PRUDENTIAL

Adding more to life

Prudential plc 2018 Half Year Financial Report

HK Stock Code: 2378

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By helping to take the financial risk out of life's big decisions, Prudential creates long-term value for our customers, our shareholders and the communities we serve. Adding more to life.

Summary financials

	Half year 2018	Half year 2017	Change on AER basis[7]	Change on CER basis[7]
IFRS operating profit based on longer-term investment returns	**£2,405m**	£2,358m	2%	9%
Underlying free surplus generated[1,2]	**£1,863m**	£1,840m	1%	6%
Life new business profit[3]	**£1,767m**	£1,689m	5%	13%
IFRS profit after tax*,[4]	**£1,356m**	£1,505m	(10)%	(5)%
Net cash remittances from business units	**£1,111m**	£1,230m	(10)%	–

	Half year 2018	Full year 2017	Change on AER basis[7]
IFRS shareholders' funds	**£15.9bn**	£16.1bn	(1)%
EEV shareholders' funds	**£47.4bn**	£44.7bn	6%
Group Solvency II capital surplus[5,6]	**£14.4bn**	£13.3bn	8%

* IFRS profit after tax includes a £513 million pre-tax loss on the reinsurance of £12 billion of UK annuity liabilities.

First interim dividend
15.67 pence **+8%**
(2017: 14.5 pence)

Notes
1 For insurance operations underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes other non-operating items. For asset management businesses it equates to post-tax IFRS operating profit for the period. Further information is set out in note 10 of the EEV basis results.
2 The half year 2017 comparative results have been re-presented from those published previously, following reassessment of the Group's operating segments as described in note B1.3 of the IFRS financial statements. This change in presentation does not alter total comparative IFRS operating profit or IFRS profit after tax.
3 New business profit on business sold in the period, calculated in accordance with EEV principles.
4 IFRS profit after tax reflects the combined effects of operating results determined on the basis of longer-term investment returns, together with negative short-term investments variances, results attaching to disposal of businesses and corporate transactions, amortisation of acquisition accounting adjustments and the total tax charge for the period. In half year 2018 it includes a £513 million pre-tax loss on the reinsurance of £12 billion (valued as at 31 December 2017) of UK annuity liabilities to Rothesay Life.
5 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
6 Before allowing for first interim dividend (31 December 2017: second interim dividend).
7 Further information on actual and constant exchange rates basis is set out in note A1 of the IFRS financial statements.

Measuring our performance

To create sustainable economic value for our shareholders we focus on delivering profitable growth and cash while maintaining appropriate capital.

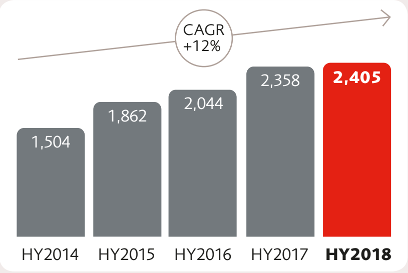
Profit, cash and capital[1]

Prudential takes a balanced approach to performance management across IFRS, EEV and cash. We aim to demonstrate how we generate profit under different accounting bases, reflecting the returns we generate on capital invested and the cash generation of our business.

IFRS operating profit based on longer-term investment returns[2] £m

The Group's business involves entering into long-term contracts with customers, and hence the Group manages its associated assets and liabilities over a longer-term time horizon. This enables the Group to manage a degree of short-term market volatility. Therefore IFRS operating profit based on longer-term investment returns gives a more relevant measure of the performance of the business. Other items are excluded from IFRS operating profit to allow more relevant period-on-period comparisons of the trading operations of the Group, eg the effects of corporate transactions are excluded.

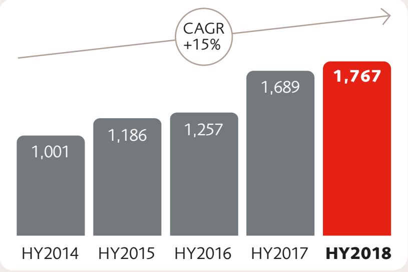
Group IFRS operating profit in the first half of 2018 is 9 per cent higher on a constant exchange rate basis at £2,405 million (2 per cent on an actual exchange rate basis) compared with half year 2017. Asia is up 14 per cent on a constant exchange rate basis (7 per cent on an actual exchange rate basis), the US up 2 per cent on a constant exchange rate basis (down 7 per cent on an actual exchange rate basis) and UK and Europe up 4 per cent.



EEV new business profit[3] £m

Life insurance products are, by their nature, long term and generate profit over a number of years. Embedded value reporting provides investors with a measure of the future profit streams of the Group. EEV new business profit reflects the value of future profit streams which are not fully captured in the year of sale under IFRS reporting.

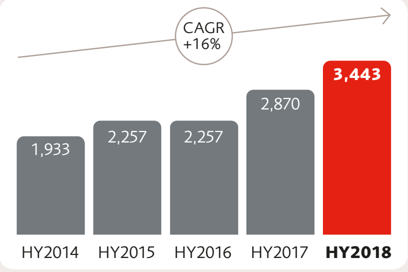
EEV new business profit in the first half of 2018 increased by 13 per cent on a constant exchange rate basis to £1,767 million (5 per cent on an actual exchange rate basis) compared with half year 2017, reflecting improved economic returns across our businesses. Asia is up 11 per cent on a constant exchange rate basis (3 per cent on an actual exchange rate basis), the US up 17 per cent on a constant exchange rate basis (7 per cent on an actual exchange rate basis), and UK and Europe up 11 per cent.



EEV operating profit[3] £m

EEV operating profit is provided as an additional measure of profitability. This measure includes EEV new business profit, the change in the value of the Group's long-term in-force business, and profit from our asset management and other businesses. As with IFRS, EEV operating profit reflects the underlying results based on longer-term investment returns.

