Asia. Overall profits also include a lower asset management contribution due to difficult market conditions, higher interest costs following the issue of the hybrids during the year and lower interest income on group assets. In the UK, operating profits for our long-term business increased by £61 million to £606 million reflecting growth from the shareholder backed annuity business. Operating profits for Asia long term business, before development expenses, increased by £159 million to £416 million of which £96 million was due to a combination of growth in our in-force book, lower new business strain and foreign exchange and the remaining £63 million was due to a one-off benefit arising from a regulatory change in Malaysia.

The total IFRS profit before disposal of Taiwan agency business was £1,367 million in 2009, significantly higher than for 2008 (loss of £451 million) reflecting increased operating profits and more favourable short-term fluctuations partially offset by a charge for the costs of hedging the Group IGD capital surplus. Total profit before tax from continuing operations on the IFRS basis was £746 million in 2009 after allowing for the loss on disposal of the Taiwan agency business of £621 million which was completed in June 2009.

Since the beginning of the year, management actions have led to a very material increase in the Group's IGD surplus position to £3.4 billion including the issuance of £400 million subordinated debt in May to part replace maturing senior debt, the net proceeds of the Tier 1 hybrid debt of US$750 million (circa £455 million) issued in July, the beneficial impact of the sale of Taiwan agency business of £800 million, with other capital initiatives and capital generation through operating earnings net of impairments, financing costs, effects of currency and rule changes accounting for the balance. We believe this level of IGD acts as a prudent regulatory buffer whilst there remains a degree of uncertainty in the future economic environment in which we operate.

At 31 December 2009 holding company cash and short-term investments was £1.5 billion, an increase of £0.3 billion over 2008. This increase comprises proceeds of £0.6 billion from higher borrowings, (before allowing for exchange translation gains of £0.2 billion on foreign currency denominated borrowings), and positive operating holding company cash flow of £38 million, net of exceptional payments of £360 million.

In the volatile economic environment experienced during 2009, we maintained our strong focus on risk, capital and cash management. Our commitment to focusing on value over volume has been demonstrated by the strong growth in both EEV and IFRS operating profit. We have also been able to continue to be cash flow positive at the holding company level, with a positive contribution of £38 million before exceptional items.

The directors recommend a final dividend for 2009 of 13.56 pence per share, bringing the total dividend for the reporting period to 19.85 pence per share, five per cent higher then the 2008 total dividend. The 2009 IFRS operating earnings after tax and minority interest cover the full year dividend 2.2 times (2008 full year: 2.1 times).

EEV results

EEV basis operating profit based on longer-term investment returns

	AER[8]			CER[8]	
	2009 £m	2008 £m	Change %	2008 £m	Change %
Insurance business					
Asia	1,105	1,213	(9)	1,379	(20)
US	1,233	586	110	693	78
UK	870	1,037	(16)	1,037	(16)
Development expenses	(6)	(26)	77	(29)	79
Long-term business profit	3,202	2,810	14	3,080	4
UK general insurance commission	51	44	16	44	16
Asset management business:					
M&G	238	286	(17)	286	(17)
Asia asset management	55	52	6	61	(10)
Curian	(6)	(3)	(100)	(4)	(50)
US broker-dealer and asset management	10	10	–	12	(17)
	3,550	3,199	11	3,479	2
Other income and expenditure	(433)	(302)	(43)	(309)	(40)
Restructuring costs	(27)	(32)	16	(32)	16
Total EEV basis operating profit	3,090	2,865	8	3,138	(2)

EEV basis profit after tax and minority interests

	AER[8]	
	2009 £m	2008 £m
EEV basis operating profit based on longer-term investment returns	3,090	2,865
Short-term fluctuations in investment returns		
– Insurance operations	481	(4,654)
– IGD hedge costs	(235)	–
– Other operations	105	(313)
	351	(4,967)
Mark to market value movements on core borrowings	(795)	656
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	(84)	(14)
Effect of changes in economic assumptions and time value of cost of options and guarantees	(910)	(398)
Profit on sale and results of Taiwan agency business	91	(248)
Profit (loss) before tax from continuing operations	1,743	(2,106)
Tax attributable to shareholders' profit (loss)	(481)	771
Discontinued operations (net of tax)	(14)	–
Minority interests	(3)	(3)
Profit (loss) after minority interests	1,245	(1,338)

In 2009, Prudential Group's total EEV basis operating profit based on longer-term investment returns was £3,090 million, up eight per cent from 2008.

Long-term profits generated by the Group in 2009 increased by 14 per cent to £3,202 million. These profits comprise new business profits of £1,607 million (2008: £1,200 million), in-force profits of £1,601 million (2008: £1,636 million) and development expenses of £6 million (2008: £26 million).

New business profits, at £1,607 million, were 34 per cent higher than in 2008, with higher margins in all businesses, particularly the US, and a one per cent increase in sales volumes year on year. The average Group new business profit margin was 56 per cent (2008: 42 per cent) on an APE basis and eight per cent (2008: six per cent) on a Present value of new business premiums (PVNBP) basis. This rise reflects increased average margins across the businesses as we concentrated on maximising sales of our most profitable products.

The contribution from in-force operating profit decreased by £35 million to £1,601 million, including unwind of discount and other expected returns that increased by £210 million to £1,421 million, primarily reflecting the growth in Asia's in-force book and the increase in risk discount rates in the US. In-force profit in 2009 also includes the effects of operating assumption changes and experience variances and other items which had an aggregate impact of £180 million. This primarily reflects the positive impact of altered assumptions for Guaranteed Minimum Withdrawal Benefits in the US of £156 million where our expectation of the utilisation of the withdrawal feature available to policyholders on Variable Annuity contracts has been modified to take account of the more recent experience of policyholder behaviour when benefits are "in the money". Also included are the broadly offsetting effects of favourable experience and other items in the US and UK against the impact of adverse persistency in Asia.

Note
See page 25.

Operating profit from the asset management business decreased to £297 million, down 14 per cent from £345 million in 2008, reflecting reduced market values in 2009 compared to 2008.

Other income and expenditure totalled a net expense of £433 million compared with £302 million in 2008, a difference of negative £131 million of which £47 million was due to the impact of the non-recurrence in 2009 of a positive one-off 2008 item of profit on the sale of a seed capital investment in an Indian mutual fund. The remaining difference principally related to lower interest received on central shareholders' funds as a result of falling interest rates and an increase in interest payable on core structural borrowings.

