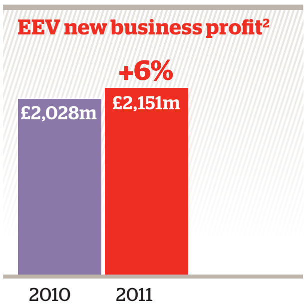
Chief Financial Officer's overview

Nic Nicandrou
Chief Financial Officer

'The continued growth in the profits of our Asian life insurance business was one of the highlights of our 2011 results, as Asia passed an important milestone becoming the largest contributor[1] to Group IFRS operating profit.'

2011 was a productive year for Prudential during which we delivered strong performance across all of our key metrics and made clear progress towards our 2013 'Growth and Cash' financial objectives.

At a Group level, the key headlines show that EEV new business profit ('new business profit') increased by 6 per cent to £2,151 million (2010: £2,028 million[2]), IFRS operating profit based on longer-term investment returns ('IFRS operating profit') increased by 7 per cent to £2,070 million (2010: £1,941 million) and underlying free surplus generation increased by 16 per cent to £1,983 million (2010: £1,714 million). These results were delivered during a particularly challenging macroeconomic environment and are testament to the quality of our franchises across Asia, the US and the UK.



58%
New business margin

Growth

In life insurance, new business profit was up 6 per cent to £2,151 million (2010: £2,028 million[2]) on APE sales in 2011 of £3,681 million (2010: £3,485 million[2]) resulting in a new business margin of 58 per cent (2010: 58 per cent[2]). The growth in both sales and new business profit was achieved while investing 14 per cent less capital than last year, reflecting our disciplined approach to optimising the balance between value creation and capital utilisation, and our ongoing focus on those products and geographies with the highest returns and shortest payback periods.

Asia produced new business profit of £1,076 million (2010: £902 million[2]), and APE sales of £1,660 million (2010: £1,501 million[2]), up 19 per cent and 11 per cent respectively on the previous year. Our new business margin increased from 60 per cent to 65 per cent in 2011, driven by favourable country mix with a particularly strong performance in Indonesia, which is now the largest contributor to virtually all of our key financial metrics in Asia.

Jackson delivered new business profit of £815 million (2010: £761 million), up 7 per cent compared to 2010, based on APE sales of £1,275 million (2010: £1,164 million). Our new business margin in the US remains attractive at 64 per cent (2010: 65 per cent). We continued to focus on variable annuities over the course of 2011 and APE sales in this product line grew by 15 per cent to £1,091 million (2010: £948 million). We remain a top three player in US variable annuities[3] and continue to balance value, risk and capital.

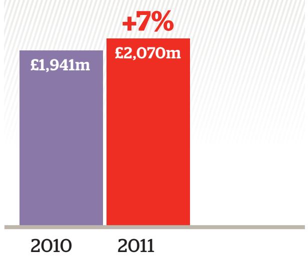
In the UK, we delivered new business profit of £260 million (2010: £365 million) and total APE sales of £746 million (2010: £820 million), down 29 per cent and 9 per cent respectively. These declines are primarily due to the level of bulk annuity activity achieved in 2010, which was not repeated in 2011, as there were fewer attractive opportunities in which to deploy our capital in that segment of the market. At a retail level, we delivered new business profit of £231 million (2010: £257 million) and APE sales of £712 million (2010: £725 million) as we continue to apply our value over volume approach, focusing on the product lines that produce the most attractive IRRs and payback periods. In 2011 we delivered a retail new business margin of 32 per cent, down from 35 per cent in 2010, due to lower volumes of higher margin individual annuities.

Notes
1 If long-term business is considered separately from asset management and UK general insurance commission.
2 Excludes Japan which ceased writing new business in 2010.
3 Source: Annuity Specs.

Across our life insurance businesses we grew our shareholder-backed policyholder liabilities by £11.3 billion in 2011 to £133.5 billion. This increase was driven by £9.0 billion of net inflows with the balance principally coming from foreign exchange and investment related movements.

