Financial review

Results summary

International Financial Reporting Standards (IFRS) basis results*

Statutory IFRS basis results

	2012	2011 note (i)
Profit after tax attributable to equity holders of the Company	£2,197m	£1,415m
Basic earnings per share	86.5p	55.8p
Shareholders' equity, excluding non-controlling interests	£10.4bn	£8.6bn

Supplementary IFRS basis information

	2012 £m	2011 £m note (i)
Operating profit based on longer-term investment returns*	2,533	2,027
Short-term fluctuations in investment returns on shareholder-backed business	204	(220)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	50	21
Gain on dilution of Group holdings	42	–
Amortisation of acquisition accounting adjustments arising on the purchase of REALIC	(19)	–
Profit before tax attributable to shareholders	2,810	1,828
Operating earnings per share* (reflecting operating profit based on longer-term investment returns after related tax and non-controlling interests)	76.8p	62.8p

European Embedded Value (EEV) basis results*

	2012 £m	2011 £m
Operating profit based on longer-term investment returns*	4,321	3,978
Short-term fluctuations in investment returns	538	(907)
Mark to market value movements on core borrowings	(380)	(14)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	62	23
Effect of changes in economic assumptions	(16)	(158)
Gain on dilution of Group holdings	42	–
Gain on acquisition of REALIC	453	–
Profit before tax (including actual investment returns)	5,020	2,922
Operating earnings per share* (reflecting operating profit based on longer-term investment returns after related tax and non-controlling interests)	125.0p	115.7p
Shareholders' equity, excluding non-controlling interests	£22.4bn	£19.6bn

	2012	2011
Dividends per share declared and paid in reporting period	25.64p	25.19p
Dividends per share relating to reporting period	29.19p	25.19p
Funds under management	£405bn	£351bn
Insurance Groups Directive capital surplus (as adjusted) notes (ii) and (iii)	£5.1bn	£4.0bn

Notes
(i) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.
(ii) The surpluses shown for 2012, which is estimated, and 2011 are before allowing for the final dividends for 2012 and 2011 respectively.
(iii) From March 2013, the basis of calculating Jackson's contribution to the Group's IGD surplus will change, further detail can be found in the 'Capital position, financing and liquidity' section of the Chief Financial Officer's overview.

* Basis of preparation

Results bases

The IFRS basis results have been prepared in accordance with the accounting policies discussed in notes A2 to A4 of the IFRS financial statements.

Life insurance products are, by their nature, long-term and the profit on this business is generated over a significant number of years. Accounting under IFRS alone does not, in Prudential's opinion, fully reflect the value of future profit streams. Prudential considers that embedded value reporting provides investors with a measure of the future profit streams of the Group's in-force long-term businesses and is a valuable supplement to statutory accounts. The EEV basis results have been prepared in accordance with the EEV principles discussed in note 1 of EEV basis supplementary information.

Operating profit based on longer-term investment returns

The Group provides supplementary analysis of profit before tax attributable to shareholders so as to distinguish operating profit based on longer-term investment returns from the other elements of total profit shown. Operating profit per share is calculated using operating profits based on longer-term investment returns, after related tax and non-controlling interests.

Exchange translation – Actual Exchange Rate (AER) and Constant Exchange Rate (CER)

The comparative results have been prepared using previously reported exchange rates (AER basis) except where otherwise stated. Results on a CER basis are also shown for the analysis of IFRS and EEV operating profit based on longer-term investment returns.

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IFRS results

IFRS basis operating profit based on longer-term investment returns

		AER		CER	
	2012 £m	2011 £m note (i)	Change %	2011 £m note (i)	Change %
Insurance business					
Long-term business:					
Asia	920	709	30	697	32
US	964	651	48	659	46
UK	703	683	3	683	3
Development expenses	(7)	(5)	(40)	(5)	(40)
Long-term business profit	2,580	2,038	27	2,034	27
UK general insurance commission	33	40	(18)	40	(18)
Asset management business:					
M&G (including Prudential Capital)	371	357	4	357	4
Eastspring Investments	75	80	(6)	79	(5)
Curian	15	6	150	6	150
US broker-dealer and asset management	24	18	33	18	33
	3,098	2,539	22	2,534	22
Other income and expenditure	(498)	(483)	3	(483)	3
RPI to CPI inflation measure change on defined benefit pension schemes note (ii)	–	42	(100)	42	(100)
Solvency II implementation costs	(48)	(55)	13	(55)	13
Restructuring costs	(19)	(16)	(19)	(16)	(19)
Total IFRS basis operating profit based on longer-term investment returns	2,533	2,027	25	2,022	25

Notes
(i) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.
(ii) During 2011 the Group altered its assumptions for future statutory increases to pension payments for its UK defined benefit pension schemes. This reflects the UK Government's decision to change the basis of indexation from RPI to CPI.

In 2012, the Group's IFRS operating profit based on longer-term investment returns was £2,533 million, an increase of 25 per cent from 2011.

In Asia, IFRS operating profit based on longer-term investment returns for long-term business increased by £211 million from £709 million[1] in 2011 to £920 million in 2012. Included with this result is a £51 million one-off profit on sale of the Group's interest in China Life Insurance Company of Taiwan, which was originally acquired in 2008 when Prudential sold its Taiwanese agency business to the company. Excluding this amount, Asia's long-term business operating profit increased by 23 per cent to £869 million, primarily reflecting strong growth in the size of our business in the region, particularly health and protection.

The contribution to profits from Indonesia, Hong Kong, Singapore and Malaysia, Prudential's largest markets in Asia, continues to rise, with operating profits from these businesses[2] up 22 per cent from £552 million in 2011 to £674 million in 2012. High consumer demand for savings and protection in Indonesia continues to drive growth in premiums and earnings, with operating profit[2] up 23 per cent from £212 million to £260 million. Hong Kong's operating profit[2] increased by 28 per cent to £88 million (2011: £69 million), as business mix has shifted towards higher return products. Singapore increased by 23 per cent to £206 million (2011: £167 million)[2] and Malaysia's operating profit[2] at £120 million (2011: £104 million) increased by 15 per cent. Operating profits from our other long-term insurance operations in the region also increased by 24 per cent to £147 million (2011: £119 million), as these businesses increase in size.

Notes
1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.
2 Before non-recurring items.

The US long-term business operating profit increased by 48 per cent from £651 million[1] in 2011 to £964 million in 2012. The 2011 result included an accelerated deferred acquisition cost (DAC) amortisation of £190 million that did not recur. Excluding this item the underlying increase reflects the continued growth in fee income on the separate account business offset by lower earnings from fixed annuities in line with the compression in corporate spreads experienced in the course of the year. The result also includes a £67 million contribution from REALIC which was acquired in September 2012 and is performing in line with our expectations.

