# INSURANCE OPERATIONS ASIA

**During the first half of 2010, Asian equity markets were adversely impacted by concerns over the global economy and the likelihood of a 'double-dip' recession. However there are few signs of any aggressive downgrading of growth forecasts in Asia as markets consider that the Asia growth story is far less dependent on the US than it has been in the past. The expectations for China's growth rates appear to suggest they will moderate rather than stall and hence this will not destabilise this region. Rapid inflation in India is a concern and the Indian central bank has responded by increasing interest rates four times so far this year.**

The region's life insurance sector has continued to recover well from the 2008/2009 downturn. During the first quarter 2010 most territories reported double digit growth in new business premiums compared to the same period in 2009. Local regulatory responses to the economic turmoil are in line with our expectations and we are seeing increased emphasis on measures to strengthen the industry. For example, in Korea the new Insurance Act includes new measures to protect customers from aggressive selling techniques and in Singapore MAS have proposed that insurers establish risk committees at the board level comprising a majority of non executive directors. In India, the IRDA has prepared draft guidelines for the IPO of insurance companies and these are expected to be discussed with the industry and Stock Exchange over the coming months.

### Strategy overview

Prudential's strategy in Asia remains firmly focused on expanding our distribution reach via tied agency and partnerships together with continuing to improve distributors' productivity. Our products provide financial solutions to customers that meet their long-term savings and protection needs while balancing capital efficiency and delivering excellent returns to shareholders. Although this strategy is designed to deliver growth rates that exceed the market over the long-term, we do not pursue headline growth for its own sake and so will not offer products that we believe have a high risk of adversely impacting shareholder value.

We are already successfully operating in the region's highest value markets, however we do continue to keep under review opportunities to expand into new territories.

### Financial performance

During the first half of 2010, Prudential Asia delivered excellent new business growth, continuing the trend seen in the first quarter this year. This demonstrates the continued strength of our businesses in Asia and we expect this strength to be reflected in an outperformance over market average growth in most countries. At £713 million, new business APE for the first half of the year is at a record high, exceeding the previous record of first half 2008 (£620 million) and 36 per cent ahead of the same period last year. This growth is broadly based with all operations, except Korea, having delivered double digit growth rates.

Agency remained the dominant distribution channel during the first half of 2010 generating 63 per cent of total APE (2009: 62 per cent) and Prudential's success in managing agency is reflected by average agent numbers (ex India) growing by 15 per cent to 153,000 agents compared to the first half last year and average APE per agent increasing by 11 per cent. Bank distribution has also performed very well with APE up 42 per cent over the same period last year. Prudential's new partnership with UOB has been particularly successful generating APE of £11 million already in Singapore and Thailand; Indonesia's start has been slower due to regulatory approvals for the partnership with UOB needing to be finalised.

Prudential's ongoing focus on higher margin regular premium business is reflected by its proportion of total APE remaining at 94 per cent, as it was in the first half of 2009. The proportion of linked business in the product mix for the first half this year is 42 per cent, marginally higher than 41 per cent for the same period last year. Although sales of health and protection products have increased by 31 per cent to £184 million APE, their proportion of the sales mix has declined marginally, from 27 per cent to 26 per cent reflecting their lower premium size relative to the savings and protection components. This consistency in delivering our product strategy is reflected by the stability of the EEV new business profit margins that at 56 per cent are marginally up on the same period last year (2009: 55 per cent). New business profits of £396 million are up 38 per cent on the same period last year demonstrating Prudential's success in delivering top line growth and, importantly, maintaining profitability discipline.

EEV operating profits of £636 million are up a very strong 59 per cent on the first half 2009 with significant drivers being the increased new business profits and increasing size of the in-force book and related profit. Following the adjustments made to persistency assumptions last year, this half year assumption changes are small at negative £14 million. Experience variances at negative £45 million are 25 per cent lower than the same period last year. The £45 million includes adverse persistency variances of negative £41 million and other experience variances, including expenses of negative £31 million being offset by positive claims variances of £28 million. Negative expense variances arise in the newer operations as these continue to build scale. Given the scale of EEV shareholder funds of the long-term business at £6.7 billion, these experience variances and assumption changes remain small.

IFRS operating profits of £262 million are up 24 per cent over the same period last year. Excluding the exceptional release of RBC related reserves in Malaysia last year, operating profits are up a significant 76 per cent. The largest contributor to IFRS profits for the first half this year was Indonesia, which grew by 67 per cent to £70 million.

Free surplus new business strain excluding Japan was £123 million and total free surplus generation of £198 million is up 90 per cent on the same period last year. In total the Asia Life operations remitted a net £81 million of cash to Group during the first half compared to £46 million last year, an increase of 76 per cent.

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 payback period of three years.