Short-term fluctuations in investment returns

In our calculation of EEV operating profit, we use longer-term investment return assumptions rather than actual investment returns achieved. Short-term fluctuations represent the difference between the actual investment return and the unwind of discount on the value of in-force business and expected returns on net worth.

Short-term fluctuations in investment returns for insurance operations of positive £481 million comprise a positive £437 million for Asia, negative £401 million for our US operations and positive £445 million in the UK.

For our Asian business, short-term fluctuations of positive £437 million (versus negative £903 million in 2008) primarily reflected the effect of strong equity market performance in particular for participating business and unit-linked business where the in-force value benefits from increases in shareholder transfers and from the capitalisation of increased projected fees due to the higher asset base at the end of the year.

For our US business, short-term fluctuations in investment returns were negative £401 million versus negative £1,344 million in 2008, and primarily reflected the excess of impairment losses for fixed income securities incurred in the year over the long-term charge included within operating profit.

For our UK business, the short-term fluctuations in investment returns were positive £445 million (versus negative £2,407 million in 2008), including positive £430 million relating to with-profits business, primarily reflecting the difference between the 15.5 per cent investment return arising in the year on the investments of the with-profits life fund (covering policyholder liabilities and unallocated surplus) and the long-term assumed return of 6.9 per cent.

For other operations, the principal component of short-term fluctuations in investment returns is a one-off £235 million cost arising from the hedge temporarily put in place during the first quarter, to protect the Group IGD capital surplus in the light of exceptional market conditions. During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to our regular operational hedging programmes. The residual short-term fluctuations in investment returns for other operations of positive £105 million includes £66 million for unrealised appreciation on Prudential Capital's debt securities portfolio and £28 million on swaps held centrally to manage Group assets and liabilities.

Mark-to-market movement on core borrowings

The mark-to-market movement on core borrowings was a negative £795 million, as credit spreads incorporated in the market value of the debt narrowed to more normal levels.

Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes of a negative £84 million reflects the impact of a reduced discount rate and other assumption changes on the measurement of the liabilities of the Scottish Amicable and M&G schemes and an increase in the deficit funding provision for the Prudential Staff Pension Scheme.

Effect of changes in economic assumptions and time value of cost of options and guarantees

The effect of changes in economic assumptions and time value of cost of options and guarantees of negative £910 million comprises negative £963 million for the effect of changes in economic assumptions partially offset by positive £53 million for the change in the time value of cost of options and guarantees arising from changes in economic factors. In our Asian business, economic assumption changes were negative £165 million primarily driven by increases in risk discount and fund earned rates across a number of territories. In our US business, economic assumption changes were negative £528 million, primarily reflecting an increase in the risk discount rates following an increase in the US 10 year Treasury rate and an increase in the allowance for credit risk for fixed annuity and variable annuity business of 1.5 per cent and 0.3 per cent respectively, partially offset by the effect of an increase in the separate account return assumption from 5.8 per cent to 7.4 per cent arising from the increase in risk free rates. In our UK business, economic assumption changes were negative £270 million, primarily relating to with-profits business, reflecting the fact that the risk discount rate has increased by significantly more than the earned rate as a result of revised correlation assumptions, a lower equity backing ratio and very low cash return.

Profit on sale and results of Taiwan agency business

In June 2009, the Group completed the sale of our Taiwan agency business. The 2009 result of £91 million reflects the profit on sale. The 2008 loss of £248 million is the total result for this business, including short-term fluctuations in investment returns.

Effective tax rates

The effective tax rate at an operating level was 28 per cent (2008: 26 per cent), the increase reflecting the inability to recognise a deferred tax asset on various tax losses of non-insurance operations being partially offset by a reduction in the effective tax rate for Asian operations from the 2008 level that was affected by certain one-off items. The effective tax rate at a total EEV level was 28 per cent (2008: 37 per cent) on a profit of £1,743 million. The reduction reflects the incidence of tax attributable to Jackson's short-term fluctuations in investment returns and other non-operating profits and losses.

IFRS results

IFRS basis operating profit based on longer-term investment returns

	AER[8]			CER[8]	
	2009 £m	2008 £m	Change %	2008 £m	Change %
Insurance business:					
Long-term business					
Asia	416	257	62	290	43
US	459	406	13	480	(4)
UK	606	545	11	545	11
Development expenses	(6)	(26)	77	(29)	79
Long-term business profit	1,475	1,182	25	1,286	15
UK general insurance commission	51	44	16	44	16
Asset management business:					
M&G	238	286	(17)	286	(17)
Asia asset management	55	52	6	61	(10)
Curian	(6)	(3)	(100)	(4)	(50)
US broker-dealer and asset management	10	10	–	12	(17)
	1,823	1,571	16	1,685	8
Other income and expenditure	(395)	(260)	(52)	(267)	(48)
Restructuring costs	(23)	(28)	18	(28)	18
Total IFRS basis operating profit based on longer-term investment returns	1,405	1,283	10	1,390	1

Group operating profit before tax based on longer-term investment returns on the IFRS basis after restructuring costs was £1,405 million, an increase of 10 per cent on 2008.

In Asia, IFRS operating profit for long-term business increased by 62 per cent from £257 million in 2008 to £416 million in 2009. As reported in our half-year results announcement this includes a £63 million one-off release of reserves in the Malaysian life operations determined after assessing the measurement basis for policyholders' liabilities, following the implementation of a Risk Based Capital (RBC) regime by the Malaysian regulatory authorities. Excluding this item, Asia delivered a strong underlying operating performance resulting in an increase of £96 million to £353 million from £257 million for 2008. This increase reflects both underlying growth as we build our in-force book and a reduction in new business strain from a charge of £97 million in 2008 to a charge of £78 million in 2009.

Our larger markets of Malaysia, Hong Kong, Singapore and Indonesia continue to show strong increases in operating profit. In Indonesia, the results increased from £55 million to £102 million, reflecting the strong underlying growth of the business and further improvements to the impact of new business on operating profits. In Malaysia, IFRS operating profit of £65 million, excluding the one-off credit, was up 41 per cent on 2008, driven mainly by the growth in the profits from the in-force business. Hong Kong recorded increased operating profit up 45 per cent to £48 million, due mainly to increased profits from the in-force non-participating business, both as a result of growth and the non-recurrence of one-off costs in 2008. This has been offset by reduced participating fund profits following lower bonus payments to policyholders in 2009 reducing the corresponding transfer to shareholders from the with-profits fund. Singapore saw an increase in operating profit of £29 million (35 per cent) to £112 million reflecting growth in the in-force business. Aside from Japan, where on 15 February 2010 the operation suspended writing new business, Taiwan, which is focusing on its bancassurance business following the disposal of its agency business in June 2009, and Thailand, all the Asian life operations are generating operating profits on the IFRS basis.