In asset management, we have delivered £4.5 billion of net inflows over 2011 (2010: £8.9 billion). This is a good performance in what was a challenging year for asset managers. At the end of 2011, our total funds under management were £351 billion, of which £111 billion are external assets. M&G produced £4.4 billion (2010: £9.1 billion) of net inflows in the period (£3.9 billion retail, £0.5 billion institutional), an excellent result given the market backdrop. M&G has ranked number 1 in the UK retail market for gross and net sales over the last 13 consecutive quarters based on data to the end of December 2011[1]. At 31 December 2011 it had external funds under management of £91.9 billion, 3 per cent higher than at the beginning of the year. External funds comprise £44.2 billion (2010: £42.5 billion) of retail and £47.7 billion (2010: £46.8 billion) of institutional assets. Adding these funds to internal amounts, M&G's total funds under management were £201.3 billion. Eastspring Investments reported retail and institutional net inflows of £633 million in 2011 (2010: £1.8 billion). At the end of 2011, Eastspring Investments had £50.3 billion of funds under management, of which £19.2 billion were external assets.

IFRS operating profit based on longer-term investment returns



Profitability

Group IFRS operating profit increased by 7 per cent to £2,070 million (2010: £1,941 million) and Group EEV operating profit based on longer-term investment returns ('EEV operating profit') by 8 per cent to £3,978 million (2010: £3,696 million), equivalent to an annualised return on embedded value of 16 per cent. The contribution to these metrics from each business operation and each source is more balanced than at any previous time in the Group's history, greatly enhancing both the quality and the resilience of the Group's earnings.

The continued growth in the profits of our Asian life insurance business was one of the highlights of our 2011 results, as Asia passed an important milestone becoming the largest contributor[2] to Group IFRS operating profit. Asia's long-term business IFRS operating profit was up 32 per cent in 2011 to £709 million (2010: £536 million) with particularly strong performances coming from our businesses in Indonesia, Singapore and Hong Kong. We continue to see significant opportunities to grow both the size and the productivity of our distribution channels across South East Asia while maintaining good penetration of high margin health and protection insurance, and this should aid strong ongoing IFRS performance. Asia's long-term EEV operating profit, a measure of the economic value creation in the year, grew by 22 per cent in 2011 to £1,764 million (2010: £1,450 million), further underlining the creation of sustainable value by these operations.

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In the US, long-term business IFRS operating profit was down 17 per cent in 2011 to £694 million (2010: £833 million). This reduction was due to the expected accounting impact of accelerated deferred acquisition cost (DAC) amortisation of £232 million (2010: £11 million), which masked an underlying improvement in earnings. Excluding this effect, Jackson's earnings continued to grow during 2011 reflecting the rising asset base which generates both higher revenues and scale economies. Fee income increased by 34 per cent from £506 million in 2010 to £680 million in 2011 as a result of the strong growth in separate account asset balances which at 31 December 2011 were 23 per cent higher at £38 billion (2010: £31 billion) reflecting strong net inflows in variable annuities. Spread income (including the expected return on shareholders' assets) was £813 million in 2011 (2010: £817 million) and the average spread margin that we earned on general account liabilities increased from 243 bps in 2010 to 258 bps in 2011. The general account closed the period with policyholder liabilities of £31 billion (2010: £29 billion). Jackson's long-term EEV operating profit decreased by 2 per cent in 2011 to £1,431 million (2010: £1,458 million).

Notes

1 Source: Fundscape. (Q4 issue, December 2011). The Pridham Report. Fundscape LLP.

2 If long-term business is considered separately from asset management and UK general insurance commission.

Chief Financial Officer's overview

'These results were delivered during a particularly challenging macroeconomic environment and are testament to the quality of our franchises across Asia, the US and the UK.'

In the UK long-term business IFRS operating profit was up by 1 per cent from £673 million in 2010 to £683 million in 2011, despite 2010 benefiting from a single large bulk annuity deal, which contributed £63 million to the result (2011: £23 million). Our UK business continues to focus on the sustained delivery of IFRS profits. The strength of the with-profits fund, which currently has a surplus estate of £6.1 billion, provides a secure platform to support future IFRS profits and cash generation. EEV operating earnings reduced by 9 per cent in 2011 to £853 million (2010: £936 million), principally reflecting the reduction in new business profits discussed above.

In asset management IFRS operating profit was up 22 per cent to £461 million compared to £378 million in 2010. M&G (including Prudential Capital) delivered a record performance, growing IFRS operating profit by 26 per cent to £357 million, (2010: £284 million) due to rising revenues which increased by 15 per cent on the prior year and a lower cost-income ratio of 60 per cent (2010: 63 per cent). Eastspring Investments produced a good performance as rising revenues and a fall in the cost-income ratio to 62 per cent (2010: 64 per cent) drove IFRS operating profit higher by 11 per cent to £80 million (2010: £72 million).