Prudential's UK business has sustained its performance at similar levels to the previous year, with total IFRS operating profit of £736 million (2011: £723 million). Long-term business generated £703 million (2011: £683 million) driven by an increase in profits from individual annuities and bulk annuity transactions, the latter contributing £31 million (2011: £23 million) to the total. Shareholders with-profits business transfers amounted to £272 million, compared with £293 million in 2011, in line with reductions in policy bonus rates. Profit from UK general insurance commission continued to decline as expected to £33 million (2011: £40 million) as the business matures and in-force policy numbers fall.

Total operating profit for 2012 from M&G and Prudential Capital increased by 4 per cent from £357 million in 2011 to £371 million in 2012, primarily reflecting positive net inflows into M&G during 2011 and 2012.

Eastspring Investments reported operating profit of £75 million, down by £5 million from the £80 million recognised in 2011. This reflects a broadly unchanged level of fee income with the effect of higher fund values offset by a shift in business mix towards bond mandates, together with increased costs as the business develops the Eastspring Investments platform and expands into new markets.

Note

1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

Financial review continued

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

	AER			AER			CER		
	2012			2011			2011		
	Operating profit £m	Average liability note (ii) £m	Margin note (i) bps	Operating profit £m	Average liability note (ii) £m	Margin note (i) bps	Operating profit £m	Average liability note (ii) £m	Margin note (i) bps
Spread income	1,074	62,174	173	1,065	57,417	185	1,072	57,572	186
Fee income	1,077	78,807	137	870	68,298	127	875	68,331	128
With-profits	311	95,681	33	331	93,056	36	331	92,946	36
Insurance margin	1,032			736			729		
Margin on revenues	1,669			1,425			1,404		
Expenses:									
Acquisition costs note (iii)	(1,997)	4,195	(48)%	(1,783)	3,681	(48)%	(1,782)	3,678	(48)%
Administration expenses	(1,248)	143,321	(87)	(1,043)	125,715	(83)	(1,039)	125,903	(82)
DAC adjustments note (iv)	406			237			243		
Expected return on shareholder assets	205			200			201		
Gain on China Life (Taiwan) shares	51			–			–		
Operating profit based on longer-term investment returns	2,580			2,038			2,034		

Notes

(i) Margin represents the operating return earned in the year as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus.

(ii) For UK and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the year, as this is seen as a good proxy for average balances throughout the year. The calculation of average liabilities for Jackson is derived from month-end balances throughout the year as opposed to opening and closing balances only. Liabilities held in the general account for variable annuity living and death guaranteed benefits together with other amounts on which no spread income is earned (eg REALIC liabilities), are excluded from the calculation of the average. In addition for REALIC, which are included in the average liability to calculate the administration expense margin, the calculation excludes the liabilities reinsured to (and in essence retained by) Swiss Re immediately prior to the acquisition by Jackson.

(iii) Acquisition cost ratio represents shareholder acquisition costs as a percentage of total APE including with-profits sales. Acquisition costs include only those relating to shareholders.

(iv) DAC adjustments have been adjusted for the retrospective application of the accounting policy change described in the basis of preparation and note A5 of the IFRS financial statements.

Spread income earned in 2012 was £1,074 million, £9 million higher than the amount received in the prior year of £1,065 million. As expected the margin secured has fallen from 185 basis points in 2011 to 173 basis points in 2012 principally due to spread compression in the US general account business, down from 258 basis points in 2011 to 239 basis points in 2012. Further reductions in this source of income are anticipated in the next few years if the current low interest rate environment persists.

Fee income has increased by 24 per cent to £1,077 million driven by the 15 per cent increase in the Group's average unit-linked liabilities, which principally reflects the £8 billion net inflows into Jackson's separate accounts as well as positive net flows in Asia's linked business in 2012. The fee income margin has increased from 127 basis points in 2011 to 137 basis points in 2012 as Jackson, where the fee margin is higher, contributes a greater proportion to the Group total fee income.

With-profits income has fallen from £331 million in 2011 to £311 million in 2012 in line with reductions in annual bonus rates on UK with-profits policies.

Insurance margin has increased by 40 per cent from £736 million in 2011 to £1,032 million in 2012 mainly due to the continued success of the health and protection strategy in Asia and an increase in guarantee fees in the US. 2012 also includes four months of revenue from REALIC amounting to £87 million following its acquisition by Jackson in September 2012.

Margin on revenues principally comprises amounts deducted from premiums to cover acquisition costs and administration expenses. The margin has increased by 17 per cent from £1,425 million in 2011 to £1,669 million in 2012. This increase is driven by Asia and primarily reflects higher premium income levels in the year.

Acquisition costs have increased in absolute terms to £1,997 million, in line with the increased new business sales. Expressed as a percentage of new business APE, 2012 has remained constant with 2011 at 48 per cent.

Administration expenses have increased to £1,248 million, principally reflecting the growth of the business in the year. Expressed as a ratio to average liabilities, acquisition costs have increased from 83 basis points in 2011 to 87 basis points in 2012. This reflects changes in business mix and the increased proportion of commission on new sales being taken by US distributors on an annual as opposed to an initial basis.

DAC adjustments are a net benefit to the result as the deferral of current year's acquisition costs exceeds the amortisation of previously deferred costs. This net benefit increased from £237 million in 2011 to £406 million in 2012. This increase arises in the US (where DAC adjustments were £442 million in 2012 compared with £228 million in 2011), reflecting a return to more normal levels of DAC amortisation in 2012. 2011 included a £190 million charge for accelerated DAC amortisation, representing the reversal of the benefit received in 2008 from the use of the mean reversion formula.

IFRS basis results – Margin analysis of asset management pre-tax IFRS operating profit based on longer-term investment returns by driver

	2012 £m				
	M&G note (i)	Eastspring Investments	PruCap	US	Total
Operating income note (i)	734	201	120	296	1,351
Operating profit based on longer-term investment returns	320	75	51	39	485
Average funds under management (FUM), including 49.99% proportional share of PPM South Africa	£209.0bn				
Average FUM, excluding PPM South Africa	£205.1bn	£55.0bn			
Margin based on operating income note (ii)	36 bps	37 bps			
Cost/income ratio note (iii)	59%	64%			

	2011 £m				
	M&G note (i)	Eastspring Investments	PruCap	US	Total
Operating income note (i)	666	196	122	249	1,233
Operating profit based on longer-term investment returns	301	80	56	24	461
Average funds under management (FUM), including 49.99% proportional share of PPM South Africa	£195.1bn				
Average FUM, excluding PPM South Africa	£190.9bn	£51.4bn			
Margin based on operating income note (ii)	35 bps	38 bps			
Cost/income ratio note (iii)	61%	62%			

Notes

(i) Operating income is presented net of commissions and excludes performance related fees, and for M&G carried interest on private equity investments. Following the divestment in 2012 of M&G's holding in PPM South Africa from 75 per cent to 49.99 per cent and its treatment from 2012 as an associate, M&G's operating income and expense shown in the table above, no longer includes any element from PPM South Africa, with the share of associate's results being presented in a separate line. In order to avoid year-on-year distortion, in the table above the 2011 operating income, margin and cost/income ratio reflect the retrospective application of the basis of presentation for 2011 results.