In the US, the long-term business operating profit increased by 13 per cent from £406 million in 2008 to £459 million in 2009, primarily from the effect of favourable exchange rate movements, increased operating profits from the fixed and fixed indexed annuity business and lower DAC amortisation on variable annuity business as compared to 2008. These increases were offset by the combined negative accounting impact of equity market movements on Jackson's variable annuity business and related hedging programme. The hedging programme is undertaken on an economic basis and the accounting measurement does not always fully capture the economic effects.

In our UK business, the long-term business IFRS operating profit of £606 million increased by 11 per cent from £545 million in 2008. This reflects growth from the shareholder-backed annuity business, with operating profits being £194 million higher than in 2008, partially offset by lower contribution from the with-profits business of £281 million in 2009, compared with £395 million in 2008. The lower profit from the with-profit business reflected the impact of rate reductions in the February 2009 bonus declaration made in response to recent volatile investment performance. These lower bonus payments to policyholders have a corresponding negative impact on operating profit as they reduce the consequential transfer to shareholders from the with-profit fund, calculated as one-ninth of the cost of policyholders' bonus. Profit from UK general insurance commission increased to £51 million in 2009 from £44 million in 2008. As a result, the total IFRS operating profit increased by 12 per cent in 2009 to £657 million from £589 million in 2008.

M&G's operating profit for 2009 was £238 million, a decrease of 17 per cent from £286 million in 2008. This primarily reflects the relative levels of equity and property markets between 2008 and 2009, with the FTSE All Share being on average 15 per cent lower than in 2008, as well as higher staff costs and lower performance-related fees. These negative impacts were partly offset by revenue earned on the very strong fund net inflows during 2009 (£13.5 billion in 2009 compared with £3.4 billion in 2008).

Note
See page 25.

IFRS basis results – Analysis of life insurance pre-tax IFRS operating profit based on longer-term investment returns by driver

	AER[8]			CER[8]	
	2009 £m	2008 £m	Change %	2008 £m	Change %
Investment spread	**1,001**	747	34	852	17
Asset management fees	**458**	403	14	466	(2)
Net expense margin	**(388)**	(385)	(1)	(434)	11
DAC amortisation (Jackson only)	**(223)**	(450)	50	(532)	58
Net insurance margin	**472**	308	53	357	32
With-profits business	**310**	425	(27)	430	(28)
Non-recurrent release of reserves for Malaysian life operation	**63**	–	–	–	–
Other	**(218)**	134	(263)	147	(248)
Total	**1,475**	1,182	25	1,286	15

The Asian asset management operations reported operating profits of £55 million, up by six per cent from £52 million in 2008. This reflects favourable exchange rates and management's focus on profitability during the period. Profit in 2009 was adversely impacted by a one-off loss in India of £6 million.

The change of £135 million in other income and expenditure to negative £395 million from the negative £260 million in 2008 primarily reflects lower returns on central funds as a result of falling interest rates, an increase in interest payable on core structural borrowings and the non-recurrence in 2009 of a positive one-off 2008 item of profit on the sale of a seed capital investment in an Indian mutual fund.

IFRS basis results – Analysis of life insurance pre-tax IFRS operating profit based on longer-term investment returns by driver

Investment spread has increased by 34 per cent to £1 billion in 2009. The main driver has been the increase in profits from our UK shareholders' annuity business.

Asset management fees have increased by 14 per cent to £458 million in 2009, with growth in our Asian and US businesses and favourable exchange rate movements more than offsetting the impact of falling asset values on fees earned.

The *net expense margin* has decreased marginally from negative £385 million in 2008 to negative £388 million in 2009. Adverse exchange rate movements have been largely offset by improvements to new business strain in Asia (total IFRS new business strain in Asia, which is predominantly included in net expense margin, has fallen from £97 million in 2008 to £78 million in 2009).

The significant decrease in Jackson's *DAC amortisation* principally reflects the improvements in equity markets in the period and the non-recurrence of the DAC acceleration of circa £140 million that occurred in 2008.

Net insurance margin has grown by 53 per cent to £472 million in 2009 principally reflecting the strong growth in our Asian in-force book (up £55 million to £253 million in 2009), improved mortality experience in the US and UK and a one-off benefit of £34 million in the UK relating to a longevity swap on certain aspects of the UK's annuity back-book liabilities.

Profits from *with-profits* business were £310 million in 2009 compared with £425 million in 2008, reflecting lower bonus rates, and hence lower transfers to shareholders, which are calculated as one-ninth of the cost of policyholders' bonus, due to market falls.

Other of negative £218 million is primarily as a result of increased hedging costs in the US. This negative impact is before allowing for VA guarantee fees of £137 million included within *net insurance margin* and reflects the economic nature of Jackson's hedging programme, with derivative losses arising from increasing equity markets and interest rates not being fully offset by the release of policyholder reserves (which are not economically valued under US GAAP, the grandfathered accounting basis under IFRS 4). After allowing for VA guarantee fees earned in the period the cumulative impact of VA hedging activities for 2008 and 2009 is a small net operating loss of £7 million.

IFRS basis profit after tax

The total profit before disposal of Taiwan agency business was £1,367 million in 2009, significantly higher than for 2008 (loss of £451 million). The improvement reflects the increase in operating profit based on longer-term investment returns and the significantly more favourable short-term fluctuations in investment returns partially offset by a charge for the costs of hedging the Group's IGD capital surplus. The total profit before tax from continuing operations on the IFRS basis was £746 million in 2009, compared with a loss of £450 million for 2008.

In calculating the IFRS operating profit, we use longer-term investment return assumptions rather than actual investment returns arising in the year. The difference between actual investment returns recorded in the income statement and longer-term returns is shown in the analysis of profits as short-term fluctuations in investment returns.