Capital generation

We take a disciplined approach to capital allocation across the Group. Over the last few years we have taken several important steps to improve the efficiency and effectiveness of the capital allocation process, emphasising an unbiased focus on the products and geographies with the most attractive profitability characteristics. This has improved not only our returns on capital invested, but also our capital strength and capital fungibility. In 2011 we have continued to produce significant amounts of free capital, which we measure as free surplus generated.

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In 2011, we generated £2,536 million of underlying free surplus before reinvestment in new business from our life in-force and asset management businesses, up 8 per cent from £2,359 million in 2010. We reinvested £553 million of the free surplus generated in the period into writing new business. The majority of this reinvestment (£297 million) was into Asia, which remains the primary destination for investment within the Group. In the US, we invested £202 million in new business with a continued emphasis on variable annuities as we capitalised on the 'baby boomer' demand for the product and a weakened competitive environment following the financial market challenges of the last few years. In the UK, we invested £54 million in new business and our product focus remains annuities and with-profits bonds. The IRRs on this invested capital were more than 20 per cent in Asia, the US, and the UK, with payback periods of three years, one year and four years respectively.

Of the remaining free surplus generated after reinvestment in new business, £1,105 million was remitted from the business units to Group. This cash was used to meet central costs of £195 million, service net interest payments of £282 million and meet dividend payments of £642 million. Furthermore, an aggregate £205 million was paid to secure new distribution agreements in Asia and to the UK tax authorities following the settlement reached in 2010.

The remaining free surplus generated in the period was retained within our businesses and this has bolstered local capital ratios. The total free surplus balance deployed across our life and asset management operations increased from £3,338 million at the beginning of the period to £3,421 million at the end of the period.

'Growth and Cash' financial objectives

The following discussion contains forward-looking statements that involve inherent risks and uncertainties. Prudential's actual future financial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement, due to a number of important factors (including those discussed under the heading 'Risk factors' in this document). See the discussion under the heading 'Forward-looking statement' at the end of this report.

At our 2010 investor conference, entitled 'Growth and Cash', we announced new financial objectives demonstrating our confidence in continued rapid growth in Asia, and increasing levels of cash remittances from all of our businesses. These objectives were defined as follows:

(i) **Asia growth and profitability objectives**[1]:
To double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: £465 million); and
To double the 2009 value of new business profits in 2013 (2009: £713 million).

(ii) **Business unit cash remittance objectives**[1]:
Asia to deliver £300 million of net cash remittance to the Group in 2013 (2009: £40 million);
Jackson to deliver £200 million of net cash remittance to the Group in 2013 (2009: £39 million); and
UK to deliver £350 million of net cash remittance to the Group in 2013 (2009: £284 million[2]).

(iii) **Cumulative net cash remittances**[1]:
All business units in aggregate to deliver cumulative net cash remittances of at least £3.8 billion over the period 2010 to end-2013. These net remittances are to be underpinned by a targeted level of cumulative underlying free surplus generation of £6.5 billion over the same period.

As mentioned in the Group Chief Executive's report we believe we remain on track to achieve these objectives. Below we set out in more detail our progress towards these objectives based on our results in 2011.

Asia profitability objectives

	Actual					Objective
	2009 £m	2010 £m	2011 £m	Change (over 2010) %	Change (since 2009) %	2013 £m
Value of new business	713	901	1,076	19	51	1,426
IFRS operating profit*	465	604	784	30	69	930

Business unit net remittance objectives

	Actual			Objective
	2009 £m	2010 £m	2011 £m	2013 £m
Asia†	40	233	206	300
Jackson‡	39	80	322	200
UK§	434	420	297	350
M&G**	175	202	280	
Total	688	935	1,105	

Objectives for cumulative period 1 January 2010 to 31 December 2013

	Actual	Objective	Percentage achieved
	1 Jan 2010 to 31 Dec 2011 £m	1 Jan 2010 to 31 Dec 2013 £m	At 31 Dec 2011 %
Cumulative net cash remittances from 2010 onwards	2,040	3,800	54
Cumulative underlying group free surplus generation (which is net of investment in new business)	3,697	6,500	57

Notes
1 The objectives assume current exchange rates and a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the half-year ended 30 June 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II, which remains uncertain.
2 Representing the underlying remittances excluding the £150 million impact of proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

* Total Asia operating profit from long-term business and Eastspring Investments after development costs.
† Net remittances from Asia in 2010 included a one-off remittance of £130 million, representing the accumulation of historic distributable reserves.
‡ Net remittances from Jackson include £122 million in 2011 representing releases of excess surplus to Group.
§ In 2009, the net remittances from the UK include the £150 million arising from the pro-active financing techniques used to bring forward cash emergence of the in-force book during the financial crisis. The 2010 net remittances include an amount of £120 million representing the releases of surplus and net financing payments.
** Including Prudential Capital.