(ii) Margin represents operating income as defined in note (i) above as a proportion of average FUM, being the average of monthly FUM, excluding PPM South Africa. The comparatives have been altered to present 2011 on the same basis.

(iii) Cost/income ratio represents cost as a percentage of operating income as defined in note (i) above. M&G's operating income and expense excludes any contribution from M&G's associate, PPM South Africa.

M&G's recent growth has seen average funds under management, excluding PPM South Africa, increase from £190.9 billion during 2011 to £205.1 billion in 2012. This has led to a 10 per cent increase in operating income to £734 million, equivalent to a margin of 36 basis points, an increase from 35 basis points in 2011. M&G continues to focus on cost control and the efficiencies created as the scale of the business grows. The benefit of this operational leverage is evident in an improvement in the cost to income ratio from 61 per cent in 2011 to 59 per cent in 2012.

At Eastspring Investments strong net inflows and positive market movements have led to an increase in average funds under management from £51.4 billion to £55.0 billion, with operating income rising from £196 million to £201 million. As the growth in funds stemmed principally from internal clients and fixed income mandates, the average fee margin declined from 38 basis points in 2011 to 37 basis points in 2012. Continued investment in developing the Eastspring Investment platform contributed to a higher cost to income ratio of 64 per cent in 2012 (2011: 62 per cent).

Financial review continued

IFRS basis profit after tax

	AER 2012 £m	2011 £m note
Operating profit based on longer-term investment returns	2,533	2,027
Short-term fluctuations in investment returns:		
– Insurance operations	122	(100)
– Other operations	82	(120)
	204	(220)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	50	21
Gain on dilution of Group holdings	42	–
Amortisation of acquisition accounting adjustments arising on the purchase of REALIC	(19)	–
Profit before tax attributable to shareholders	2,810	1,828
Tax charge attributable to shareholders' profit	(613)	(409)
Non-controlling interests	–	(4)
Profit for the year attributable to shareholders	2,197	1,415

Note
Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

IFRS basis profit after tax

The 2012 total profit before tax attributable to shareholders was 54 per cent higher at £2,810 million in 2012 (2011: £1,828 million)[1]. The improvement predominantly reflects the increase in operating profit based on longer-term investment returns, and the positive investment market returns earned in the year.

IFRS operating profit is based on 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 £122 million comprised of positive £76 million for Asia, negative £90 million in the US and positive £136 million in the UK.

The positive short-term fluctuations of £76 million for our Asia operations in 2012 relates to unrealised gains on bond assets held across the region following the fall in long-term yields in the period.

The combination of higher equity markets and lower market volatility in the US has reduced the technical reserves held for the variable annuity guarantees. This favourable effect was more than offset by the net unrealised value movement on derivative instruments held to manage the Group's exposure to these guarantees, producing a net £90 million negative fluctuation in our US operation.

The positive short-term fluctuations of £136 million for our UK operations primarily reflect net valuation gains on fixed income assets supporting the capital of the shareholder-backed annuity business.

Short-term fluctuations for other operations were positive £82 million. This primarily represents appreciation on Prudential Capital's bond portfolio partially offset by net realised and unrealised losses in the year on derivatives held centrally to manage market risks.

Note
1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

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 positive £50 million (2011: positive £21 million) mainly reflects the partial recognition of actuarial surplus in the Prudential Staff Pension Scheme following the results of the triennial valuation, further details of which are given in note I3 of the IFRS basis results.

Gain on dilution of Group holdings

On 22 February 2012, M&G completed transactions to reduce its majority holding in PPM South Africa from 75 per cent to 49.99 per cent. Under IFRS the transactions give rise to a gain on dilution of £42 million, which has been excluded from the Group's IFRS operating profit.

Amortisation of acquisition accounting adjustments arising on the purchase of REALIC

On 4 September 2012, Jackson completed the acquisition of 100 per cent of the issued share capital of SRLC America Holding Corp. (SRLC), and its primary operating subsidiary, REALIC for a total cash consideration of £370 million. The amortisation primarily comprises the difference between the yield on the acquired investments based on market values at acquisition and historic investment income on book yields recognised in IFRS operating profit. Movement in the fair value acquisition adjustments on the value of business acquired and policyholder liabilities is also included. Further details are given in note I1 of IFRS basis results.

Effective tax rates

The effective rate of tax on operating profit based on longer-term investment returns was 23 per cent (2011: 21 per cent). The 2011 effective rate had benefited from utilising carried forward tax losses for which no deferred tax asset had been recognised.

The effective rate of tax on the total IFRS profit was 22 per cent (2011: 22 per cent). In both 2012 and 2011 we have benefited from reductions in the main UK corporation tax rate – 28 per cent to 26 per cent in 2011 and 26 per cent to 24 per cent in 2012.

EEV results

EEV basis operating profit based on longer-term investment returns

		AER		CER	
	2012 £m	**2011** £m (note)	**Change** %	**2011** £m (note)	**Change** %
Insurance business:					
Asia	1,960	1,764	11	1,747	12
US	1,610	1,431	13	1,448	11
UK	866	853	2	853	2
Development expenses	(7)	(5)	(40)	(5)	(40)
Long-term business profit	4,429	4,043	10	4,043	10
UK general insurance commission	33	40	(18)	40	(18)
Asset management business:					
M&G (including Prudential Capital)	371	357	4	357	4
Eastspring Investments	75	80	(6)	79	(5)
Curian	15	6	150	6	150
US broker-dealer and asset management	24	18	33	18	33
	4,947	4,544	9	4,543	9
Other income and expenditure	(554)	(536)	(3)	(536)	(3)
RPI to CPI inflation measure change on defined benefit pension schemes(note)	–	45	–	45	–
Solvency II implementation costs	(50)	(56)	11	(56)	11
Restructuring costs	(22)	(19)	(16)	(18)	(22)
Total EEV basis operating profit	4,321	3,978	9	3,978	9

Note
During 2011 the Group altered its assumptions for future statutory increases to pension payments for its UK defined benefit pension schemes. This reflects the UK government's decision to change the basis of indexation from RPI to CPI.