IFRS Short-term fluctuations in investment returns

Short-term fluctuations in investment returns for our insurance operations of positive £166 million comprises £31 million for Asia, £27 million for US operations and £108 million in the UK.

The positive short-term fluctuations of £31 million for our Asian operations primarily reflect strong market performance in Taiwan and Japan partially offset by the impact of unrealised losses on the debt securities portfolio in Vietnam.

Note
See page 25.

IFRS basis profit after tax

	AER[8]	
	2009 £m	2008 £m
Operating profit based on longer-term investment returns	**1,405**	1,283
Short-term fluctuations in investment returns		
– Insurance operations	166	(1,408)
– IGD hedge costs	(235)	–
– Other operations	105	(313)
	36	(1,721)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	(74)	(13)
Profit (loss) before loss on sale and results of Taiwan agency business	1,367	(451)
Loss on sale and results of Taiwan agency business	(621)	1
Profit (loss) before tax from continuing operations attributable to shareholders	**746**	(450)
Tax (charge) credit attributable to shareholders' profit (loss)	(55)	59
Discontinued operations (net of tax)	(14)	–
Minority interests	(1)	(5)
Profit (loss) for the year attributable to equity holders of the Company	**676**	(396)

BUSINESS REVIEW

The positive short-term fluctuations of £27 million for our US operations comprise positive £385 million for market value movements on the free standing derivatives used to manage the fixed annuity and other general account business, negative £414 million in respect of debt securities, and positive £56 million of other items. The negative £414 million for debt securities reflects the levels of realised gains and losses (including write-downs) in excess of the allowance for longer-term defaults and amortisation of interest-related gains included in the operating result adjusted for associated deferred acquisition costs.

The positive short-term fluctuations of £108 million for our UK operations reflect principally value movements on the assets backing the capital of the shareholder-backed annuity business.

Short-term fluctuations for other operations, in addition to the previously discussed IGD hedge costs of £235 million, were £105 million positive, which includes £66 million for unrealised appreciation on Prudential Capital's debt securities portfolio and £28 million on swaps held centrally to manage Group assets and liabilities.

Sale of Taiwan agency business

On 20 February 2009 we announced our agreement to transfer the assets and liabilities of the agency distribution business in Taiwan, including the capital consuming in-force book, to China Life Insurance Limited (Taiwan). We completed the transaction on 19 June 2009 following regulatory approval being given on that day. The transfer has resulted in a one-off negative pre-tax impact of £621 million. After allowing for tax, and other adjustments, the effect on shareholders' equity was negative £607 million. The overall size of loss reflects the carrying value of the IFRS equity of the business as applied in the calculation of the loss on sale and the application of 'grandfathered' US GAAP under IFRS 4 for insurance assets and liabilities. US GAAP does not and is not designed to include the costs of holding economic capital to support the legacy interest rate guaranteed products, as recognised under the Company's supplementary reporting basis under European Embedded Value principles. The loss on sale reflects this element of the economic value. Separately, it is to be noted that under IFRS there is no recognition of the enhanced IGD capital surplus position arising on completion.

Effective tax rates

The effective rate of tax on operating profits, based on longer-term investment returns, was 23 per cent (2008: 23 per cent). The effective rate of tax at the total IFRS profit level for continuing operations was seven per cent (2008: 13 per cent) due to the ability to utilise losses carried forward for which we were previously unable to recognise a deferred tax asset in Jackson, partially offset by the absence of tax relief on the loss on the disposal of the Taiwan agency business.

Earnings and dividend per share

Earnings per share

	2009 p	2008 p
Basic EPS based on operating profit after tax and minority interest		
EEV	88.8	85.1
IFRS	43.4	39.9
Basic EPS based on total profit (loss) after minority interests		
EEV	49.8	(54.1)
IFRS	27.0	(16.0)

Dividend per share

The directors recommend a final dividend for 2009 of 13.56 pence per share payable on 27 May 2010 to shareholders on the register at the close of business on 9 April 2010. The interim dividend for 2009 was 6.29 pence per share. As a result, the total dividend for this year, including the interim dividend and the recommended final dividend, amounts to 19.85 pence per share compared with 18.90 pence per share for 2008, an increase of five per cent.

The Board will maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account our Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate. The 2009 IFRS operating earnings after tax and minorities cover the full year dividend 32.2 times (2008: 2.1 times).

Note
See page 25.

Movement on shareholders' funds

	EEV		IFRS	
	2009 £m	2008 AER* £m	2009 £m	2008 AER* £m
Operating profit based on longer-term investment returns	3,090	2,865	1,405	1,283
Items excluded from operating profit	(1,347)	(4,971)	(659)	(1,733)
Total profit (loss) before tax	1,743	(2,106)	746	(450)
Tax, discontinued operations and minority interest	(498)	768	(70)	54
Profit (loss) for the period	1,245	(1,338)	676	(396)
Exchange movements, net of related tax	(750)	2,129	(195)	510
Unrealised gains and losses on Jackson securities classified as available for sale[note 1]	–	–	1,043	(831)
Dividends	(481)	(453)	(481)	(453)
New share capital subscribed	141	170	141	170
Other	162	(152)	29	(4)
Net increase (decrease) in shareholders' funds	317	356	1,213	(1,004)
Shareholders' funds at beginning of year	14,956	14,600	5,058	6,062
Shareholders' funds at end of year	15,273	14,956	6,271	5,058
Comprising:				
Long-term business				
Free surplus[note 2]	2,065	447		
Required capital[note 3]	2,994	4,117		
Net worth[note 4]	5,059	4,564		
Value of in-force	10,283	9,958		
Total	15,342	14,522		
Other business[note 5]	(69)	434		
Total	15,273	14,956		

Notes
1 Net of related change to deferred acquisition costs and tax.
2 The increase in free surplus of £1.6 billion arises primarily from £0.9 billion being generated by the long-term businesses, and an increased of £1 billion from the disposal of Taiwan off-set by cash paid to the holding company and other items.
3 The reduction in required capital from £4,117 million at 31 December 2008 to £2,994 million at 31 December 2009, principally reflects the sale of the Taiwan agency business.
4 Net worth principally reflects the free surplus generated in the period, offset by cash paid to the holding company and other items.
5 Shareholders' funds for other than long-term business of negative £69 million comprises £1,659 million for asset management operations, including goodwill of £1,230 million, holding company net borrowings of £1,780 million and net other shareholders' funds of £52 million. The reduction in shareholders' funds for Other business from £434 million in 2008 to negative £69 million in 2009 primarily reflects the change in the mark-to-market value movement on core borrowings between the two balance sheet dates.
* See page 25.