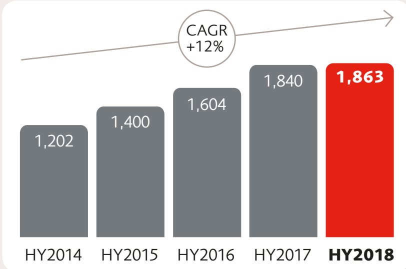
Group EEV operating profit in the first half of 2018 increased by 29 per cent on a constant exchange rate basis to £3,443 million (20 per cent on an actual exchange rate basis), compared with the first half of 2017, driven by the growth in new business profit and in-force profit in the Group's life businesses. The Group EEV operating profit also includes the post-tax IFRS basis profit of the Group's asset management businesses of £296 million (2017: £270 million) and other net expenditure of £382 million (2017: £394 million).



Group free surplus generation[4,5] £m

Free surplus generation is used to measure the internal cash generation of our business units. For insurance operations it represents amounts maturing from the in-force business during the period less investment in new business and excludes other non-operating items. For asset management it equates to post-tax IFRS operating profit for the year.

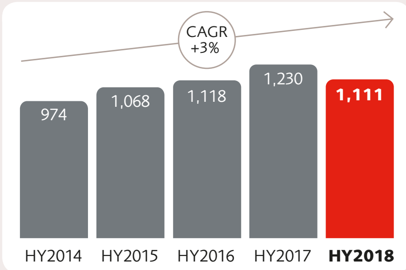
Overall underlying free surplus generation increased by 6 per cent on a constant exchange rate basis to £1,863 million (1 per cent on an actual exchange rate basis), after financing new business growth. This was driven by growth of 14 per cent in Asia on a constant exchange rate basis (7 per cent on an actual exchange rate basis) and 18 per cent in the US on a constant exchange rate basis (8 per cent on an actual exchange rate basis).



Business unit remittances[6] £m

Remittances measure the cash transferred from business units to the Group. Cash flows across the Group reflect our aim of achieving a balance between ensuring sufficient net remittances from business units to cover the dividend (after corporate costs) and the use of cash for reinvestment in profitable opportunities available to the Group.

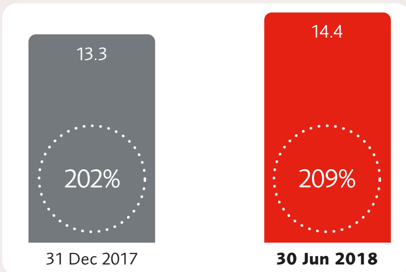
Cash remitted to the corporate centre in the first half of 2018 amounted to £1,111 million (2017: £1,230 million). Asia's net remittance increased to £391 million (2017: £350 million), driven by ongoing business growth. Jackson's remittance was £342 million (2017: £475 million), and the UK and Europe remittance was £341 million (2017: £390 million).



Group Solvency II capital surplus[7,8] £bn

Prudential is subject to the risk-sensitive solvency framework required under European Solvency II Directives (Solvency II) as implemented by the Prudential Regulation Authority in the UK. The Solvency II surplus represents the aggregated capital (own funds) held by the Group, less solvency capital requirements.

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in the Group's shareholder Solvency II capital surplus being estimated at £14.4 billion at 30 June 2018 (equivalent to a solvency ratio of 209 per cent) compared with £13.3 billion (202 per cent) at 31 December 2017.



Notes

1. The comparative results shown above have been prepared using actual exchange rates (AER) basis except where otherwise stated. Comparative results on a constant exchange rate (CER) basis are also shown in financial tables in the Chief Financial Officers' report on our 2018 half year financial performance. CAGR is compound annual growth rate.
2. IFRS operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the IFRS financial statements.
3. The EEV basis results have been prepared in accordance with EEV principles discussed in note 1 of the EEV basis results. A reconciliation between IFRS and the EEV shareholders' funds is included in note II(i) of the Additional financial information.
4. Further information on underlying free surplus generation is set out in note 10 of the EEV basis results.
5. The comparative results have been re-presented from those previously published following reassessment of the Group's operating segments as described in note B1.3 of the IFRS financial statements. On re-presentation, Prudential Capital is excluded from total segment profit and underlying free surplus generated.
6. Cash remitted to the Group forms part of the net cash flows of the holding company. A full holding company cash flow is set out in note II(a) of Additional financial information. This differs from the IFRS Consolidated Statement of Cash Flows which includes all cash flows relating to both policyholders' and shareholders' funds. The holding company cash flow is therefore a more meaningful indicator of the Group's central liquidity.
7. The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
8. Estimated before allowing for the first interim dividend.

Delivering high-quality, profitable growth

I am pleased to report that we have had a good first half of 2018, delivering high-quality, profitable growth. This performance has been achieved alongside good progress towards the demerger of M&G Prudential from Prudential plc, announced in March, which will create two separately listed businesses with distinct investment prospects and capital allocation priorities.

Each of our businesses is built around strong and growing customer needs. The savings and protection requirements of the Asian middle class, the retirement income needs of Americans and the increasing demand for managed savings solutions in the UK and Europe are creating sustained opportunities. We continue to target profitable growth in high-quality, recurring-premium health and protection and fee business.

Financial performance

Our financial performance is again led by Asia, which delivered double-digit growth in new business profit, IFRS operating profit based on longer-term investment returns[1] and underlying free surplus generation.

As in previous years, we comment on our performance in local currency terms (expressed on a constant exchange rate basis) to show the underlying business trends in a period of currency movement.