Prudential Group's total EEV basis operating profit based on longer-term investment returns was £4,321 million in 2012, 9 per cent higher than the £3,978 million earned in 2011.

Long-term business operating profit generated by the Group was £4,429 million (2011: £4,043 million). This profit comprises:

- New business profit of £2,452 million (2011: £2,151 million);
- In-force profit of £1,984 million (2011: £1,897 million); and
- Negative £7 million for development expenses (2011: negative £5 million).

New business profit at £2,452 million was 14 per cent higher than last year, reflecting a 14 per cent increase in new business APE. The higher sales volumes and pricing actions coupled with favourable business mix mitigated the pressure on margins from the low level of long-term interest rates.

The new business profit for the Asia business increased by 18 per cent to £1,266 million compared to £1,076 million in 2011. The growth in new business profit was driven by Indonesia, Singapore and Malaysia reflecting strong volume growth in Indonesia and Singapore and favourable product mix changes in Malaysia. Jackson in the US delivered new business profit of £873 million, an increase of 7 per cent compared to £815 million. Throughout 2012, Jackson proactively adjusted pricing and product features to respond to both market conditions and the competitive environment, actions which counteracted the adverse effect of lower long-term yields and tighter spreads. UK new business profit increased by 20 per cent to £313 million in 2012 compared to £260 million in 2011 and includes the benefit of two bulk annuity buy-ins in 2012. This increase reflected higher sales volumes, and a favourable change in product mix towards higher margin individual annuities and with-profits bonds.

Financial review continued

EEV basis operating profit based on longer-term investment returns continued

The contribution to operating profit from life in-force business was £1,984 million (2011: £1,897 million) and comprises £1,493 million (2011: £1,447 million) from the unwind of the discount on the opening embedded value and other expected returns, and £491 million (2011: £450 million) from the effect of operating assumption changes, experience variances and other items. The unwind of discount and other expected returns is £46 million higher than 2011 with the growth in the business more than offsetting the effect on this profit measure of lower interest rates. The economic effects have adversely affected the unwind and other expected returns by an estimated £83 million.

Asia continues to be the highest contributor to the Group's life profit, contributing £1,960 million in 2012 (2011: £1,764 million). Included in Asia's result is £694 million of profit from in-force business (2011: £688 million) which includes an overall positive contribution from operating experience and assumption changes of £95 million (2011: £75 million).

US life in-force profit was higher at £737 million in 2012 compared to £616 million in 2011, with 2012 including £19 million of post-acquisition profit from REALIC. Overall experience and operating assumption changes contributed positive £325 million towards in-force profits compared to £267 million in 2011. Within these amounts, swap transactions undertaken from 2010 to more closely match the overall asset and liability duration contributed enhanced profits with an overall spread gain of £205 million (2011: £152 million).

UK life in-force profit was lower at £553 million (2011: £593 million) and included £482 million (2011: £485 million) from the unwind of the discount rate on the opening embedded value. Other in-force profits totalled £71 million (2011: £108 million) which includes a charge of £52 million for the annuity business reflecting the net impact of strengthening longevity assumptions, gains on portfolio rebalancing, and releases of margins previously held in the balance sheet. Included in both years are the beneficial effects on future profits arising from the reduction in UK corporation taxes enacted in both periods; in 2012 this amounted to £87 million, while in 2011 it amounted to £79 million.

EEV basis profit after tax

	AER 2012 £m	AER 2011 £m
EEV basis operating profit based on longer-term investment returns	4,321	3,978
Short-term fluctuations in investment returns:		
– Insurance operations	456	(787)
– Other operations	82	(120)
	538	(907)
Mark to market value movements on core borrowings	(380)	(14)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	62	23
Effect of changes in economic assumptions	(16)	(158)
Gain on dilution of Group holdings	42	–
Gain on acquisition of REALIC	453	–
Profit before tax attributable to shareholders	5,020	2,922
Tax charge attributable to shareholders' profit	(1,207)	(776)
Non-controlling interests	–	(4)
Profit for the year attributable to shareholders	3,813	2,142

EEV basis profit after tax

The 2012 total profits before tax attributable to shareholders was 72 per cent higher at £5,020 million (2011: £2,922 million). The improvement predominantly reflects the increase in operating profit based on longer-term investment returns, improved markets and the gain posted on this reporting basis on the acquisition of REALIC.

EEV operating profit is based on longer-term investment return assumptions rather than actual investment returns achieved. Short-term fluctuations in investment returns represent the difference between the actual investment return and those assumed in arriving at the reported operating profit.

EEV Short-term fluctuations in investment returns

Short-term fluctuations in investment returns for insurance operations of positive £456 million comprised of positive £395 million for Asia, negative £254 million for our US operations and positive £315 million in the UK.

In Asia, positive short-term fluctuations in investment returns of £395 million (2011: negative £155 million) principally reflect unrealised bond and equity gains following market movements in the year, principally in Hong Kong, Singapore and Taiwan.

In the US, short-term fluctuations in investment returns were negative £254 million (2011: negative £491 million). This includes the net value movements on derivatives held to manage the Group's equity and interest rate exposures offset by the positive impact of equity market increases on the expected level of future fee income from the variable annuity separate accounts.

For our UK business, the short-term fluctuations in investment returns were positive £315 million (2011: negative £141 million). This arises principally because the actual 2012 investment return of the with-profits fund (covering policyholder liabilities and unallocated surplus) of 9.8 per cent was higher than the longer-term assumed rate of 5.0 per cent.

Mark to market value movement on core borrowings

The mark to market value movement on core borrowings of negative £380 million in 2012 reflects the effect on the market value of Prudential's borrowings from reductions in both interest rates and credit spreads.

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 on the EEV basis comprises the IFRS charge attributable to shareholders, and the shareholders' share of movements in the scheme assets and liabilities attributable to the PAC with-profits fund. On the EEV basis there was a gain of £62 million (2011: gain of £23 million) mainly reflecting the partial recognition of actuarial surplus in the Prudential Staff Pension Scheme following the results of the triennial valuation, further details of which are given in note 7 of EEV basis results.

Financial review continued

EEV basis profit after tax continued

Effect of changes in economic assumptions

The effect of changes in economic assumptions of negative £16 million, comprises negative £149 million for Asia, positive £85 million for the US and positive £48 million for the UK. These reflect the aggregate effects of the reduction in long-term yields and the associated decrease in risk discount rates across these businesses.