EEV

On an EEV basis, which recognises the shareholders' interest in long-term business, shareholder funds at 31 December 2009 were £15.3 billion, an increase of £0.3 billion from the 2008 year-end level. This increased level of shareholders' funds reflects the profit after tax of £1.2 billion, the adverse effects of exchange movements of £0.7 billion and dividend payments of £0.5 billion, which are partially offset by new share capital subscribed of £0.1 billion and other movements of £0.2 billion.

The shareholders' funds at the end of 2009 relating to long-term business of £15.3 billion comprise £5.8 billion for our Asian long-term business operations, £4.1 billion for our US long-term business operations and £5.4 billion for our UK long-term business operations.

At 31 December 2009, the embedded value for our Asian long-term business operations was £5.8 billion. The embedded value for the established markets of Hong Kong, Singapore and Malaysia was £3.8 billion. There is also substantial embedded value in Indonesia (£584 million), Korea (£408 million), and Vietnam (£199 million).

For Prudential's other Asian markets, following the sale of the Taiwan agency business, the embedded value was £848 million in aggregate.

IFRS

Statutory IFRS basis shareholders' funds at 31 December 2009 were £6.3 billion. This compares to the £5.1 billion at 31 December 2008, an increase of £1.2 billion.

The movement reflects the profit for the year after tax of £0.7 billion, exchange translation losses, principally on Jackson, of £0.2 billion and dividend payments of £0.5 billion, the positive effect of a reduction in the level of net unrealised losses on Jackson's debt securities of £1.0 billion and other items of £0.2 billion.

In 2009 the net unrealised gains/losses within the statement of financial position value for debt securities classified as available-for-sale moved from a net unrealised loss of £2,897 million to a net unrealised gain of £4 million. After allowing for DAC and tax effects this reduction in the level of unrealised gains/losses has led to a £1.0 billion increase in shareholders' funds during the year. The reduction in unrealised gains/losses reflects the benefits of some normalisation in credit markets with spreads tightening.

Free surplus and holding company cash flow

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

	AER[8]	
	2009 £m	**2008** £m
Free surplus generation		
Expected in-force cash flows (including expected return on net assets)	1,914	1,623
Changes in operating assumptions and variances	175	(65)
Underlying free surplus generated in the period	2,089	1,558
Provisions for additional allowance for credit risk	–	(770)
Market related items	(198)	(689)
Investment in new business	(675)	(806)
Free surplus generated in the period from retained businesses	1,216	(707)
Effect of disposal and trading results of Taiwan agency business	987	(276)
Net cash remitted by the business units	(688)	(515)
Other movements and timing differences	157	442
Total movement during the period	1,672	(1,056)
Free surplus at 1 January	859	1,915
Free surplus at 31 December	2,531	859
Comprised of:		
Free surplus relating to long-term insurance business	2,065	447
Free surplus of other insurance business	37	–
IFRS net assets of asset management businesses excluding goodwill	429	412
Total free surplus	2,531	859

Free surplus generation

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

Group free surplus at the end of the period comprises free surplus for the insurance businesses, representing the excess of the net worth over the required capital included in the EEV results, and IFRS net assets for the asset management businesses excluding goodwill. The free surplus generated during the period comprises the movement in this balance excluding foreign exchange, capital movements, and other reserve movements. Specifically, it includes amounts maturing from the in-force operations during the period less the investment in new business, the effect of market movements and other one-off items.

For asset management operations we have defined free surplus generation to be total post tax IFRS profit for the period. Group free surplus generated also includes the general insurance commission earned during the period and excludes restructuring and shareholders' centrally arising other income and expenditure.

During 2009 we generated total free surplus from the retained businesses of £1,216 million (2008: negative £707 million). Underlying free surplus generated from the in-force book increased 34 per cent from £1,558 million in 2008 to £2,089 million in 2009, reflecting favourable exchange rates, the underlying growth of the portfolio, and positive changes in operating assumptions and variances of £175 million for our life businesses (2008: negative £65 million). These positive changes include £158 million arising in the UK (2008: £118 million) and £115 million arising in the US (2008: negative £1 million), consistent with management's on-going focus on capital preservation, and were offset by the negative changes in Asia of £98 million (2008: negative £182 million) principally arising from adopting higher required capital level assumptions in a number of businesses.

Underlying free surplus generated has been used by our life businesses to invest in new business. Investment in new business has fallen by £131 million to £675 million in 2009. This reduction reflects the Group's deliberate focus on conserving capital and is in part due to the substantially reduced levels of wholesale business sales in the UK and the US.

Market related movements have improved from negative £689 million in 2008 to negative £198 million in 2009. These improvements have been driven by higher equity returns in Asia, and improved market performance in the US, offset by the one-off profit in 2008 arising from the rebalancing of the credit portfolio in the UK not being repeated in 2009.

In June 2009 we completed the sale of the Taiwan agency business. As anticipated, this gave rise to an increase in free surplus of £987 million, representing the release of negative free surplus that previously applied. This compares to an increase in IGD capital of £800 million. The difference arises predominantly because the calibrations underpinning the capital requirements on a regulatory (IGD) basis are different from those applied on an economic capital (EEV) basis.

Overall, the Group wrote £2,896 million of sales on an APE basis in 2009 (2008: £2,879 million) generating a post-tax new business contribution to embedded value of £1,131 million (2008: £855 million). To support these sales, we invested £675 million of capital (2008: £806 million). We estimate the Group's internal rate of return for 2009 to be greater than 20 per cent. The amount of capital invested covers both new business strain, including commissions, of £224 million (2008: £334 million) and the required capital of £451 million (2008: £472 million). Management's focus in 2009 was on capital preservation and so capital investment was focused on those areas which added most value to the Group. Overall investment in new business has fallen as a result of this strategy but the amount of post-tax new business profit contribution to embedded value per £1 million of free surplus invested increased by 55 per cent to £1.7 million (2008: £1.1 million).

Note
See page 25.