## Asia

| | AER[8] | | | CER[8] | |
|---|---|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Change % | Half year 2009 £m | Change % |
| APE sales (excluding Japan) | **713** | 524 | 36 | 555 | 28 |
| NBP (excluding Japan) | **396** | 286 | 38 | 303 | 31 |
| NBP margin (excluding Japan) (% APE) | **56%** | 55% | | 55% | |
| NBP margin (% PVNBP) | **11.9%** | 11.2% | | 11.3% | |
| Total EEV operating profit* | **636** | 401 | 59 | 418 | 52 |
| Total IFRS operating profit* | **262** | 212 | 24 | 224 | 17 |

*Operating profit from long-term operations excluding asset management operations, development costs and Asia regional head office expenses and including Japan.

Looking at developments in each of our major markets:

### *China*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | **27** | 21 | 21 |
| Percentage change | | 29% | 29% |

In China, Prudential's share of new business volumes for the first half of 2010, reflecting our 50 per cent ownership, is £27 million up 29 per cent on 2009 and represents our highest ever first half. CITIC Prudential remains one of the leading foreign joint ventures in China and operates in 31 cities.

CITIC Prudential is growing multi channel distribution in China; in the first half the mix of APE by distribution channel was approximately 50:50 agency and bancassurance. Competition for agents in China is high but although our number declined by 20 per cent in the first half 2010 compared to the same period last year, our focus on quality and productivity management is demonstrated by an increase of 48 per cent in average APE per agent. We work with a number of banks in China but the largest contributor to APE is CITIC Bank where we have increased by 19 per cent the number of branches we operate from 294 to a total of 350.

New business profit margins in China, at 44 per cent for the half year, are only marginally lower than last year (2009: 45 per cent).

### *Hong Kong*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | **130** | 95 | 92 |
| Percentage change | | 37% | 41% |

Hong Kong continues to perform very well with growth rates closer to an emerging market rather than those which might be expected from one of Asia's more mature economies. Prudential is well placed in Hong Kong as the market leading producer of agency business and the exclusive partner in a very successful bancassurance distribution agreement with Standard Chartered Bank.

First half 2010 APE of £130 million is up 37 per cent over the same period in 2009 with both agency and bank distribution performing very well. Average agent numbers for the first half 2010 were up 15 per cent and the average APE per agent was up 29 per cent. In the bank channel Financial Service Consultant headcount has remained broadly in line with last year with increased production being driven by higher conversion rates and higher average case sizes. Production from bank staff has increased significantly over last year.

New business profit margins in Hong Kong remain very strong at 72 per cent with the slight decline from 76 per cent for the first half last year resulting from a lower proportion of protection products in the mix as average premiums for the savings element of policies have increased.

### *India*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | **119** | 76 | 80 |
| Percentage change | | 57% | 49% |

In India, ICICI-Prudential has seen resurgence in new business volumes during the first half following on from the market related decline in 2009. The product mix in India continues to be predominately unit-linked based. The regulatory changes effective from this year designed to ensure customers treat investment linked insurance products as longer term financial solutions did not affect our performance because this has been the way we have consistently positioned these products.

Agency remains our dominant distribution channel in India and although the average number of agents has declined by 13 per cent to 227,000 agents as we actively manage out non performers, average APE per agent has increased by 55 per cent reflecting the success of productivity related initiatives. We continue to work with a number of bank partners in India that generated 27 per cent of total APE and we are also successfully expanding into the broker channel with APE generated from this channel up 200 per cent over the same period last year and contributing 20 per cent of total APE.

New business profit margins in India at 20 per cent for the first half have increased by one percentage point over the same period last year.

### *Indonesia*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | **129** | 83 | 98 |
| Percentage change | | 55% | 32% |

Growth in Indonesia continues at a fast pace with £129 million of new business APE up 55 per cent on the first half of 2009. Agency continues to be the predominant distribution channel and our successful agency management system has driven an 18 per cent increase in average agency numbers to 82,000 for the half year 2010 coupled with a 10 per cent increase in the average APE generated per agent. These results demonstrate that regulatory changes implemented this year to tighten agency licensing requirements in the industry have not impacted our business.

New business in Indonesia is mostly protection business and unit-linked, of which within unit-linked 22 per cent is takaful. New business profit margins in Indonesia remain very strong at 71 per cent, up from 61 per cent for the first half of last year.

### *Korea*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | **45** | 66 | 75 |
| Percentage change | | (32)% | (40)% |

As seen during 2009, the market in Korea remains very challenging and a key contributing factor to the 32 per cent decline in new business volumes over the first half 2009 to £45 million. The performance in the first half of 2010 continues to be informed by our unwillingness to compete in the low margin, high capital guaranteed products sector. Our average agent numbers in Korea have declined by 39 per cent compared to the first half 2009, but we continue to remain focussed on quality as reflected by a 11 per cent increase in average APE per agent. Although generating a small proportion of total APE (nine per cent for first half 2010), the bank channel had a stronger first half with APE up more than double over prior year with Citibank and SC First Bank generating the majority of the APE.

Persistency in Korea is on an improving trend, particularly during the first year of policies' lives, which is significantly higher than the equivalent cohort last year.

New business profit margins in Korea at 45 per cent have improved significantly over the 36 per cent reported last year as the proportion of linked business in the mix has increased from 71 per cent to 80 per cent.