The adverse changes in economic assumptions for Asia of negative £149 million primarily reflects the impact of lower interest rates and projected fund earned rates in Hong Kong, partially offset by the impact of a lower discount rate for Indonesia and Malaysia.

In our US business, economic effects totalled positive £85 million, principally reflecting the 50 basis point reduction in the allowance for short-term credit risk for our fixed annuity business, as the market stabilises and credit spreads reduce.

In the UK, the positive £48 million represents the net impact on future profits of reduced bond yields, where the negative impact on with-profits has been more than offset by the positive shareholder annuity impact.

Gain on dilution of Group holdings

On 22 February 2012, M&G completed transactions to reduce its majority holding in PPM South Africa from 75 per cent to 49.99 per cent, giving rise to gain on dilution of £42 million.

Gain on acquisition of REALIC

On 4 September 2012, Jackson completed acquisition of 100 per cent issued share capital of SRLC America Holding Corp., and its primary operating subsidiary, REALIC. The embedded value of the acquired business at that date of £823 million was higher than the consideration of £370 million resulting in a gain on acquisition of £453 million. In line with financial reporting guidelines this gain has been recognised in full as a profit in the year.

Effective tax rates

The 2012 effective rate on operating profit based on longer-term investment returns of 26 per cent was consistent with the equivalent rate in 2011. The 2012 effective rate of tax on total EEV profit of 24 per cent was lower than the equivalent rate in the previous year (2011: 27 per cent), reflecting changes in the composition of non-operating items.

Earnings and dividends per share

Earnings per share (EPS)

	2012 pence	2011 pence
Basic EPS based on operating profit after tax and non-controlling interests		
IFRS[note]	76.8	62.8
EEV	125.0	115.7
Basic EPS based on total profit after tax and non-controlling interests		
IFRS[note]	86.5	55.8
EEV	150.1	84.6

Note
Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

Dividend per share

Interim dividends are recorded in the period in which they are paid. Final dividends are recorded in the period in which they are approved by shareholders. The final dividend for the year ended 31 December 2011 of 17.24 pence per ordinary share was paid to eligible shareholders on 24 May 2012 and the 2012 interim dividend of 8.4 pence per ordinary share was paid to eligible shareholders on 27 September 2012.

The Board has decided to rebase the full year dividend upwards by 4 pence, reflecting the strong progress made in both the earnings and free surplus generation of the business and in the delivery of our financial objectives. In line with this, the directors recommend a final dividend of 20.79 pence per share (2011: 17.24 pence), which brings the total dividend for the year to 29.19 pence (2011: 25.19 pence), representing an increase of 15.9 per cent over 2011.

The 2012 final dividend of 20.79 pence per ordinary share will be paid on 23 May 2013 in sterling to shareholders on the principal register and the Irish branch register at 6.00pm BST on Tuesday, 2 April 2013 (Record Date), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 3 June 2013. The final dividend will be paid on or about 30 May 2013 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte.) Limited (CDP) at 5.00pm Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 12 March 2013. The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG$, will be determined by CDP. The dividend will distribute an estimated £532 million of shareholders' funds.

Shareholders on the principal register and Irish branch register will be able to participate in a Dividend Reinvestment Plan.

The Board will maintain its focus on delivering a growing dividend from this new higher base, which will continue to be determined after taking into account the 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.

Financial review continued

Movement on shareholders' funds

	IFRS £m 2012	IFRS £m 2011 AER note (a)	EEV £m 2012	EEV £m 2011 AER
Operating profit based on longer-term investment returns	2,533	2,027	4,321	3,978
Items excluded from operating profit	277	(199)	699	(1,056)
Total profit before tax	2,810	1,828	5,020	2,922
Tax and non-controlling interests	(613)	(413)	(1,207)	(780)
Profit for the year	2,197	1,415	3,813	2,142
Exchange movements, net of related tax	(216)	(105)	(469)	(158)
Unrealised gains and losses on Jackson securities classified as available for sale[note (b)]	387	349	–	–
Dividends	(655)	(642)	(655)	(642)
New share capital subscribed	17	17	17	17
Other	65	9	100	71
Net increase in shareholders' funds	1,795	1,043	2,806	1,430
Shareholders' funds at beginning of the year	8,564	7,521	19,637	18,207
Shareholders' funds at end of the year	10,359	8,564	22,443	19,637
Comprising				
Long-term business:				
Free surplus[note (c)]			2,957	2,839
Required capital			3,898	3,447
Net worth			6,855	6,286
Value of in-force			15,411	13,364
Total			22,266	19,650
Other business[note (d)]			177	(13)
Total[(note e)]			22,443	19,637

Notes
(a) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.
(b) Net of related changes to deferred acquisition costs and tax.
(c) The £1,364 million free surplus generated by the long-term business (net of new business investment and market related movements and investment in REALIC) in the year, has been used to pay £921 million to the holding company.
(d) Shareholders' funds for other than long-term business comprises:

	2012 £m	2011 £m
Asset management operations[note]	1,937	1,783
Holding company net borrowings	(2,282)	(2,188)
Other, net	522	392
Total shareholders' funds for other business	177	(13)

Note
Including goodwill of £1,230 million for 31 December 2012 and 31 December 2011.

(e) EEV shareholders' funds excluding goodwill attributable to shareholders at 31 December 2012 is £20,974 million (31 December 2011: £18,172 million).

EEV shareholders' funds

The shareholders' funds at 31 December 2012 relating to long-term business of £22.3 billion comprise £9.5 billion (up 11 per cent from 31 December 2011) for our Asia long-term business operations, £6.0 billion (up 19 per cent from 31 December 2011) for our US long-term business operations and £6.8 billion (up 12 per cent from 31 December 2011) for our UK long-term business operations.

At 31 December 2012, the embedded value for our Asian long-term business operations was £9.5 billion, with £8.0 billion (up £0.9 billion from 2011) being in the South-east Asia countries of Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam together with Hong Kong. For Prudential's other Asian markets, the embedded value was £1.5 billion in aggregate, broadly unchanged from 2011.

Free surplus and holding company cash flow

Overview

The Group manages its internal cash flow by focusing on the free surplus generated by the life and asset management businesses. Remittances are, however, made as and when required by the holding company with excess surplus being left in the businesses where it can be redeployed most profitably.

Free surplus generation

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

The Group's free surplus at the end of the year 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 generation for the insurance business represents amounts maturing from the in-force operations during the year less the investment in new business. For asset management operations we have defined free surplus generation to be the total post-tax IFRS profit for the year.

The Group's free surplus generated also includes the general insurance commission earned during the year and excludes foreign exchange, capital movements, shareholders' other income and expenditure and centrally arising restructuring and Solvency II implementation costs.