Value created through investment in new business by life operations

	2009 Asia £m	2009 US £m	2009 UK £m	2009 Group £m	AER[8] 2008 Asia* £m	AER[8] 2008 US £m	AER[8] 2008 UK £m	AER[8] 2008 Group £m
Free surplus invested in new business	(246)	(326)	(103)	(675)	(224)	(289)	(293)	(806)
Increase in required capital	69	300	82	451	42	265	165	472
Net worth invested in new business	(177)	(26)	(21)	(224)	(182)	(24)	(128)	(334)
Value of in-force created by new business	710	458	187	1,355	650	214	325	1,189
Post tax new business profit for the year	533	432	166	1,131	468	190	197	855
Tax	180	232	64	476	166	103	76	345
Pre-tax new business profit for the year	713	664	230	1,607	634	293	273	1,200
New business sales (APE)	1,261	912	723		1,216	716	947	
New business margins (% APE)	57%	73%	32%		52%	41%	29%	
Internal rate of return†	>20%	>20%	>15%		>20%	18%	14%	

	CER[8] 2008 Asia* £m	CER[8] 2008 US £m	CER[8] 2008 UK £m	CER[8] 2008 Group £m
Free surplus invested in new business	(250)	(342)	(293)	(885)
Increase in required capital	47	313	165	525
Net worth invested in new business	(203)	(29)	(128)	(360)
Value of in-force created by new business	729	253	325	1,307
Post tax new business profit for the year	526	224	197	947
Tax	185	123	76	384
Pre-tax new business profit for the year	711	347	273	1,331
New business sales (APE)	1,350	846	947	
New business margins (% APE)	53%	41%	29%	
Internal rate of return†	>20%	18%	14%	

*2008 comparatives for Asia exclude amounts in respect of the sold Taiwan agency business.
†The internal rate of return is equivalent to the discount rate at which the present value of the post-tax cash flows expected to be earned over the lifetime of the business written in shareholder-backed life funds is equal to the total invested capital to support the writing of the business. The capital included in the calculation of the IRR is equal to the amount required to pay acquisition costs and set up statutory reserves less premiums received, plus encumbered capital. The impact of the time value of options and guarantees is included in the calculation.

In Asia, investment in new business was £246 million, which was flat compared to 2008 on a CER basis (£250 million). For each £1 million of free surplus invested we generated £2.2 million of post-tax new business contribution to embedded value (2008: £2.1 million). This increase arises predominantly from the benefit derived from a change in sales mix from the lower margin markets of Korea and India to higher margin territories in the region. The average free surplus undiscounted payback period for business written in the 12 months to 31 December 2009 was three years (12 months to 31 December 2008: four years).

In the US, investment in new business was £326 million, five per cent lower than 2008 on a CER basis (£342 million). For each £1 million of free surplus invested we generated £1.3 million of post-tax new business contribution to embedded value (2008: £0.7 million). This higher return reflects the Group's prioritisation of capital preservation which resulted in a change in business mix away from capital intensive wholesale products to sales of more profitable variable annuities, as well as an increase in spread margins due to Jackson's reduced crediting rates. The average free surplus undiscounted payback period for business written in the 12 months to 31 December 2009 was two years (12 months to 31 December 2008: five years).

In the UK, investment in new business decreased by 65 per cent from £293 million in 2008 to £103 million in 2009, and for each £1 million of free surplus invested we generated £1.6 million of post-tax new business contribution to embedded value (2008: £0.7 million). This reflects the UK's focus on capital preservation with an increase in with-profits bonds sales and minimal bulk annuity transactions in 2009 and its disciplined approach to individual annuity pricing. The average free surplus undiscounted payback period for business written in the 12 months to 31 December 2009 was five years (12 months to 31 December 2008: six years).

Note
See page 25.

Holding company cash flow

	2009 £m	2008 £m
Net cash remitted by business units:		
UK Life fund paid to Group	284	279
Shareholder-backed business:		
Other UK paid to Group	189	46
Group invested in UK	(39)	(126)
Total shareholder-backed business	150	(80)
UK net	434	199
US paid to Group	39	144
Group invested in US	–	–
US net	39	144
Asia paid to Group		
Long-term business	181	163
Other operations	46	234
	227	397
Group invested in Asia		
Long-term business	(101)	(310)
Other operations	(86)	(82)
	(187)	(392)
Asia net	40	5
M&G paid to Group	93	106
PruCap paid to Group	82	61
Net remittances to Group from Business Units	688	515
Net interest paid	(214)	(128)
Tax received	71	130
Corporate activities	(163)	(177)
Total central outflows	(306)	(175)
Operating holding company* cash flow before dividend	382	340
Dividend paid net of scrip and share options	(344)	(286)
Operating holding company* cash flow after dividend	38	54
Exceptional Items:		
Cash flow arising from sale of Taiwan agency business	(125)	–
IGD hedge costs†	(235)	–
Other cash movements		
Issue of hybrid debt, net of costs	822	–
Repayment of maturing debt	(249)	–
Receipts (payments) arising from foreign exchange movements on US$ hedging instruments	60	(352)
Total holding company cash flow	311	(298)
Cash and short-term investments at 1 January	1,165	1,456
Foreign exchange movements	10	7
Cash and short-term investments at 31 December	1,486	1,165

*Including central finance subsidiaries.
†Costs in respect of IGD hedge taken out in Q1 2009 to mitigate against further adverse movement in market indices from the lows experienced at that time.

Holding company cash flow

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient net remittances from the businesses to cover the progressive dividend (after corporate costs) and maximising value for shareholders through the reinvestment of the free surplus generated at business unit level in the particularly profitable opportunities available to the Group given its established position in key life insurance markets. On this basis, the holding company cash flow statement at an operating level should generally balance to close to zero before exceptional cash flows.

Operating holding company cash flow for 2009 before dividend was £382 million, £42 million higher than for 2008. After dividend, the operating holding company cash flow was £38 million, £16 million lower than 2008 reflecting the higher dividend paid in 2009 and a higher scrip take-up in 2008.

The holding company received £688 million net remittances from business units in 2009, (including £506 million which relates to long-term business operations) up from £515 million in 2008, with increased contributions from the UK and Asia businesses partly offset by lower remittances from the US operations. The UK shareholder-backed business was cash flow positive in 2009, one year ahead of our previously announced target.

We have flexibility available in our management of the holding company cash flow from and to the different business units. In 2009, we have utilised this flexibility to bring forward the cash emergence of the in-force value through the proactive use of financing techniques.