### *Malaysia*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | **77** | 52 | 56 |
| Percentage change | | 48% | 38% |

Malaysia delivered an excellent first half with new business APE up 48 per cent over the first half last year. Agency is Prudential's major distribution channel in Malaysia and the success of our agency management is evidenced by average agent numbers being up 12 per cent over the same period last year and average APE per agent being up 25 per cent. Malaysia remains an exemplary operation in terms of packaging higher margin protection components with core savings policies and in 2010 we also launched a very popular new par product that generated 20 per cent of new business APE during the period.

### *Singapore*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | 75 | 52 | 54 |
| Percentage change | | 44% | 39% |

Singapore also had an exceptionally strong first half in 2010, with new business volumes up 44 per cent to £75 million. Agency generated 73 per cent of APE during the first half and although average agent numbers only increased by a modest four per cent, productivity initiatives boosted average APE per agent by 31 per cent. APE from partnership distribution increased by 66 per cent, supported by the new relationship with UOB bank that got underway in the first quarter and is exceeding our performance expectations. To date sales from UOB have been predominantly from bank staff as we are early in the process of embedding our Financial Service Consultants.

During the first half, protection business still remains popular in Singapore and represented 29 per cent of the total APE, and the proportion of linked business increased to 25 per cent, up from 19 per cent for the same period last year.

### *Taiwan*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | 70 | 51 | 52 |
| Percentage change | | 37% | 35% |

Following our exit from the agency channel in 2009, Taiwan is now successfully focussed on bank distribution principally with partners E.Sun Bank and Standard Chartered Bank. New business volumes of £70 million for the first half 2010 are up 37 per cent on the same period last year. E.Sun Bank has delivered a particularly material increase in activity from both the Financial Service Consultants and bank staff.

We have increased the proportion of protection business in the product mix from 12 per cent to 16 per cent and this has supported an increase in average new business profit margins of four percentage points from 15 per cent to 19 per cent.

### *Others – Philippines, Thailand and Vietnam*

| | AER[8] | | CER[8] |
|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Half year 2009 £m |
| APE sales | 41 | 27 | 27 |
| Percentage change | | 52% | 52% |

In the first half Vietnam delivered a solid result with APE sales up 20 per cent on the prior period. Both Philippines and Thailand have had record first halves with growth of 150 per cent and 63 per cent respectively. In the Philippines agent numbers have increased by 30 per cent and a new bancassurance initiative with HSBC contributed 17 per cent of total APE in the first half. In Thailand our new relationship with UOB got off to a very encouraging start and generated 38 per cent of new business.

### *Japan*

We announced at the start of 2010 that PCA Life Japan was suspending writing new business sales with effect from 15 February 2010. Sales for Japan in the first half of 2010 amounted to £7 million (first half 2009: £29 million). In order to reflect the results of our ongoing Asian operations, APE sales and NBP metrics included in this report exclude the contribution from Japan.

# INSURANCE OPERATIONS UNITED STATES

**The United States is the world's largest retirement savings market. Each year as more of the 78 million baby boomers[1] reach retirement age, additional amounts of retirement assets will shift from asset accumulation to income distribution. There are already $2 trillion of assets generating retirement income in the US – and this amount is forecast to rise to some $7.3 trillion by 2029[2].**

During the first half of 2010, the US financial services industry continued to face many challenges. The continued recovery witnessed in the first quarter - the S&P 500 index increased five per cent, interest rates remained relatively steady and AA corporate spreads and volatility declined somewhat from year-end 2009 levels – was reversed in the second quarter – the S&P 500 index ended the first half of the year down 7.6 per cent, 10-year Treasury rates dropped below three per cent, swap rates declined to approximate historic lows, AA corporate spreads increased slightly and volatility increased to levels more consistent with the end of the first half of 2009.

These unstable market conditions continue to provide a competitive advantage to companies with strong financial strength ratings and a relatively consistent product set. Companies that were hardest hit by the market disruption over the past 24 months are still struggling to regain market share as customers are increasingly seeking product providers that offer consistency, stability and financial strength. Jackson has continued to benefit significantly from this flight to quality. Through its financial stability and innovative products that provide clear value to the consumer, Jackson has established a reputation as a high-quality and reliable business partner, with sales increasing as more advisers have recognised the benefits of working with Jackson.

Jackson's strategy remains focused on increasing volumes in variable annuities whilst managing fixed annuity sales in line with the goal of capital preservation. There were no institutional sales during the first half of 2010, as we directed available capital to support higher-margin variable annuity sales.

## Financial performance

Jackson delivered total APE sales of £560 million in the first half of 2010, representing a 43 per cent increase over the same period of 2009. APE retail sales in the first half of 2010 were also £560 million, the highest half-year total in the company's history. This achievement continues to demonstrate the resilience of Jackson's business model, as well as high-quality products, exceptional wholesaling support and consistency demonstrated throughout the economic downturn.