Group IFRS operating profit increased by 9 per cent[2] to £2,405 million (up 2 per cent on an actual exchange rate basis). Reflecting our strategic priorities and our focus on health and protection products in Asia, insurance margin was 17 per cent[2] higher. IFRS operating profit from our Asia life insurance business increased by 14 per cent[2] and profit from Eastspring, our Asia asset management business, by 13 per cent[2], in line with the uplift in average assets under management. In the US, total IFRS operating profit was up 2 per cent[2], with growth in fee income driven by higher average separate account balances, offset by an expected reduction in spread earnings and a higher DAC amortisation charge. In the UK and Europe, M&G Prudential's total IFRS operating profit increased by 4 per cent, driven by 10 per cent growth in operating profit from asset management operations.

The Group's capital generation continues to be underpinned by our large and growing in-force portfolio and our focus on profitable, short-payback business. Our overall in-force underlying operating free surplus generation[3] increased by 5 per cent[2] to £2,403 million (level on an actual exchange rate basis), reflecting higher contributions across all our business units, partly offset by higher restructuring costs, while investment in new life business increased by 2 per cent[2] (decreased by 5 per cent on an actual exchange rate basis), compared with a 13 per cent[2] increase in new business profit to £1,767 million (5 per cent on an actual exchange rate basis). Overall net cash remitted to the corporate centre in the first half of 2018 was £1,111 million (2017: £1,230 million on an actual exchange rate basis), with Asia being the largest contributor of net remittances to the Group at £391 million (2017: £350 million).

The Group remains strongly capitalised, with a Solvency II cover ratio of 209 per cent[4,5]. Over the period, IFRS shareholders' funds reduced to £15.9 billion, reflecting profit after tax of £1.4 billion (including, as anticipated, a pre-tax loss of £513 million on the reinsurance of £12 billion[6] of annuity liabilities), the 2017 second interim dividend and negative revaluation movements. EEV shareholders' funds increased to £47.4 billion, equivalent to 1,830 pence per share[7,8].

New business profits increased by 13 per cent[2] to £1,767 million (5 per cent on an actual exchange rate basis), reflecting growth across all our business units, and external asset management net flows[9] were £2.7 billion, driven by M&G Prudential asset management.

In Asia, we continue to focus on growing our scale and enhancing the quality of our returns. New business profit grew by 11 per cent[2], despite the 4 per cent[2] decline in APE sales, reflecting an improved sales mix, pricing actions and prioritisation of regular premium health and protection business. The quality in our sales is also evident in the 19 per cent[2] increase in health and protection-related new business profit. While headline sales for the half year declined, our businesses saw improved performance in the second quarter with overall growth of 6 per cent[2] compared to the same period in 2017. This quarterly growth was broad based with six businesses (including Hong Kong and China) growing at a double digit rate.

In the US, while variable annuity sales were slightly reduced and institutional sales were 19 per cent[2] lower, the combination of higher interest rates and beneficial tax reform underpinned an increase in new business profit of 17 per cent[2].

M&G Prudential continues to perform well, with robust external net inflows of £3.5 billion in its external asset management business and PruFund-related net inflows of £4.4 billion. Life new business profit increased by 11 per cent, primarily driven by a 7 per cent increase in APE sales. Overall assets under management[10] were £341.9 billion, £9 billion lower than at the end of 2017, mainly as a result of the £12 billion[6] of annuity liabilities reinsured to Rothesay Life, announced in March.

Long-term opportunities

We are focused on long-term, sustainable opportunities arising from structural trends in Asia, the US, the UK and Europe.

Across Asia, the multiple insurance markets in which we operate are benefiting from economic and demographic tailwinds that are driving demand for our products. Our prospects are underpinned by low insurance market penetration (currently under 3 per cent[11]), high levels of out-of-pocket healthcare spend (42 per cent of total spend[12]), a fast-rising working population (1 million per month, expected to rise to 2.5 billion people by 2030[13]) and improved life expectancy (the number of people over 60 years of age is expected to double to over 1 billion by 2050[13]). The scale of our presence across life and asset management, which gives us access to 3.6 billion people[14], means that our business is well placed to benefit from these trends.

In the United States, the world's largest retirement market, approximately 40 million people will reach retirement age over the next decade alone[15]. These consumers have a clear need for investment options that will increase their savings and protect their incomes for the rest of their lives. We are broadening the range of options we offer in order to meet the varied preferences of these consumers and intermediaries.

In the UK and Europe, the number of people of retirement age is forecast to grow by 55 million over the next four decades[16]. The region's wealth is increasingly concentrated in the hands of the older generations: in the UK the over-55s control two-thirds of the nation's total wealth[17]. Many of these savers want products that offer better returns than cash, while smoothing out the ups and downs of markets. M&G Prudential is ideally placed to meet this growing demand for investment solutions with its market-leading with-profits funds and comprehensive range of actively managed funds. Once demerged from the Group, supported by the benefits of its merger and transformation programme, M&G Prudential is expected to be in an even better position to serve these customers as an independent, capital-efficient business.

Developing our businesses

We are constantly working to improve what we do for our customers, across all our markets. We pay close attention to their changing needs and respond with an evolving suite of high-quality products and services. At the same time, we constantly develop our capabilities to serve our customers and add value for our shareholders.