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

	2012 £m	2011 £m
Free surplus generation		
Expected in-force cash flows (including expected return on net assets)	2,405	2,335
– Life operations	2,019	1,972
– Asset management and other operations	386	363
Changes in operating assumptions and experience variances	295	168
RPI to CPI inflation measure change on defined benefit pension schemes	–	33
Underlying free surplus generated in the year from in-force business	2,700	2,536
Investment in new business	(618)	(553)
Underlying free surplus generated in the year	2,082	1,983
Market-related items	(79)	(531)
Gain on dilution of Group holdings	42	–
Acquisition of REALIC	(169)	–
Free surplus generated in the year	1,876	1,452
Net cash remitted by the business units	(1,200)	(1,105)
Other movements (including foreign exchange effects) and timing differences	(408)	(264)
Total movement during the year	268	83
Free surplus at 1 January	3,421	3,338
Free surplus at end of year	3,689	3,421
Comprised of:		
Free surplus relating to long-term insurance business	2,957	2,839
Free surplus of other insurance business	25	29
IFRS net assets of asset management businesses excluding goodwill	707	553
Total free surplus	3,689	3,421

Financial review continued

Free surplus and holding company cash flow continued

During 2012 Prudential generated underlying free surplus from the in-force book of £2,700 million (2011: £2,536 million) despite lower investment return conditions, reflecting the progress we have made in growing the portfolio of business and our focus on managing the in-force book for value. Changes in operating assumptions and experience variances were £295 million in 2012 compared with £168 million in 2011. These variances included positive £80 million from Asia (2011: positive £52 million), which in 2012 included £51 million from the sale of the Group's share-holding in China Life Insurance Company of Taiwan. The US continued to record strong positive variances of £219 million (2011: positive £154 million), which included a significant level of favourable spread experience. These variances also included a reduced negative £4 million from the UK (2011: negative £38 million). 2011 also benefited from a one-off credit of £33 million arising from a reduction in the liabilities of the Group's defined benefit pension schemes following the UK Government's decision to change the basis of indexation from RPI to CPI, which did not reoccur in 2012.

Underlying free surplus generated from in-force business has been used by our life businesses to invest in new business. Investment in new business has increased by 12 per cent to £618 million in 2012. This compares to a 14 per cent increase in sales and a 14 per cent increase in new business profit.

Market-related movements of negative £79 million in 2012 includes negative £330 million from the US, principally reflecting the valuation movements of derivatives, net of movements in reserves held for variable annuity guarantees reflecting market movements in the year. Offsetting these amounts are positive £114 million in Asia, positive £53 million from the UK and positive £84 million from our asset management business primarily reflecting in part the impact of lower bond yields on bond values in the year.

The acquisition of REALIC consumed £169 million of free surplus.

In contrast free surplus benefited by £42 million as a result of the divestment of M&G's holding in PPM South Africa from 75 per cent to 49.99 per cent.

Value created through investment in new business by life operations

	2012 £m			
	Asia insurance operations	US insurance operations	UK insurance operations	Group total
Free surplus invested in new business	(292)	(281)	(45)	(618)
Increase in required capital	97	271	86	454
Net worth invested in new business	(195)	(10)	41	(164)
Value of in-force created by new business	1,177	578	200	1,955
Post-tax new business profit for the year	982	568	241	1,791
Tax	284	305	72	661
Pre-tax new business profit for the year	1,266	873	313	2,452
New business sales (APE)	1,897	1,462	836	
Internal rate of return[note]	>20%	>20%	>20%	

	AER			
	2011 £m			
	Asia insurance operations	US insurance operations	UK insurance operations	Group total
Free surplus invested in new business	(297)	(202)	(54)	(553)
Increase in required capital	97	232	77	406
Net worth invested in new business	(200)	30	23	(147)
Value of in-force created by new business	1,011	500	172	1,683
Post-tax new business profit for the year	811	530	195	1,536
Tax	265	285	65	615
Pre-tax new business profit for the year	1,076	815	260	2,151
New business sales (APE)	1,660	1,275	746	
Internal rate of return[note]	>20%	>20%	>20%	

	CER			
	2011 £m			
	Asia insurance operations	US insurance operations	UK insurance operations	Group total
Free surplus invested in new business	(295)	(205)	(54)	(554)
Increase in required capital	96	235	77	408
Net worth invested in new business	(199)	30	23	(146)
Value of in-force created by new business	1,003	506	172	1,681
Post-tax new business profit for the year	804	536	195	1,535
Tax	261	289	65	615
Pre-tax new business profit for the year	1,065	825	260	2,150
New business sales (APE)	1,642	1,290	746	
Internal rate of return[note]	>20%	>20%	>20%	

Note
The internal rate of return (IRR) 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.

Financial review continued

Value created through investment in new business by life operations continued

Overall, the Group wrote £4,195 million of sales on an APE basis in 2012 (2011: £3,681 million) generating a post-tax new business contribution to embedded value of £1,791 million (2011: £1,536 million). To support these sales, we invested £618 million of capital (2011: £553 million) equivalent to 23 per cent (2011: 22 per cent) of underlying free surplus generated by the life in-force and asset management businesses.

In Asia, we generated an 18 per cent increase in new business profit despite investing 2 per cent less capital at £292 million (2011: £297 million). In other words, for each £1 million of free surplus invested we generated £3.4 million of post-tax new business profit (2011: £2.7 million). This improved capital efficiency reflects the benefit of pricing actions and a shift in mix towards those products and geographies with lower strain and higher return characteristics. The average free surplus undiscounted payback period for business written in 2012 was three years (2011: three years).

In the US, investment in new business was £281 million (2011: £202 million), an increase of 39 per cent, and compares to a 7 per cent increase in new business profit in the year. Consequently, for each £1 million of free surplus invested we generated £2.0 million of post-tax new business contribution to embedded value (2011: £2.6 million). The higher capital consumption per unit of profit reflects a more punitive valuation interest rate being used to establish liabilities upon policy inception following recent falls in interest rates. Notwithstanding this effect, the internal rates of return achieved in the US remain attractive at above 20 per cent, and the fast payback nature of the business written means that the initial capital outlay is recouped quickly. The average free surplus undiscounted payback period for business written in 2012 was two years (2011: one year).