In light of continued volatility in US equity markets, and historically low interest rates, customers are increasingly seeking to mitigate equity risk while receiving an acceptable return through the purchase of fixed index annuities and variable annuities with guaranteed living benefits. Jackson is a beneficiary of this trend.

Variable annuity APE sales of £447 million through June 2010 were up 77 per cent from the same period of 2009, with second quarter APE sales of £246 million, up 22 per cent on the first quarter, despite an environment in which equity markets declined 13 per cent in May and June. In the first quarter of 2010, Jackson ranked fourth in new variable annuity sales in the US with a market share of 10 per cent, up from eighth and a market share of five per cent in the first quarter of 2009[3]. With significant sales increases and continued low surrender rates, Jackson also ranked first in variable annuity net flows in the first quarter of 2010, up from fifth in the first quarter of 2009[4].

Fixed annuity APE sales of £42 million were down 40 per cent from the prior year, as consumer demand for the products fell due to the low interest rate environment. Jackson's new business opportunities were balanced with the goals of capital and cash conservation. Jackson ranked ninth in sales of traditional deferred fixed annuities during the first quarter of 2010, with a market share of three per cent[5].

Fixed index annuity (FIA) APE sales of £60 million in the first half of 2010 were up three per cent over the first half of 2009. Industry FIA sales have benefited from an increase in customer demand for products with guaranteed rates of return, coupled with additional upside potential linked to stock market index performance. Additionally, Jackson's FIA sales have benefited from the company's strong financial strength ratings and disruptions among some of the top FIA sellers. Jackson ranked fourth in sales of fixed index annuities during the first quarter of 2010, with a market share of 6.9 per cent, up from sixth and a market share of five per cent in the first quarter of 2009[6].

Retail annuity net flows increased 93 per cent, reflecting the benefit of record sales and continued low levels of surrender activity.

Jackson has maintained the same financial strength ratings for more than seven years and, during 2009 and 2010, all four of the major rating agencies affirmed Jackson's financial strength ratings.

Jackson achieved extraordinary EEV new business margins in 2009, partially as a result of our ability to take advantage of extreme dislocation in the corporate bond market. While the recovery in the corporate bond market has led to somewhat lower EEV new business margins due to lower spreads in 2010, we continue to write new business at internal rates of return in excess of 20 per cent, with a payback period of two years.

The abnormally high spread assumptions in 2009 included a provision that crediting rates and spreads would normalise in the future.

EEV basis new business profits of £361 million were up 24 per cent on the first half of 2009, reflecting a 43 per cent increase in APE sales offset somewhat by lower new business margins. Total new business margin was 64 per cent, compared to 74 per cent achieved in the first half of 2009.

Notes
1 Source: US Census Bureau
2 Source: Tiburon Strategic Advisers, LLC
3 Source: VARDS
4 Source: Morning Star
5 Source: LIMRA
6 Source: The Advantage Group

## United States

| | Half year 2010 £m | AER[8] Half year 2009 £m | AER[8] Change % | CER[8] Half year 2009 £m | CER[8] Change % |
|---|---|---|---|---|---|
| APE sales | 560 | 392 | 43 | 383 | 46 |
| NBP | 361 | 292 | 24 | 286 | 26 |
| NBP margin (% APE) | 64% | 74% | | 74% | |
| NBP margin (% PVNBP) | 6.5% | 7.5% | | 7.5% | |
| Total EEV operating profit* | 667 | 501 | 33 | 490 | 36 |
| Total IFRS operating profit* | 450 | 217 | 107 | 212 | 112 |

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

The variable annuity new business margin of 71 per cent in the first half of 2010 held steady with the same period in 2009, as lower spreads on the guaranteed funds were offset by an increase in the take-up rate on guaranteed benefits – particularly guaranteed minimum withdrawal benefits.

The fixed index annuity new business margin decreased from 85 per cent in the first half of 2009 to 45 per cent in the first half of 2010 due to decreased spread assumptions and an increase in the discount rate for short-term credit risk. These factors also caused the fixed annuity new business margin to normalise from 77 per cent to 31 per cent. For both products, the spread assumptions decreased due primarily to abnormally high investment yields during the first half of 2009.

Total EEV basis operating profit for the long-term business in the first half of 2010 was £667 million, compared to £501 million in the first half of 2009. In-force EEV profits of £306 million for the first half of 2010 were 46 per cent higher than the first half 2009 profit of £209 million. Experience variances and other items were £42 million higher in the first half of 2010 due primarily to favourable spread and persistency variances that were partially offset by lower expense and mortality variances.

In the first half of 2010, Jackson invested £179 million of free surplus to write £560 million of new business, which equated on average to £32 million per £100 million of APE sales (2009: £43 million). The reduction in capital consumption year-on-year was caused predominantly by the differing business mix in the first half of 2010, when Jackson wrote a higher proportion of variable annuity business while maintaining a very disciplined approach to fixed and fixed index annuity pricing.