In Asia, we are continuing to build our broad-based portfolio of businesses and improve the way we serve our customers. We employ a multi-channel strategy to maximise our reach across the region. Our highly productive agency force is complemented by our bancassurance partnerships, which have expanded following the signing of new agreements in Thailand, the Philippines, Indonesia and Vietnam so far this year. We maintain a contemporary suite of products and remain at the forefront of product developments, evolving our offering to meet changing customer needs. In Hong Kong, we launched a new critical illness product with extended protection for cancer, heart attacks and strokes, three common causes of death. In Singapore we unveiled PRUVital cover, a first-in-the-market protection plan, for customers with four types of pre-existing chronic medical conditions, and in China we have recently started offering customers a new savings product, designed with education costs in mind. To support our agency and bank channels, we also embrace new digital capabilities to increase efficiency and improve our customers' experience. In Hong Kong, for example, we developed two new innovations, 'Hospital to Prudential' and 'Chatbot Claims', to redefine the way our customers and medical professionals manage hospital claims, significantly reducing the time and effort required. In addition we have recently announced an exclusive partnership with UK-based Babylon Health[18] that will add a comprehensive set of digital health tools to our existing world-class protection products. Through a Babylon-enabled digital platform we will offer customers in up to 12 Asian markets a world-leading suite of artificial intelligence ('AI') health services, including personal health assessment and treatment information, empowering users to proactively manage their health in a flexible and cost-efficient manner.

China represents an important growth opportunity for us. Operating through our joint venture, CITIC-Prudential, we now have access to around 70 per cent of the population following the disciplined expansion of our footprint over the past 18 years. In April we took another step forward when CITIC-Prudential received regulatory approval to begin preparations for the establishment of a new branch in Hunan, China's seventh-largest province, with a population of 68 million. Our business in China is the highest rated in the industry for risk management[19], and was among the first group of insurers to be granted approval to offer a tax-deferred pension insurance programme, as part of a pilot programme targeted on Shanghai, Suzhou and Fujian.

Eastspring, our Asian fund manager is well placed to capitalise on the expected growth in Asia's retail mutual fund market. Eastspring has a presence in 11 markets across the region following its recent entry into Thailand in July. Eastspring's consistent investment performance helped it to win Asian Investor's prestigious Asia Fund House of the Year award for 2018, for the third time in four years. In China, the establishment of our investment management wholly foreign-owned enterprise will enable Eastspring to create an on-the-ground team that will operate an onshore investment management business. This business complements our existing asset management joint venture partnership with CITIC and represents an important step in deepening our presence in this market.

In the US, we continue to develop our business to ensure that we best address the opportunity presented by the millions of Americans entering retirement and their need for secure income. During the first half of 2018, we continued to strengthen our position in the US fee-based advisory market through new relationships with key distributors and the launch of relevant products, including a new fee-based index annuity. Jackson has also played a leading role in bringing together 24 of the country's financial services organisations to launch the Alliance for Lifetime Income. This aims to educate Americans about the need for protected retirement income, enabling more customers to take action to secure their financial futures.

In the UK and Europe, M&G Prudential continues to improve customer outcomes, leveraging our scale, financial strength and complementary product and distribution capabilities to develop and deliver capital-efficient investment solutions for a range of customer needs. It is one year since we announced the merger and transformation of M&G and Prudential UK & Europe. In that time, we have made good progress, announcing a new partnership with Tata Consulting Services to modernise our existing life portfolio, developing a combined approach to distribution and creating central service functions. M&G Prudential's investment products continue to perform well. We announced £2.1 billion in annual with-profits bonuses, lifting the value of contracts by up to 10 per cent and marking the ninth consecutive year of positive returns for investors in our market-leading PruFund. Over the three years to 30 June, 58 per cent of M&G's retail funds generated returns in the upper quartiles of performance. I would like to thank Anne Richards for her contribution to the Group's success as Chief Executive of M&G Investments. As announced on 27 July 2018, Anne is resigning from the Group, effective on 10 August 2018, to take up a new senior position in the financial services industry, and we wish her all the best.

We are also continuing to develop our newer but growing businesses in five markets in Africa. During the first half of the year APE sales rose to £18 million[20] (2017: £8 million), reflecting growth in our agency force and new distribution agreements with Standard Chartered Bank in Ghana and Zenith Bank in Nigeria and Ghana.

Demerger of M&G Prudential

At the same time as delivering growth in operating performance, we have been focused on progressing the actions needed for the demerger of M&G Prudential from the Group. Our internal teams have been mobilised and we are engaging positively with external stakeholders. We have also announced leadership changes at M&G Prudential in preparation for the demerger. Clare Bousfield will become Chief Financial Officer and John Foley, Chief Executive of M&G Prudential, will take on the additional responsibilities of becoming Chief Executive of the key regulated entities of M&G and Prudential UK & Europe. These changes will simplify the way we make decisions, improve accountability and align management capabilities with M&G Prudential's future needs as an independent listed business. As we outlined in March, we believe we will be better able to focus on meeting our customers' rapidly evolving needs and to deliver long-term value to investors as two separate businesses. Following separation, M&G Prudential will have control over its business strategy and capital allocation, which will enable it to play a greater role in developing the savings and retirement markets in the UK and Europe through two of the financial sector's most trusted brands, M&G and Prudential UK & Europe. Prudential plc, focused on our market-leading businesses in Asia and the US, will be strongly positioned to develop consistent, attractive returns and realise the growth potential across our international footprint.

Until the demerger is completed, the Bank of England's Prudential Regulation Authority (PRA) will continue to be the group-wide supervisor of Prudential plc. In line with the current Solvency II requirements, the PRA will be the group-wide supervisor of M&G Prudential following the demerger. After the demerger, Prudential plc's individual insurance and asset management businesses will continue to be supervised at a local entity level and local statutory capital requirements will continue to apply. The Supervisory College, made up of the authorities overseeing the principal regulated activities in jurisdictions where the future Prudential plc will operate, has made a collective decision that Hong Kong's Insurance Authority should become the new group-wide supervisor for Prudential plc and they have begun preparations to take over that role. Prudential plc will continue to be headquartered and domiciled in the United Kingdom and will continue to hold a premium listing on the London Stock Exchange. Both Prudential plc and M&G Prudential are expected to meet the criteria for inclusion in the FTSE 100 index.