In the UK, we continue to manage capital with discipline and have achieved a 20 per cent increase in new business profit, while investing 17 per cent less capital at £45 million (2011: £54 million). For each £1 million of free surplus invested, therefore, we generated £5.4 million of post-tax new business contribution to embedded value (2011: £3.6 million) benefiting from favourable changes in business mix. These sustained levels of high capital efficiency in the UK reflect our strategy of participating selectively in the UK's retirement savings and income market, focusing on those products and distribution mechanisms which meet our strict high return and short payback characteristics. The average free surplus undiscounted payback period for shareholder-backed business written in 2012 was three years (2011: four years).

Holding company cash flow

	2012 £m	2011 £m
Net cash remitted by business units:		
UK net remittances to the Group		
UK Life fund paid to the Group	216	223
Shareholder-backed business:		
Other UK paid to the Group	101	116
Group invested in UK	(4)	(42)
Total shareholder-backed business	97	74
Total UK net remittances to the Group	313	297
US remittances to the Group	249	322
Asia net remittances to the Group		
Asia paid to the Group:		
Long-term business	491	289
Other operations	60	55
	551	344
Group invested in Asia:		
Long-term business	(107)	(50)
Other operations	(103)	(88)
	(210)	(138)
Total Asia net remittances to the Group	341	206
M&G remittances to the Group	206	213
PruCap remittances to the Group	91	67
Net remittances to the Group from business units	1,200	1,105
Net interest paid	(278)	(282)
Tax received	194	181
Corporate activities	(158)	(139)
Solvency II costs	(47)	(56)
Total central outflows	(289)	(296)
Operating holding company cash flow before dividend[note]	911	809
Dividend paid	(655)	(642)
Operating holding company cash flow after dividend[note]	256	167
Issue of hybrid debt, net of costs	–	340
Repayment of subordinated debt	–	(333)
Hedge purchase cost (equity tail risks)	(32)	–
Other net cash payments	(43)	(205)
Total holding company cash flow	181	(31)
Cash and short-term investments at beginning of year	1,200	1,232
Foreign exchange movements	(1)	(1)
Cash and short-term investments at end of year	1,380	1,200

Note
Including central finance subsidiaries.

Financial review continued

Holding company cash flow continued

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 dividend (after corporate costs) and maximising value for shareholders through the retention of the free surplus generated at business unit level, so that it can be reinvested in the profitable opportunities available to the Group. On this basis, the holding company cash flow statement at an operating level should ordinarily balance close to zero before exceptional cash flows, but from time to time additional remittances from business operations will be made to provide the Group with greater financial flexibility at the corporate centre.

Operating holding company cash flow for 2012 before the shareholder dividend was £911 million, £102 million higher than 2011. After deducting the shareholder dividend the operating holding company cash flow was £256 million (2011: £167 million).

Cash remittances to the Group from business units

The holding company received £1,200 million of net cash remittances from the business units in 2012, an increase of 9 per cent over the £1,105 million received in 2011.

Asia became the largest contributor of cash, with net cash remittances to the Group in 2012 of £341 million (2011: £206 million) exceeding its 2013 cash objective. This includes non-recurring items of £27 million representing cash received from the sale of the Group's holdings in China Life Insurance Company of Taiwan of £97 million offset by repayments of funding contingent on future profits of the Hong Kong Life insurance operations of £70 million. This financing was taken out in 2009 and 2010 in order to increase the financial flexibility of the Group during the investment market crisis and has now been repaid.

Cash received from Jackson of £249 million for 2012 is lower than the £322 million remitted in 2011 as annual remittances return to a more sustainable level. This follows the exceptional release of excess surplus made in the prior year.

The UK insurance operations remitted £313 million in 2012 (2011: £297 million). Cash from the annual with-profits transfer to shareholders contributed £216 million (2011: £223 million). During 2012, surpluses in the UK's shareholder-backed business were utilised to repay £60 million of funding contingent on future profits that was taken out in 2009 and 2010 and to remit a net £97 million (2011: £74 million) to Group. The UK's objective remains £350 million of net cash remittances in 2013.

M&G and PruCap collectively remitted £297 million in 2012, as the asset management businesses continue to remit significant portions of their annual post-tax earnings to the Group.

Net central outflows and other movements

Net central outflows improved to £289 million in 2012 (2011: £296 million) with higher corporate costs offset by lower net interest payments, lower Solvency II costs, and higher tax receipts.

After central costs, there was a net cash inflow before dividend of £911 million in 2012 compared to £809 million in 2011. The dividend paid was £655 million in 2012 compared to £642 million in the same period in 2011.

Outside of the normal recurring central cash flow items and in light of the heightened risks surrounding the Eurozone, we incurred a net cash flow of £32 million for short-dated hedges to provide downside protection against severe equity market falls. We also incurred £43 million of other net cash payments in 2012, representing payments of £68 million to the UK tax authorities following the settlement reached in 2010 on historic tax issues offset by a receipt of £25 million from an increased bank loan in the year. A final instalment on the agreed settlement will be paid in 2013 to the UK tax authorities at a level similar to 2012.

The overall holding company cash and short-term investment balances at 31 December 2012 was £180 million higher than the balance held at the end of 2011 at £1.4 billion. The company seeks to maintain a central cash balance in excess of £1 billion.

EEV balance sheet

Summary

	AER 2012 £m	AER 2011 £m (note)
Goodwill attributable to shareholders	1,469	1,465
Investments	283,428	250,605
Holding company cash and short-term investments	1,380	1,200
Other	23,976	19,475
Total assets	310,253	272,745
Less: Liabilities		
Policyholder liabilities	260,774	227,075
Unallocated surplus of with-profits funds	10,589	9,215
	271,363	236,290
Less: Shareholders' accrued interest in the long-term business	(12,084)	(11,073)
	259,279	225,217
Core structural borrowings of shareholders' financed operations (IFRS book value basis)	3,554	3,611
Other liabilities including non-controlling interest	24,977	24,280
Total liabilities and non-controlling interest	287,810	253,108
EEV basis net assets	22,443	19,637
Share capital and premium	2,017	2,000
IFRS basis shareholders' reserves	8,342	6,564
IFRS basis shareholders' equity	10,359	8,564
Additional EEV basis retained profit	12,084	11,073
EEV basis shareholders' equity (excluding non-controlling interest)	22,443	19,637

Note
The 2011 comparative component of EEV shareholders' funds for the IFRS basis shareholders' equity and the additional EEV basis retained profit have been adjusted for the retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 to the IFRS financial statements. Total EEV shareholders' funds for 2011 are not altered by the change of IFRS policy.

Net asset value per share

	2012	2011
EEV	878p	771p
IFRS	405p	336p

Investments

The Group is exposed to financial risk through its financial assets, financial liabilities and policyholder liabilities. The key financial risk factors that affect the Group include market risk, credit risk and liquidity risk. Information on the Group's exposure to financial risk factors, and our financial risk management objectives and policies, is provided in the Risk and capital management section. Further information on the sensitivity of the Group's financial instruments to market risk and its use of derivatives is also provided in the IFRS financial statements.