IFRS pre-tax operating profit for the long-term business[1] was £450 million in the first half of 2010, more than double the £217 million in the first half of 2009. This increase was primarily due to higher separate account fee income as the equity markets rallied throughout the second half of 2009 and first quarter of 2010, higher spread income and a £123 million benefit from net equity hedging gains. Jackson hedges the product economics rather than the accounting results and higher hedge gains were primarily a result of market movements during the first half of 2010 (S&P 500 down 7.6 per cent in first half 2010, up 1.8 per cent in first half 2009) and the accounting differences that arise as the liabilities for certain guaranteed minimum death and withdrawal benefits are not marked to fair value similarly to the hedging instrument. Hedging results also benefited from Jackson's separate accounts outperforming the overall market. Jackson's separate accounts historically outperform in down markets and lag somewhat in rising markets given the mix of assets in our underlying portfolios.

At 30 June 2010, Jackson had £24 billion in separate account assets. Separate account assets averaged £9 billion higher than during the same period of 2009, reflecting the impact of sales and the improved market performance during the second half of 2009. This increase, combined with the increasing take-up rate on VA guaranteed benefits, resulted in VA fee income of £342 million during the first half of 2010, up 68 per cent over the £204 million during the first half of 2009.

With the improvement in the bond and equity markets throughout the second half of 2009 and first half of 2010, and active management of the investment portfolio to reduce certain investment risks in 2010, Jackson had net realised gains of £8 million in the first half of 2010 compared to net realised losses of £291 million in the first half of 2009. Jackson incurred losses, net of recoveries and reversals, on credit related sales of bonds of £97 million (2009:£42 million). Write downs were £64 million (£324 million in first half of 2009), including £39 million on RMBS and £25 million on ABS. More than offsetting these losses were interest related gains of £169 million (2009: £75 million), primarily due to sales of lower rated CMBS and corporate debt.

Gross unrealised losses improved from £966 million at 31 December 2009 to £521 million at 30 June 2010. The net unrealised gain position has also improved significantly, from £4 million at 31 December 2009 to £1,171 million at 30 June 2010 due primarily to a 91bp decline in the US Treasury rates offset somewhat by slightly higher AA corporate spreads.

**Note**

1 Jackson IFRS operating profit of £450 million includes £123 million of net equity hedging gains (2009: £23 million losses) representing the movement in fair value of free standing derivatives included in operating profit and the movement in the accounting value of guarantees in Jackson's variable and fixed index annuity products, a significant proportion of which are not fair valued, net of related DAC. Excluding these amounts, which are variable in nature, Jackson IFRS operating profit increased by 36 per cent as compared to half year 2009.

# INSURANCE OPERATIONS UNITED KINGDOM

**Prudential UK continues to focus on balancing writing new business with sustainable cash generation and capital preservation. By competing selectively in the UK's retirement savings and income markets, it has successfully generated attractive returns on capital employed.**

The business remains a market leader in both individual annuities and with-profits and has a unique combination of competitive advantages including longevity experience, multi-asset investment capabilities, strong brand and financial strength.

### Financial performance

Total APE sales for the first half of 2010 of £382 million were two per cent up on 2009. This performance is entirely consistent with Prudential UK's strategy of not pursuing top-line sales growth as a business objective but instead deploying capital to opportunities that play to the core strengths of the business, which has enabled it to continue writing profitable new business while maintaining margins.

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 Prudential UK was in excess of 15 per cent.

Prudential UK has a strong individual annuity business, built on a robust profit flow from its internal vestings pipeline from maturing individual and corporate pension policies. This strong flow of business is supplemented by strategic partnerships with third parties where Prudential is the recommended annuity provider for customers vesting their pensions at retirement.

During the first half of 2010, Prudential UK continued to actively manage sales volumes to control capital consumption. Total individual annuity sales of APE £112 million were two per cent lower than the first half of 2009. With-profits sales for the half-year were 22 per cent of total annuity sales, compared with 14 per cent for the corresponding period last year, due to the success of the innovative new Income Choice Annuity launched in March 2009.

Internal vestings were 12 per cent down on 2009, principally due to lower asset values in the first quarter and the proportion of customers vesting with Prudential UK being lower than in the first half of 2009.

Onshore bond sales of APE £69 million were down nine per cent, including with-profits bond sales of APE £60 million which were 15 per cent down on the first half of 2009. PruFund made up 77 per cent of total with-profits bonds, with sales continuing to be driven by customer demand for products offering a smoothed investment return and optional guarantees. Unit-linked bond sales at APE £9 million were £4 million (71 per cent) above the first half of 2009, helped by the launch of Pru Dynamic funds in January 2010.

Within corporate pensions, Prudential UK continues to focus principally on the opportunities from Additional Voluntary Contribution (AVC) arrangements to the public sector as well as opportunities from the substantial existing Defined Contribution book of business. Prudential administers corporate pensions for over 600,000 members. Prudential UK has been the sole AVC provider to Teachers Pensions for 20 years and provides AVCs to 65 of the 99 Local Government Authorities in England and Wales. For the first half of 2010, corporate pension sales of APE £122 million were six per cent above 2009 and growth into existing schemes has remained healthy.