Positive outlook

We remain focused on our purpose, which is to help remove uncertainty from the big events in the lives of our customers. We have strong underlying opportunities, a proven ability to deliver for our customers, an ongoing focus on risk management and a strong balance sheet. Our planned demerger of M&G Prudential demonstrates our commitment to creating shareholder value. I am confident that we are well positioned to continue to grow profitably and provide value for our shareholders and customers into the future.

Mike Wells
Group Chief Executive

Notes

1 IFRS operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the IFRS financial statements.
2 Increase stated on a constant exchange rate basis.
3 For insurance operations underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes non-operating items. For asset management businesses it equates to post-tax IFRS operating profit for the period. Restructuring costs are presented separately from the underlying business unit amount. Further information is set out in note 10 of the EEV basis results.
4 Before allowing for first interim dividend (31 December 2017: second interim dividend).
5 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
6 Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.
7 The EEV basis results have been prepared in accordance with EEV principles discussed in note 1 of EEV basis results. A reconciliation between IFRS and the EEV shareholder funds is included in note II(i) of the Additional financial information.
8 Closing EEV shareholders' funds divided by issued shares, as set out in note II(l) of the Additional financial information.
9 Net inflows exclude Asia Money Market Fund (MMF) inflows of £665 million (2017: net inflows £449 million on an actual exchange rate basis).
10 Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
11 Swiss Re Sigma 2017. Insurance penetration calculated as premiums in % of GDP. Asia penetration calculated on a weighted population basis.
12 World Health Organisation – Global Health Observatory data repository (2013). Out of pocket as % of Total Health Expenditure. Asia calculated as a weighted average out of pocket.
13 United Nations, Department of Economic and Social Affairs, Population Division, World Population Prospects 2017 Revision.
14 United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision, custom data acquired via website.
15 Based on approximately four million people per year reaching age 65 over the period 2018-2028 – source: U.S. Census Bureau, Population Division.
16 Office for National Statistics & Eurostat.
17 Office for National Statistics.
18 Exclusivity is in respect of up to 12 health, life and pension markets in Asia.
19 Source: 2017 Solvency Aligned Risk Margin Requirements and Assessment (SARMRA) issued by the China Insurance Regulatory Commission (CIRC).
20 Given the relative immaturity of the African business, it is incorporated into the Group's EEV results on an IFRS basis and for now it is excluded from our new business sales and profit metrics.

02

Business performance

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Chief Financial Officer's report on the 2018 first half financial performance – Mark FitzPatrick

Driving targeted growth in high-quality business

Our financial results in the first half of 2018 continue to reflect the benefits of driving targeted growth in high-quality, recurring premium health and protection and fee business across our geographies, products and distribution channels. We have also made progress in the ongoing preparations for the demerger of M&G Prudential from Prudential plc and in delivering M&G Prudential's merger and transformation programme.

The growth in our financial performance across a wide range of metrics has again been led by our businesses in Asia which delivered double-digit growth in new business profit (up 11 per cent[1]), IFRS operating profit based on longer-term investment returns ('IFRS operating profit') (up 14 per cent[1]) and underlying free surplus generation[2] (up 14 per cent[1]). In the US, fee income[3] increased by 13 per cent[1] supported by higher average separate account balances and continued positive net flows, but was balanced by an expected reduction in spread income and increased amortisation of deferred acquisition costs.

M&G Prudential delivered external net inflows of £3.5 billion in its asset management business. This, together with PruFund-related net inflows of £4.4 billion and the reduction arising from the previously announced reinsurance of a £12 billion[4] UK annuity portfolio resulted in overall assets under management[5] of £341.9 billion at 30 June 2018 (31 December 2017: £350.7 billion). M&G Prudential remains on track to deliver the announced annual shareholder cost savings of circa £145 million by 2022 for a shareholder investment of circa £250 million.

Sterling weakened moderately compared with most of the currencies in our major international markets over the first half of 2018. However, average exchange rates over the first half of 2018 remained above those in the same period of 2017, leading to a negative effect on the translation of the results from our non-sterling operations. To aid comparison of underlying progress, we continue to express and comment on the performance trends of our international businesses on a constant currency basis.

During the first half of 2018 the performance of many equity markets was subdued and characterised by higher levels of volatility with the S&P 500 index up 2 per cent, the FTSE 100 index down 1 per cent and the MSCI Asia excluding Japan down 5 per cent. However, all these equity markets remain above first half 2017 levels. Longer-term yields increased favourably in the US and in our larger Asia markets, but were only slightly higher in the UK.

The key operational highlights in the first half of 2018 were as follows:

— **New business profit** was 13 per cent higher at £1,767 million (up 5 per cent on an actual exchange rate basis). Asia new business profit increased 11 per cent, with improved new business margins reflecting product mix, pricing actions and our focus on health and protection business. In the US, the benefit of tax reform and higher interest rates more than offset lower headline APE sales volumes to drive new business profit growth of 17 per cent. At M&G Prudential, higher sales at an improved margin contributed to 11 per cent growth.

— **Asset management net inflows** at M&G Prudential were robust with external net inflows of £3.5 billion (2017: net inflows of £7.2 billion) in its wholesale/direct and institutional business. Eastspring reported external net outflows of £0.9 billion excluding money market funds (2017: net inflows of £2.3 billion on an actual exchange rate basis) with modestly positive retail net flows offset by higher institutional bond fund redemptions.

— **IFRS operating profit based on longer-term investment returns** increased 9 per cent to £2,405 million (2 per cent on an actual exchange rate basis). IFRS operating profit from our Asia businesses increased by 14 per cent to £1,016 million driven by the compounding nature of our regular premium protection businesses. In the US, IFRS operating profit was 2 per cent higher with increased fee income offset by an expected reduction in spread earnings and a higher DAC amortisation charge. M&G Prudential's total IFRS operating profit was £778 million, 4 per cent higher than the prior year. Within this, asset management earnings increased by 10 per cent resulting from higher fees driven by higher average assets under management, and operating profit from our core with-profits and annuity life businesses were lower at £255 million (2017: £288 million), reflecting the impact of the previously announced annuity portfolio reinsurance.