The Group's investments are discussed in further detail in the Risk and capital management section B.1.b 'Credit risk'.

Financial review continued

Policyholder liabilities and unallocated surplus of with-profits funds

	2012 £m				2011 £m
Shareholder-backed business	Asia	US	UK	Total	Total
At 1 January	18,269	69,189	46,048	133,506	122,183
Premiums	4,141	14,907	3,801	22,849	20,296
Surrenders	(1,933)	(4,356)	(2,585)	(8,874)	(7,975)
Maturities/Deaths	(226)	(954)	(2,345)	(3,525)	(3,315)
Net cash flows	1,982	9,597	(1,129)	10,450	9,006
Investment related items and other movements	1,539	4,241	4,586	10,366	1,988
Acquisition of REALIC	–	12,912	–	12,912	–
Foreign exchange translation differences	(577)	(3,678)	–	(4,255)	329
At 31 December	21,213	92,261	49,505	162,979	133,506
With-profits funds					
– Policyholder liabilities				97,795	93,569
– Unallocated surplus				10,589	9,215
Total at 31 December				108,384	102,784
Total policyholder liabilities including unallocated surplus at 31 December				271,363	236,290

Policyholder liabilities and unallocated surplus of with-profits funds

Policyholder liabilities relating to shareholder-backed business grew by £29.5 billion from £133.5 billion at 31 December 2011 to £163.0 billion at 31 December 2012.

The increase reflects positive net flows (premiums net of upfront charges less surrenders, maturities and deaths) of £10.5 billion in 2012 (2011: £9.0 billion), driven by strong inflows in the US £9.6 billion and Asia £2.0 billion. The negative net flows in UK £1.1 billion are distorted by the fluctuating nature of unit-linked corporate pension scheme transfers. Net flows in Asia have increased by 8 per cent to £2.0 billion in 2012 (2011: £1.8 billion) while the overall rate of surrenders in the region (expressed as a percentage of opening liabilities) was 10.6 per cent in 2012 (2011: 9.8 per cent). Excluding India, where the market has been going through a significant period of change following regulatory changes in 2010, the surrender rate in 2012 was 9.7 per cent (2011: 9.6 per cent).

Other movements include negative foreign exchange effects of £4.3 billion (2011: positive £0.3 billion) together with investment related and other items of £10.4 billion. Investment related and other items increased from £2.0 billion in 2011 to £10.4 billion in 2012 principally following improvements in the bond and equity markets. The acquisition of REALIC reflects the liabilities acquired at the date of acquisition.

During 2012, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Group's with-profits funds on an IFRS basis, increased by 15 per cent from £9.2 billion at 31 December 2011 to £10.6 billion at 31 December 2012.

Shareholders' net borrowings and ratings

Shareholders' net borrowings at 31 December 2012:

	2012 £m			2011 £m		
	IFRS basis	Mark to market value	EEV basis	IFRS basis	Mark to market value	EEV basis
Perpetual subordinated Capital securities (Innovative Tier 1)	1,746	120	1,866	1,823	(10)	1,813
Subordinated notes (Lower Tier 2)	831	258	1,089	829	120	949
	2,577	378	2,955	2,652	110	2,762
Senior debt:						
2023	300	94	394	300	56	356
2029	249	64	313	249	21	270
Holding company total	3,126	536	3,662	3,201	187	3,388
Prudential Capital	275	–	275	250	–	250
Jackson surplus notes (Lower Tier 2)	153	43	196	160	17	177
Total	3,554	579	4,133	3,611	204	3,815
Less: Holding company cash and short-term investments	(1,380)	–	(1,380)	(1,200)	–	(1,200)
Net core structural borrowings of shareholder-financed operations	2,174	579	2,753	2,411	204	2,615

Shareholders' net borrowings and ratings

On an IFRS basis, the Group's core structural borrowings at 31 December 2012 were broadly unchanged at £3.6 billion.

After adjusting for holding company cash and short-term investments of £1,380 million, net core structural borrowings at 31 December 2012 were £2,174 million compared with £2,411 million at 31 December 2011. The decrease of £237 million represents the net fall in borrowings of £57 million, mainly reflecting the foreign exchange movements in the year, together with a £180 million rise in holding company cash and short-term investments.

In addition to its core structural borrowings set out above, Prudential also has in place an unlimited global commercial paper programme. As at 31 December 2012, commercial paper issued under this programme totalled £183 million, US$1,512 million, €493 million, CHF20 million and AU$12 million. The central treasury function also manages our £5 billion medium-term note (MTN) programme, covering both core and non-core borrowings. In November 2012 Prudential issued a £300 million three-year senior note to pre-finance a £250 million senior note maturing in January 2013 for operational funding. Also in January 2013 Prudential issued a new US$700 million 5.25 per cent perpetual Innovative Tier 1 hybrid under this programme, primarily to Asian retail investors. Under the MTN programme at 31 December 2012 the outstanding subordinated debt was £835 million, US$1,300 million and €20 million and the senior debt outstanding was £550 million. In addition, Prudential's holding company has access to £2.1 billion of syndicated and bilateral committed revolving credit facilities, provided by 17 major international banks, expiring between 2013 and 2017. Apart from small draw downs to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2012. The commercial paper programme, the MTN programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential's holding company and are intended to maintain a strong and flexible funding capacity.

Prudential manages the Group's core debt within a target level consistent with its current debt ratings. At 31 December 2012, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders' funds plus net debt) was 8.8 per cent, compared with 10.9 per cent at 31 December 2011. Prudential plc has strong debt ratings from Standard & Poor's, Moody's and Fitch. Prudential's long-term senior debt is rated A+, A2 and A from Standard & Poor's, Moody's and Fitch, while short-term ratings are A-1, P-1 and F1 respectively. All ratings from Fitch and Moody's are on stable outlook, and all ratings from Standard & Poor's are on negative outlook.

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

Jackson National Life Insurance Company's financial strength is rated AA by Standard & Poor's, A1 by Moody's and AA by Fitch.

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 £7.0 billion at 31 December 2012 (31 December 2011: £6.1 billion), before a deduction for the risk capital margin. The value of the shareholders' interest in future transfers from the UK with-profits fund is estimated at £2.1 billion (31 December 2011: £2.0 billion).

Despite the continued volatility in financial markets, Prudential UK's With-Profits fund performed relatively strongly achieving a 9.8 per cent pre-tax investment return for policyholder asset shares during 2012.