Sales of other products at APE £78 million were 11 per cent higher than in the first half of 2009. Individual pension sales of £41 million (including income drawdown) were 12 per cent up on the first half of 2009. Sales of the Flexible Retirement Plan, Prudential UK's individual pension product with customer-agreed remuneration, grew by 20 per cent to £12 million. Sales have been helped by PruFund Cautious, launched in the fourth quarter of 2009, and the new Pru Dynamic portfolio funds launched in January 2010, which together made up 29 per cent of individual pension sales. Sales of the income drawdown product of APE £7 million were up 41 per cent on the same period last year, reflecting Prudential UK's strong proposition with the option of guarantees either through PruFund or traditional with-profits.

Prudential UK announced its exit from the equity release market in the last quarter of 2009 due to the capital-intensive nature of the product and long pay-back period. Sales of APE £5 million were broadly in line with 2009, driven from the pipeline of business in progress and additional drawdowns on the in-force book. Existing customers are not impacted in any way by the closure to new business.

The PruHealth joint venture uses the Prudential brand and Discovery's expertise to build branded distribution in Health and Protection. In August 2010, Discovery announced the completion of the acquisition of Standard Life Healthcare and its combination with the PruHealth business. This acquisition was fully funded by Discovery and as a result, Prudential reduced its shareholding in the combined business from 50 per cent to 25 per cent with effect from 1 August 2010, the date of the acquisition. PruHealth currently has 220,000 lives insured, an increase of five per cent over the last year. PruProtect sales at APE £11 million were £5 million (98 per cent) up on the first half of 2009, supported by the launch of the 'Essential' Plan in November 2009.

## United Kingdom

| | AER[8] | | | CER[8] | |
|---|---|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Change % | Half year 2009 £m | Change % |
| APE sales | 382 | 376 | 2 | 376 | 2 |
| NBP | 135 | 122 | 11 | 122 | 11 |
| NBP margin (% APE) | 35% | 32% | | 32% | |
| NBP margin (% PVNBP) | 4.4% | 4.0% | | 4.0% | |
| Total EEV operating profit | 472 | 433 | 9 | 433 | 9 |
| Total IFRS operating profit | 330 | 330 | – | 330 | – |

Prudential UK has maintained a strict focus on value in the bulk annuity and back-book markets. In the first half of 2010, Prudential UK did not write any new business in this market reflecting its disciplined approach of only participating in transactions that meet its strict return on capital requirements.

EEV new business profit increased by 11 per cent to £135 million in the first half of 2010 from £122 million in 2009, reflecting an increase in new business margin to 35 per cent from 32 per cent. This was primarily due to increased margins on with-profits bond business together with strong margins achieved on shareholder-backed annuity business.

EEV basis total operating profit based on longer-term investment returns of £472 million (including £23 million of general insurance commission), was up nine per cent compared with the first half of 2009. This was mainly the result of the in-force operating profit (at £314 million) being up 11 per cent on the first half of 2009. The increase in in-force operating profit was principally within the shareholder-backed annuity business.

Prudential UK continues to manage actively the retention of the in-force book. During the first half of 2010, experience at an aggregate level has been in line with long-term assumptions.

The average free surplus undiscounted payback period for business written in the first half of 2010 was five years.

Total IFRS operating profit remained stable in 2010 at £330 million. Non-long term business IFRS profit reflected a profit of £23 million from general insurance commission, 15 per cent below 2009 due to lower in-force policy numbers as the business matures.

Prudential UK has continued to make good progress against its cost reduction plans. As previously announced, the first phase of the programme delivered savings of £115 million per annum, with a further £80 million per annum expected to be delivered by the end of 2010. By 30 June 2010, the total annual cost savings target of £195 million per annum savings had been delivered, which was earlier than originally planned.

### Financial strength of the UK Long-term Fund

On a realistic valuation basis, with liabilities recorded on a market consistent basis, the free assets were valued at approximately £5.9 billion at 30 June 2010, before a deduction for the risk capital margin. The value of the shareholder's interest in future transfers from the UK with-profits fund is estimated at £2.2 billion. The financial strength of PAC is rated AA (negative watch) by Standard & Poor's, Aa2 (negative outlook) by Moody's and AA+ (negative watch) by Fitch Ratings.

Despite continued volatility in financial markets, the with-profits sub-fund performed relatively strongly with the with-profits life fund achieving a 2.6 per cent investment return in the first half of the year.

### Inherited estate of Prudential Assurance

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

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

# ASSET MANAGEMENT M&G

## Global

**The Group's asset management businesses provide value to the insurance businesses within the Group by delivering sustained superior performance. They are also important profit generators in their own right, having low capital requirements and generating significant cash flow for the Group.**

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

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

Each business and its performance in 2010 is summarised below.

### M&G

M&G is our UK and European fund manager, responsible for £178 billion of investments as at 30 June 2010 on behalf of both internal and external clients. M&G is an investment-led business which aims to deliver superior investment performance and maximise risk-adjusted returns in a variety of macro-economic environments. Through M&G we seek to add value to our Group by generating attractive returns on internal funds as well as growing profits from the management of third-party assets.