Capital invested in business units in 2009 was £226 million compared to £518 million for 2008. Injections into Asia and the UK were both down from 2008 levels, when higher injections into Asia were made to meet solvency requirements following market falls, and reflecting our disciplined approach to capital preservation in the UK.

Net interest paid in 2009 increased from £128 million to £214 million. £38 million of the increase was in respect of the two debt issues in 2009 and in addition interest received on central shareholders' funds fell by £48 million due to falling interest rates.

Tax received in 2009 was £71 million, down £59 million from 2008, due to lower UK taxable profits available for offset. Payments for corporate activities at £163 million were £14 million lower, mainly due to the non-recurrence of 2008 costs relating to the investigation of the potential reattribution of the inherited estate.

After corporate costs, there was a net cash inflow before dividend of £382 million in 2009 compared to £340 million for 2008. The dividend paid net of scrip, was £344 million in 2009 compared to £286 million in 2008. The take-up of scrip dividends in 2009 continued to be significant at £137 million (2008: £157 million).

As a consequence, overall, we reported a positive underlying cash inflow before exceptional items of £38 million in 2009. There were also two exceptional payments. We paid £125 million in connection with the sale of the Taiwan agency business to China Life Insurance Company Ltd of Taiwan, which comprised of £45 million to purchase a 9.99 per cent stake in that company and £80 million for transaction related expenditure including restructuring costs.

In the first quarter of 2009, we incurred one-off exceptional costs in relation to an IGD hedge taken out in 2009 to mitigate against further adverse movement in market indices from the lows experienced at that time, with the transaction being executed by Jackson where the specialist skills reside for the particular types of instruments utilised and we have injected £235 million of capital into Jackson.

When taken in aggregate with the subordinated and Tier 1 debt raising net of repayments undertaken during 2009, the overall Holding Company cash balances at 31 December 2009 increased by £0.3 billion to £1.5 billion (2008: £1.2 billion).

Balance sheet
Summary

	AER[8] 2009 £m	2008 £m
Investments	208,722	193,434
Holding company cash and short-term investments	1,486	1,165
Other	17,546	20,943
Total assets	227,754	215,542
Less: Liabilities		
Policyholder liabilities	186,398	173,977
Unallocated surplus of with-profits funds	10,019	8,414
	196,417	182,391
Less: shareholders' accrued interest in the long-term business	(9,002)	(9,898)
	187,415	172,493
Core structural borrowings of shareholders' financed operations (IFRS book value basis)	3,394	2,958
Other liabilities including minority interest	21,672	25,135
Total liabilities and minority interest	212,481	200,586
EEV basis net assets	15,273	14,956
Share capital and premium	1,970	1,965
IFRS basis shareholders' reserves	4,301	3,093
IFRS basis shareholders' equity	6,271	5,058
Additional EEV basis retained profit	9,002	9,898
EEV basis shareholders' equity (excluding minority interest)	15,273	14,956

The following sections focus on key areas of interest in the balance sheet.

Investments

	2009 £m				2008 £m
	Participating Funds	Unit-Linked and variable annuities	Shareholder-backed	Total Group	Total Group
Debt securities	47,327	8,848	45,576	101,751	95,224
Equity	29,962	38,620	772	69,354	62,122
Property investments	8,759	662	1,484	10,905	11,992
Commercial mortgage loans	145	–	4,489	4,634	5,473
Other loans	1,742	27	2,351	4,120	5,018
Deposits	9,638	746	2,436	12,820	7,294
Other investments	3,448	110	1,580	5,138	6,311
Total	101,021	49,013	58,688	208,722	193,434

Total investments held by the Group at 31 December 2009 were £208.7 billion, of which £101.0 billion were held by participating funds, £49.0 billion by unit-linked funds and £58.7 billion by shareholder-backed operations. Shareholders are not directly exposed to value movements on assets backing participating or unit-linked operations, with sensitivity mainly related to shareholder-backed operations.

Of the £58.7 billion investments related to shareholder-backed operations, £3.9 billion was held by Asia long-term business, £28.9 billion by Jackson and £22.8 billion by the UK long-term business respectively.

The investments held by the shareholder-backed operations are predominantly debt securities, totalling £2.5 billion, £22.8 billion and £19.0 billion for Asia, the US and the UK long-term business respectively, of which 79 per cent, 93 per cent and 95 per cent are rated, either externally or internally, as investment grade. Included within debt securities of shareholder-backed operations are Tier 1 and Tier 2 bank holdings of £3.6 billion, of which Tier 1 holdings of UK bank securities is £153 million, with exposure being wholly within the UK long-term business. Within Tier 2, our exposure to UK banks is £0.9 billion, with exposure being £0.7 billion, £0.1 billion, and £0.1 billion for the UK long-term business, the US and other operations respectively.

In addition £3.0 billion was held by asset management and other operations, of which £2.8 billion was managed by Prudential Capital, and a further £0.2 billion in central operations.

Note
See page 25.

Policyholder liabilities and unallocated surplus of with-profits funds

	Shareholder-backed business			
	Asia £m	US £m	UK £m	Total £m
At 1 January 2009	12,975	45,361	33,853	**92,189**
Premiums	2,984	9,177	3,596	**15,757**
Surrenders	(840)	(3,255)	(1,577)	**(5,672)**
Maturities/Deaths	(89)	(733)	(2,092)	**(2,914)**
Net cash flows	**2,055**	**5,189**	**(73)**	7,171
Investment related items and other movements	2,811	2,986	5,023	**10,820**
Disposal of Taiwan agency business	(3,508)	–	–	**(3,508)**
Assumption changes	(67)	–	(46)	**(113)**
Foreign exchange translation difference	(1,216)	(5,225)	(57)	**(6,498)**
At 31 December 2009	13,050	48,311	38,700	**100,061**
With-profits funds				
– Policyholder liabilities				**86,337**
– Unallocated surplus				**10,019**
Total at 31 December 2009				**96,356**
Total policyholder liabilities including unallocated surplus at 31 December 2009				**196,417**

Policyholder liabilities and unallocated surplus of with-profits funds

Policyholder liabilities related to shareholder-backed business grew by £ 7.9 billion from £ 92.2 billion at 31 December 2008 to £100.1 billion at 31 December 2009.

The increase reflects positive net cash flows (premiums less surrenders and maturities/deaths) of £7.2 billion in 2009, predominantly driven by strong inflows in the US (£5.2 billion) and Asia (£2.1 billion), as well as positive investment-related items of £10.8 billion, primarily reflecting the growth in global equity and bond markets during the year.