— **Total IFRS post-tax profit** was £1,356 million (2017: £1,425 million), after a £513 million anticipated pre-tax loss following the reinsurance of UK annuities to Rothesay Life, contributing to **Group IFRS shareholders' equity** of £15.9 billion (31 December 2017: £16.1 billion). EEV basis shareholders' equity was £47.4 billion (31 December 2017: £44.7 billion).

— **Underlying free surplus generation**[2,6], our preferred measure of cash generation from our life and asset management businesses, increased 6 per cent to £1,863 million (up 1 per cent on an actual exchange rate basis), after financing new business growth. This performance metric was driven by 14 per cent growth from our Asian operations and 18 per cent growth in our US business.

— **Group shareholders' Solvency II capital surplus**[7,8] was estimated at £14.4 billion at 30 June 2018, equivalent to a cover ratio of 209 per cent (31 December 2017: £13.3 billion, 202 per cent). The movement since the start of the year primarily reflects the Group's continuing strong operating capital generation, partially offset by the payment of the 2017 second interim dividend.

IFRS profit[6]

	Actual exchange rate			Constant exchange rate	
	Half year 2018 £m	**Half year 2017** £m	**Change** %	**Half year 2017** £m	**Change** %
Operating profit before tax based on longer-term investment returns					
Asia					
Long-term business	**927**	870	7	812	14
Asset management	**89**	83	7	79	13
Total	**1,016**	953	7	891	14
US					
Long-term business	**1,001**	1,079	(7)	988	1
Asset management	**1**	(6)	117	(6)	117
Total	**1,002**	1,073	(7)	982	2
UK and Europe					
Long-term business	**487**	480	1	480	1
General insurance commission	**19**	17	12	17	12
Total insurance operations	**506**	497	2	497	2
Asset management	**272**	248	10	248	10
Total	**778**	745	4	745	4
Other income and expenditure[9]	**(329)**	(382)	14	(376)	13
Total operating profit based on longer-term investment returns before tax and restructuring costs	**2,467**	2,389	3	2,242	10
Restructuring costs[9]	**(62)**	(31)	(100)	(31)	(100)
Total operating profit based on longer-term investment returns before tax	**2,405**	2,358	2	2,211	9
Non-operating items:					
Short-term fluctuations in investment returns on shareholder-backed business	**(113)**	(573)	80	(523)	78
Amortisation of acquisition accounting adjustments	**(22)**	(32)	31	(29)	24
(Loss) profit attaching to disposal of businesses and corporate transactions	**(570)**	61	n/a	61	n/a
Profit before tax	**1,700**	1,814	(6)	1,720	(1)
Tax charge attributable to shareholders' returns	**(344)**	(309)	(11)	(295)	(17)
Profit for the period	**1,356**	1,505	(10)	1,425	(5)

IFRS earnings per share

	Actual exchange rate			Constant exchange rate	
	Half year 2018 pence	**Half year 2017** pence	**Change** %	**Half year 2017** pence	**Change** %
Basic earnings per share based on operating profit after tax	**76.8**	70.0	10	65.7	17
Basic earnings per share based on total profit after tax	**52.7**	58.7	(10)	55.6	(5)

IFRS operating profit based on longer-term investment returns
Total IFRS operating profit increased by 9 per cent (2 per cent on an actual exchange rate basis) in the first half of 2018 to £2,405 million.

Asia total operating profit was 14 per cent higher (7 per cent on an actual exchange rate basis) at £1,016 million, and includes 13 per cent growth from Eastspring's asset management businesses. Life insurance operating profit was 14 per cent higher at £927 million, driven by continued growth in insurance margin which increased by 17 per cent, reflecting our focus on recurring premium health and protection business. This strategy underpins IFRS operating profit growth of 33 per cent and 22 per cent in Hong Kong and China respectively. IFRS operating profit in Singapore increased 11 per cent, while the contribution from Indonesia was the same as in the first half of last year.

US total operating profit at £1,002 million increased by 2 per cent (7 per cent decrease on an actual exchange rate basis), with increased fee income driven by a 10 per cent increase in separate account balances since 30 June 2017 offset by a decline in spread income, reflecting the impact of lower yields on our fixed annuity portfolio and reduced contribution from asset duration swaps, and a higher DAC amortisation charge. The higher DAC expense arises largely from a £42 million acceleration of amortisation relating primarily to the reversal of the benefit received in 2015 under the mean reversion formula.

UK and Europe total operating profit of £778 million was 4 per cent higher, reflecting growth of 10 per cent in asset management operating profit and 11 per cent in the UK with-profits transfer. This was partially offset by the anticipated reduction in profit from in-force annuities following the reinsurance of £12 billion[4] of annuity liabilities to Rothesay Life in March 2018. Operating earnings in the first half of 2018 also benefited from management actions of £63 million (2017: £188 million) and a £166 million insurance recovery related to the costs of reviewing internally vesting annuities sold without advice after 1 July 2008, for which a provision of £400 million had previously been established.

Life insurance profit drivers
We track the progress that we make in growing our life insurance business by reference to our obligations to our customers, which are referred to in the financial statements as policyholder liabilities. Each period these increase as we write new business and collect regular premiums from existing customers and decrease as we pay claims and policies mature. These policyholder liabilities contribute, for example, to our ability to earn fees on the unit-linked element and indicates the scale of the insurance element, another key source of profitability for the Group.