External funds now represent 42 per cent of M&G's total funds under management (FUM). M&G's overall strategy is to focus first and foremost on investment performance, by recruiting, developing and retaining market-leading investment talent, and by creating the environment and infrastructure this talent needs to perform to its full potential.

In the retail market, M&G's strategy is to maximise the value of a centralised investment function through a multi-channel, multi-geography distribution approach. Key themes in recent years have included growing the proportion of business sourced from intermediated channels and increased sales of UK-based funds in European and other international markets.

M&G's institutional strategy centres on leveraging capabilities developed primarily for internal funds into higher-margin external business opportunities. In recent years this has allowed M&G to operate at the forefront of a number of specialist fixed income strategies, including leveraged finance and infrastructure investment.

### *Financial performance*

Profits at the operating level for the first half rose to £122 million, a 63 per cent increase compared with the same period in 2009. This is a record level of interim profits for M&G and reflects primarily higher equity market levels. A continuation of exceptionally strong net inflows, particularly in the Retail Business, and increased sales of more profitable equity products also contributed to the rise.

The Retail Business in the UK and Europe continued to attract exceptional levels of new money. Net inflows, including South Africa, totalled £3.4 billion for the first six months of the year. Although this was lower than the £4.1 billion gathered during the same period in 2009, it is far higher than we anticipated at the start of the year.

We had expected inflows to return to more normal levels this year after a record 2009 for M&G, when clients invested heavily in its top-performing bond funds to exploit a near unique opportunity in fixed income markets. However, retail fund flows have continued to be exceptional and are now spread across a wider range of funds. In the UK market M&G has now been the top net seller of retail funds for six consecutive quarters.

Much of this is due to excellent investment performance. Over the three years ending 30 June 2010, 34 per cent of M&G's retail funds ranked in the top quartile and 66 per cent of funds in the top half. The consistency and excellence of its performance resulted in M&G being recently awarded the prestigious Global Group of the Year 2010 nomination by *Investment Week*. This is the second time in three years that M&G has received this award.

## M&G

| | Half year 2010 £m | AER[8] Half year 2009 £m | AER[8] Change % | CER[8] Half year 2009 £m | CER[8] Change % |
|---|---|---|---|---|---|
| Net investment flows | 4,674 | 8,625 | (46) | 8,625 | (46) |
| Revenue | 298 | 195 | 53 | 195 | 53 |
| Other income | 1 | 7 | (86) | 7 | (86) |
| Staff costs | (122) | (85) | 44 | (85) | 44 |
| Other costs | (58) | (42) | 38 | (42) | 38 |
| Underlying profit before performance-related fees | 119 | 75 | 59 | 75 | 59 |
| Performance-related fees | 3 | – | | – | |
| Operating profit from asset management operations | 122 | 75 | 63 | 75 | 63 |
| Operating profit from Prudential Capital | 21 | 27 | (22) | 27 | (22) |
| Total IFRS operating profit | 143 | 102 | 40 | 102 | 40 |
| Funds under management | 178bn | 149bn | 19 | 149bn | 19 |

The Institutional Business also attracted strong new business with net inflows at £1.3 billion for the first half of 2010, including £1.1 billion of new money into public debt funds and a new £0.1 billion into the Private Finance business. This compares with net inflows of £4.6 billion for the same period last year, although this was flattered by a single fixed income mandate for £4 billion. Investment performance on the Institutional side continues to be particularly strong with 95 per cent of our external mandates at or above benchmark over the three years to 30 June 2010.

Net new business at the group level for the first half of 2010 remained strong at £4.7 billion. This was in line with net inflows for the same period last year, once the single institutional fixed income mandate of £4 billion is excluded from the comparator figure.

M&G's total funds under management at 30 June 2010 were £178.5 billion, up two per cent on the 2009 year-end and up 19 per cent on the first half of 2009. Total external funds under management at 30 June 2010 were £75.7 billion, a rise of eight per cent since the start of the year and of 35 per cent compared with 30 June 2009. The increase in external funds in the first half represents the combined result of market and other movements of £0.7 billion and net flows of £4.7 billion.

M&G continues to provide capital efficient profits and cash generation for the Prudential Group, as well as strong investment returns on our long-term business funds. Cash remittances of £80 million to date in 2010 to Group provided strong support for the Group's corporate objectives.

### *Relative performance*

In its core UK retail market, M&G continues to outsell all of its competitors. Based on the Investment Management Association (IMA) UK retail numbers to the end of June 2010 M&G had a 10 per cent market share in gross retail inflows and a 19 per cent market share in net retail inflows. In consequence, M&G's retail assets under management have grown 13 per cent in the six months to the end of June compared with four per cent growth for the market as a whole, according to the IMA.

## Prudential Capital

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

The business has consolidated its position in a period of difficult and volatile markets, focusing on liquidity across the Prudential Group, management of existing asset portfolio and conservative levels of new investment. Development of new product and infrastructure has continued, helping to maintain the dynamism and flexibility necessary to identify and realise opportunities for profit within acceptable risk parameters. Prudential Capital is committed to working closely with other business units across the Prudential Group to exploit opportunities and increase value creation for Prudential as a whole. In particular, Prudential Capital offers to the Prudential Group a holistic view on hedging strategy, liquidity and capital management.