Chief Financial Officer's overview

'All of our businesses are now remitting considerable amounts of cash to Group and this is in line with our strategy as we seek to move away from the historical reliance on the UK.'

In 2011 net remittances from business operations increased to £1,105 million. All of our businesses are now remitting considerable amounts of cash to Group and this is in line with our strategy as we seek to move away from the historical reliance on the UK. Jackson delivered the largest increase in net remittances during 2011, as we began to reap the rewards of our post-financial crisis expansion in variable annuities. It is testament to the quality of what Jackson has achieved in recent years that it can pay such a large remittance while financing growth and maintaining a strong RBC ratio, which at the end of 2011 was 429 per cent. Remittances from the UK life operations continue to be underpinned by the with-profits business but also reflect positive cashflows from the shareholder-backed business. M&G delivered a large increase in net remittances, reflecting its highly profitable growth and its 'capital-lite' business model that facilitates a high dividend payout ratio from its earnings. Asia's remittances were also very strong in 2011 as it matures into an increasingly cash generative business, reaping the rewards of its significant growth and its health and protection product focus.

Against the cumulative 2010 to 2013 target of £3.8 billion, by the end of 2011 a total of £2,040 million has been remitted by business operations. We remain confident of achieving this target. Our confidence is underpinned by the strong underlying free surplus generation of our businesses which, by the end of 2011, had generated a total of £3.7 billion against our 2010 to 2013 cumulative target of £6.5 billion.

Capital position, financing and liquidity

The Group has continued to maintain a strong capital position. At 31 December 2011, our IGD surplus is estimated at £4.0 billion (2010: £4.3 billion), with coverage a very strong 2.75 times the requirement. All of our subsidiaries maintain strong capital positions at the local regulatory level. As mentioned above, Jackson's RBC ratio at the end of 2011 was 429 per cent.

In addition to our strong capital position, on a statutory (Pillar 1) basis the total credit default reserve for the UK shareholder annuity funds also contributes to protecting our capital position in excess of the IGD surplus. This credit default reserve, as at 31 December 2011, was £2.0 billion, notwithstanding the positive steps taken through 2011 to improve the credit quality of the £26.8 billion asset portfolio (measured on a statutory basis). This represents 33 per cent of the portfolio spread over swaps, compared with 43 per cent at 31 December 2010, when bond spreads over swap rates were much lower. Importantly, it is equivalent to a default rate of 7.6 per cent over the life of these investments, considerably higher than what has been experienced historically for the types of fixed income securities that we hold.

Solvency II, which is currently anticipated to be effective from 1 January 2014, represents a major overhaul of the capital adequacy regime for European insurers. We are supportive in principle of the development of a more risk-based approach to capital, but we have concerns as to the potential consequences of some aspects of the Solvency II regime under consideration. With the continued delays to policy development, the final outcome of Solvency II remains uncertain. Despite this uncertainty, we continue to prepare for when the regime is eventually implemented.

Our financing and liquidity position remained strong throughout the year. In December of 2011 we redeemed €500 million of Tier 2 subordinated notes at their first call date. This redemption was effectively pre-financed via an issuance of US$550 million of Tier 1 subordinated notes in January of 2011, which raised £340 million net of transaction costs. The next call on external financing is in December 2014 on the US$750 million of Perpetual Subordinated Capital Securities. Our central cash resources amounted to £1.2 billion at the end of 2011, a strong position.

We continue to engage with rating agencies in order to provide insurance financial strength ratings for the Group's insurance operations. Prudential's senior debt is currently rated A+ by Standard & Poor's, A2 by Moody's and A by Fitch.

Shareholders' funds

In 2011, investment markets experienced considerable volatility and recorded drops in both the global equity market indices and in long-term interest rates. Despite these effects the Group's EEV shareholders' funds increased by 8 per cent during 2011 to £19.6 billion (2010: £18.2 billion). On a per share basis EEV at the end of 31 December 2011 stood at 771 pence, up from 715 pence at 31 December 2010. IFRS shareholders' funds were also 14 per cent higher at £9.1 billion (2010: £8.0 billion).

The increases on both reporting bases are the result of the Group's strong operating performance, offset by the relatively muted effect of the investment markets on the business, reflecting both the quality of the asset portfolio and the effectiveness of our proactive approach to risk management.

Nic Nicandrou
Chief Financial Officer

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