Shareholder-backed policyholder liabilities and net liability flows[10]

	Actual exchange rate				Actual exchange rate			
	Half year 2018 £m				Half year 2017 £m			
	At 1 January	Net liability flows[11]	Market and other movements	At 30 June	At 1 January	Net liability flows[11]	Market and other movements	At 30 June
Asia	37,402	1,463	(717)	38,148	32,851	1,016	1,173	35,040
US	180,724	82	4,344	185,150	177,626	1,958	(1,805)	177,779
UK and Europe	56,367	(1,813)	(12,238)	42,316	56,158	(1,167)	1,500	56,491
Total Group	274,493	(268)	(8,611)	265,614	266,635	1,807	868	269,310

Focusing on the business supported by shareholder capital, which generates the majority of life profit, in the first half of 2018 net flows into our businesses reflected positive net inflows into our Asia and US operations, which have been offset by outflows from our UK and Europe operations. US net inflows remained positive, but at a lower level, reflecting a lower level of institutional business and a higher level of variable annuity surrenders as our portfolio develops. The outflow from our UK and Europe operations primarily reflects the run-off of the in-force annuity portfolio following our withdrawal from selling new annuity business and outflows from unit-linked business which is driven by more variable movements in corporate pension business. This decrease in shareholder liabilities has been partly offset by the flows into the with-profit funds of £1.8 billion as shown in the table below. Market and other movements include the £12 billion[4] reduction in policyholder liabilities arising from the classification of the annuity liabilities reinsured to Rothesay Life as held for sale. Excluding this reclassification market and other movements increased liabilities by £3.4 billion reflecting currency effects as sterling weakened over the period, partly offset by adverse market movements in the first half.

Policyholder liabilities and net liability flows in with-profits business[10,12]

	Actual exchange rate Half year 2018 £m				Actual exchange rate Half year 2017 £m			
	At 1 January	Net liability flows[11]	Market and other movements	At 30 June	At 1 January	Net liability flows[11]	Market and other movements	At 30 June
Asia	36,437	2,399	31	38,867	29,933	2,295	1,053	33,281
UK and Europe	124,699	1,832	(675)	125,856	113,146	1,574	3,729	118,449
Total Group	161,136	4,231	(644)	164,723	143,079	3,869	4,782	151,730

Policyholder liabilities in our with-profits business have increased by 2 per cent[13] to £164.7 billion in the first half of 2018, driven by growth in M&G Prudential's PruFund proposition and participating products in Asia, with consumers seeking protection from the impact of volatile market conditions. As returns from these funds are smoothed and shared with customers, the emergence of shareholder profit is more gradual. The business, nevertheless, remains an important source of shareholder value.

Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver[14]

	Actual exchange rate						Constant exchange rate		
	Half year 2018			Half year 2017			Half year 2017		
	Operating profit £m	Average liability £m	Margin bps	Operating profit £m	Average liability £m	Margin bps	Operating profit £m	Average liability £m	Margin bps
Spread income	454	80,938	112	583	89,314	131	543	85,504	127
Fee income	1,320	172,662	153	1,279	164,152	156	1,175	153,255	153
With-profits	187	145,813	26	172	132,701	26	170	131,600	26
Insurance margin	1,213			1,152			1,072		
Margin on revenues	1,083			1,138			1,069		
Expenses:									
Acquisition costs*	(1,133)	3,322	(34)%	(1,241)	3,624	(34)%	(1,154)	3,411	(34)%
Administration expenses	(1,177)	257,782	(91)	(1,115)	259,451	(86)	(1,040)	244,721	(85)
DAC adjustments	154			186			173		
Expected return on shareholder assets	103			103			100		
	2,204			2,257			2,108		
Share of related tax charges from joint ventures and associate[15]	(18)			(16)			(16)		
Longevity reinsurance and other management actions to improve solvency	63			188			188		
Insurance recoveries of costs associated with review of past annuity sales	166			–			–		
Operating profit based on longer-term investment returns	2,415			2,429			2,280		

* The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business.

We continue to maintain our preference for higher-quality sources of income such as insurance margin and fee income. We favour insurance margin because it is relatively insensitive to the equity and interest rate cycle and prefer fee income to spread income because it is more capital-efficient. In line with this approach, on a constant exchange rate basis, in the first half of 2018, insurance margin has increased by 13 per cent (up 5 per cent on an actual exchange rate basis) and fee income by 12 per cent (up 3 per cent on an actual exchange rate basis), while spread income declined by 16 per cent (down 22 per cent on an actual exchange rate basis). Administration expenses increased to £1,177 million (2017: £1,040 million) as the business continues to expand, including an increase in US asset-based commissions on higher separate account balances which are treated as an administrative expense in this analysis.

Asset management profit drivers

Movements in asset management operating profit are influenced primarily by changes in the scale of these businesses, as measured by funds managed both on behalf of external institutional and retail customers and our internal life insurance operations.

Asset management external funds under management[16,17]

	Actual exchange rate Half year 2018 £m				Actual exchange rate Half year 2017 £m			
	At 1 January	Net flows	Market and other movements	At 30 June	At 1 January	Net flows	Market and other movements	At 30 June
UK and Europe	163,855	3,548	(1,913)	165,490	136,763	7,179	5,176	149,118
Asia[18]	46,568	(863)	(3,335)	42,370	38,042	2,273	4,281	44,596
Total asset management	210,423	2,685	(5,248)	207,860	174,805	9,452	9,457	193,714
Total asset management (including MMF)	219,740	3,350	(5,163)	217,927	182,519	9,951	9,571	202,041

Average assets under management in both our Asia and UK and Europe asset management businesses were higher compared with the prior period, and reflect positive net flows in the period in the UK and Europe, and favourable market performance over the second half of 2017. IFRS operating profit from **M&G Prudential** asset management increased by 10 per cent to £272 million and by 13 per cent at **Eastspring** (up 7 per cent on an actual exchange rate basis) to £89 million.