Prudential Capital has a diversified earnings base derived from its portfolio of secured loans, debt investments and the provision of wholesale markets services. As a result of lower operating revenue and prevailing market conditions, IFRS operating profits decreased by 22 per cent to £21 million, however, PruCap still delivered a cash remittance to the Group holding company of £50 million.

## Asia Asset Management

| | AER[8] | | | CER[8] | |
|---|---|---|---|---|---|
| | Half year 2010 £m | Half year 2009 £m | Change % | Half year 2009 £m | Change % |
| Third-party net inflows | **(298)** | 1,456 | (120) | 1,565 | (119) |
| Funds under management | **46.1bn** | 35.8 bn | 29 | 41.0 bn | 12 |
| Total IFRS operating profit | **36** | 21 | 71 | 21 | 71 |

The net retail outflows for the first half were driven by substantial outflows from money market funds in India with corporate clients bolstering their cash positions ahead of the 3G telecom licence auction, the need for banks to hold more cash as result of reserve ratio changes implemented by the Reserve Bank of India and a surge in primary debt issuance. These net outflows masked what was otherwise a successful first half of 2010 with net inflows to non money market funds of £1,327 million of which £753 million was to higher margin equity funds.

Total funds under management (FUM) for the first half of 2010, at £46.1 billion, were 29 per cent higher than the same period last year. The overall FUM level is comprised of £21.6 billion from Prudential's Asian life funds, £4.2 billion assets from the rest of the Group, and £20.3 billion from third parties.

IFRS operating profits of £36 million for the first half 2010 are up 71 per cent on the same period last year principally on higher revenues.

## US Asset Management

| PPM America | AER[8] Half year 2010 £m | AER[8] Half year 2009 £m | AER[8] Change % | CER[8] Half year 2009 £m | CER[8] Change % |
|---|---|---|---|---|---|
| Total IFRS operating profit | 8 | 3 | 167 | 3 | 167 |

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

### *Financial performance*

IFRS operating profit in the first half of 2010 was £8 million, compared to £3 million in the same period of 2009.

At 30 June 2010, funds under management of £54 billion were as follows:

| | Half year 2010 US £bn | UK £bn | Asia £bn | Total £bn |
|---|---|---|---|---|
| Insurance | 33 | 15 | – | 48 |
| Unitised | – | 1 | 4 | 5 |
| CDOs | 1 | – | – | 1 |
| Total funds under management | 34 | 16 | 4 | 54 |

| | AER[8] Half year 2009 US £bn | UK £bn | Asia £bn | Total £bn |
|---|---|---|---|---|
| Insurance | 26 | 10 | – | 36 |
| Unitised | – | 1 | 3 | 4 |
| CDOs | 1 | – | – | 1 |
| Total funds under management | 27 | 11 | 3 | 41 |

## US broker-dealer

| Broker-dealer | AER[8] Half year 2010 £m | AER[8] Half year 2009 £m | AER[8] Change % | CER[8] Half year 2009 £m | CER[8] Change % |
|---|---|---|---|---|---|
| Revenue | 224 | 191 | 17 | 187 | 20 |
| Costs | (219) | (189) | 16 | (185) | 18 |
| Total IFRS operating profit | 5 | 2 | 150 | 2 | 150 |

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

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

### *Financial performance*

NPH generated revenues of £224 million during the first half of the year, up from £191 million in the same period of 2009, on gross product sales of £4.7 billion. The network continues to achieve profitable results, with IFRS operating profit through 30 June 2010 of £5 million, a 150 per cent increase from £2 million in the first half of 2009. At 30 June 2010, the NPH network had 3,455 registered advisers, down slightly from 3,478 at year-end 2009.

## Curian

| Curian | AER[8] Half year 2010 £m | AER[8] Half year 2009 £m | AER[8] Change % | CER[8] Half year 2009 £m | CER[8] Change % |
|---|---|---|---|---|---|
| Gross investment flows | 669 | 270 | 148 | 264 | 153 |
| Revenue | 20 | 14 | 43 | 14 | 43 |
| Costs | (18) | (17) | 6 | (17) | 6 |
| Total IFRS operating profit/(loss) | 2 | (3) | 167 | (3) | 167 |

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

***Financial performance***

At 30 June 2010, Curian had total assets under management of £2.8 billion, compared to £2.3 billion at the end of 2009 and £1.6 billion at 30 June 2009. Curian generated deposits of £669 million through June 2010, up 148 per cent over the same period in 2009. The increase in both deposits and assets under management was mainly due to a rebound from the difficult conditions in the equity markets in early 2009.

With Curian's assets under management surpassing its break-even point in early 2010, Curian reported its first half-yearly IFRS basis operating profit during the first half of 2010, with a net profit of £2 million versus a loss of £3 million during the first half of 2009.