These increases were offset by foreign exchange movements of negative £6.5 billion, the disposal of the Taiwan agency business in June 2009 (negative impact of £3.5 billion) and a reduction in liabilities of £0.1 billion following assumptions changes primarily in Malaysia, namely £63 million relating to a consequential change in reserves following the adoption of a Risk-based Capital regime by the local regulator, (as previously highlighted), and the UK.

During 2009, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Group's with-profit funds on a statutory basis, increased from £8.4 billion at 31 December 2008 to £10.0 billion at 31 December 2009.

Shareholders' net borrowings and ratings

The Group's core structural borrowings at 31 December 2009 totalled £3.4 billion on an IFRS basis, compared with £3.0 billion at the end of 2008. In May 2009, senior debt of £0.3 billion was repaid on maturity and new hybrid debt of £0.4 billion was issued. In July 2009 a further £0.5 billion of new hybrid debt was issued. In addition there were exchange translation gains of £0.2 billion on foreign currency denominated borrowings in the period.

After adjusting for holding company cash and short-term investments of £1.5 billion, net core structural borrowings at 31 December 2009 were £1.9 billion compared with £1.8 billion at the end of 2008. The movement of £0.1 billion includes the gains of £0.2 billion mentioned above and the previously discussed positive cash flow of £38 million offset by the exceptional payments of £360 million.

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

In addition to our core structural borrowings set out above, we also have in place an unlimited global commercial paper programme. As at 31 December 2009, we had issued commercial paper under this programme totalling £409 million, US$1,976 million, and EUR 449 million. The central treasury function also manages our £5,000 million medium-term note (MTN) programme covering both core and non-core borrowings, under which the outstanding subordinated debt at 31 December 2009 was £835 million, US$750 million and EUR 520 million, while the senior debt outstanding was £200 million and US$12 million. In addition, our holding company has access to £1,600 million of committed revolving credit facilities, provided by 15 major international banks, and renewable between September 2011 and March 2012; and an annually renewable £500 million committed securities lending liquidity facility. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2009. The commercial paper programme, the MTN programme, the committed revolving credit facilities and the committed securities lending liquidity facility are all available for general corporate purposes and to support the liquidity needs of our holding company and are intended to maintain a strong and flexible funding capacity.

We manage the Group's core debt within a target level consistent with our current debt ratings. At 31 December 2009, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders' funds plus debt) was 11.1 per cent, compared with 10.7 per cent at 31 December 2008.

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

Shareholders' net borrowings and ratings

Shareholders' net borrowings at 31 December 2009:

	2009 £m			2008 £m		
	IFRS basis	Mark-to-market value	EEV basis	IFRS basis	Mark-to-market value	EEV basis
Perpetual subordinated						
Capital securities (Innovative Tier 1)	1,422	(71)	1,351	1,059	(546)	513
Subordinated notes (Lower Tier 2)	1,269	103	1,372	928	(191)	737
	2,691	32	2,723	1,987	(737)	1,250
Senior debt						
2009	–	–	–	249	–	249
2023	300	8	308	300	(12)	288
2029	249	(14)	235	249	(53)	196
Holding company total	3,240	26	3,266	2,785	(802)	1,983
Jackson surplus notes (Lower Tier 2)	154	4	158	173	(19)	154
Total	3,394	30	3,424	2,958	(821)	2,137
Less: Holding company cash and short-term investments	(1,486)	–	(1,486)	(1,165)	–	(1,165)
Net core structural borrowings of shareholder-financed operations	1,908	30	1,938	1,793	(821)	972

The financial strength of PAC is rated AA (negative outlook) by Standard & Poor's, Aa2 (negative outlook) by Moody's and AA+ (negative outlook) by Fitch.

Jackson National Life's financial strength is rated AA (negative outlook) by Standard & Poor's, A1 (negative outlook) by Moody's and AA (negative outlook) by Fitch.

Financial position on defined benefit pension schemes

The Group currently operates three defined benefit schemes in the UK, of which by far the largest is the Prudential Staff Pension Scheme (PSPS) and two smaller schemes, Scottish Amicable (SAPS) and M&G.

Defined benefit schemes in the UK are generally required to be subject to a full actuarial valuation every three years, in order to assess the appropriate level of funding for schemes in relation to their commitments. The valuations of PSPS as at 5 April 2008 and SAPS as at 31 March 2008 were finalised in the second quarter of 2009. The valuation of the M&G pension scheme as at 31 December 2008 was finalised in January 2010. The valuation of PSPS demonstrated the scheme to be 106 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. Accordingly, the total contributions to be made by the Group into the scheme, representing the annual accrual cost and deficit funding, has been reduced from the previous arrangement of £75 million per annum to £50 million per annum effective from July 2009.

The actuarial valuation of SAPS as at 31 March 2008 demonstrated the scheme to be 91 per cent funded, representing a deficit of £38 million. Based on this valuation, deficit funding amounts of £7.3 million per annum designed to eliminate the actuarial deficit over a seven year period are being made from July 2009.

The actuarial valuation of the M&G pension scheme as at 31 December 2008 demonstrated the scheme to be 76 per cent funded, representing a deficit of £51 million. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period are being made from January 2010 of £14.1 million per annum for the first two years and £9.3 million per annum for the subsequent three years.

The valuation basis under IAS 19 for the Group financial statements differs markedly from the full triennial actuarial valuation basis. For PSPS, the terms of the trust deed restrict shareholders' access to any underlying surplus in the scheme. Accordingly, under IAS 19, any underlying surplus is not recognised. The financial position for PSPS recorded reflects the higher of any underlying IAS 19 deficit and any obligation for deficit funding. At 31 December 2009, the Group has not recognised its interest in the underlying PSPS IAS 19 surplus of £433 million net of related tax relief and has instead recognised a deficit funding obligation of £63 million net of related tax relief. All amounts are based on the new funding arrangement described above. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the PAC with-profits fund and shareholder-backed operations.

As at 31 December 2009, on the Group IFRS statement of financial position, the shareholders' share of the liabilities for these UK schemes amounted to a £92 million liability net of related tax relief. The total share attributable to the PAC with-profits fund amounted to a liability of £110 million net of related tax relief.

Financial instruments

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

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