M&G Prudential's external assets under management have continued to benefit from net inflows during the period backed by strong investment performance. External net flows totalled £3.5 billion (2017: net flows of £7.2 billion), led by contributions from European investors in the Optimal Income Fund and our multi-asset fund range, and from institutional clients investing in illiquid credit and equity infrastructure strategies. The contribution from positive net flows was partly offset by negative market movements, resulting in overall external assets under management at 30 June 2018 of £165.5 billion, up 1 per cent compared with the start of the year. M&G Prudential's total assets under management at 30 June 2018 were £341.9 billion (31 December 2017: £350.7 billion) with external growth offset by lower internally managed assets following the £12 billion[4] annuity portfolio reinsurance to Rothesay Life. IFRS operating profit increased 10 per cent to £272 million, consistent with the year-on-year increase in average assets under management and reflecting a stable cost-income ratio of 54 per cent. M&G's full year cost-income ratio is typically higher than for the first half, as its cost base is weighted towards the second half of the year (half year 2017: 53 per cent, full year 2017: 58 per cent).

Eastspring reported net outflows[18] of £0.9 billion as modest retail inflows were more than offset by higher redemptions in institutional fixed income products. Eastspring's total assets under management were stable at £138.2 billion (31 December 2017: £138.9 billion), reflecting total net flows (including those from money market funds and from assets managed for internal life operations) of £3.0 billion, offset by market and other movements. Eastspring's cost-income ratio improved to 54 per cent (2017: 55 per cent).

Other income and expenditure and restructuring costs[9]
Overall net central expenditure reduced to £391 million (2017: £407 million) as higher restructuring costs relating to the UK merger and transformation programme were balanced by a reduction in the interest payable on core borrowings.

IFRS non-operating items[9]
IFRS non-operating items consist of negative short-term fluctuations of £113 million (2017: £523 million), losses on the disposal of businesses and other corporate transactions of £570 million and the amortisation of acquisition accounting adjustments of £22 million (2017: £29 million) arising principally from the REALIC business acquired in 2012. Losses on the disposal of businesses and other corporate transactions include a pre-tax loss of £513 million arising from the reinsurance of a portfolio of UK and Europe annuity contracts with Rothesay Life. Further information on other transactions is given in note D1 of the IFRS financial statements. Short-term investment fluctuations are discussed further below.

IFRS short-term investment fluctuations
IFRS operating profit is based on longer-term investment return assumptions. The difference between actual investment returns recorded in the income statement and the assumed longer-term returns is reported within short-term fluctuations in investment returns. In the first half of 2018 the total short-term fluctuations in investment returns relating to the life operations were negative £113 million, comprising negative £326 million for Asia, positive £244 million in the US, negative £122 million in the UK and Europe and positive £91 million in other operations[32].

Rising interest rates in many territories in Asia led to unrealised bond losses in the period, and widening credit spreads and a rise in interest rates in the UK led to losses on fixed income assets supporting the capital of the shareholder-backed annuity business. In the US, Jackson provides certain guarantees on its annuity products, the value of which would typically rise when equity markets fall and long-term interest rates decline. The 46 basis points rise in the 10 year US Treasury yield has resulted in a positive impact from the revaluation of the IFRS guarantee liabilities in the current period.

IFRS effective tax rates
In the first half of 2018, the effective tax rate on IFRS operating profit based on longer-term investment returns was 18 per cent (2017: 24 per cent). The lower rate is due mainly to the reduction in the US corporate income tax rate from 35 per cent to 21 per cent which took effect from 1 January 2018.

The effective tax rate on the total IFRS profit was 20 per cent in the first half of 2018 (2017: 17 per cent). This reflects a higher effective tax rate in Asia as a result of non-operating investment losses in the first half of 2018 which do not attract tax relief, and also a higher effective tax rate in the US as a result of generating non-operating taxable profits in the first half of 2018, compared to the non-operating taxable losses generated in the first half of 2017.

The main driver of the Group's effective tax rate overall is the mix of profits between jurisdictions with higher tax rates (such as Indonesia and Malaysia), jurisdictions with lower tax rates (such as Hong Kong and Singapore) and jurisdictions with rates in between (such as the UK and the US).

Total tax contribution

The Group continues to make significant tax contributions in the countries in which it operates, with £1,560 million remitted to tax authorities in the first half of 2018. This was lower than the equivalent amount of £1,595 million (on an actual exchange rate basis) in the first half of 2017. This reduction reflects a decrease in corporation tax payments, down from £535 million (on an actual exchange rate basis) to £305 million, partly offset by increases in payroll taxes, property taxes and taxes collected from customers. The reduction in corporation tax payments reflects the full impact of changes in the US basis for taxing derivatives introduced in 2015 which transitioned into effect across the 2016 to 2018 tax returns.

Publication of tax strategy

In May 2018 the Group published its updated tax strategy which, in addition to complying with mandatory requirements, also included a number of additional disclosures, including a breakdown of revenues, profits and taxes for all jurisdictions where more than £5 million tax was paid. This disclosure was included as a way of demonstrating that our tax footprint (ie where we pay taxes) is consistent with our business footprint.

New business performance

Life EEV new business profit and APE new business sales (APE sales)

	Actual exchange rate						Constant exchange rate			
	Half year 2018 £m		Half year 2017 £m		Change %		Half year 2017 £m		Change %	
	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit	APE sales	New business profit
Asia	1,736	1,122	1,943	1,092	(11)	3	1,811	1,009	(4)	11
US	816	466	960	436	(15)	7	879	399	(7)	17
UK and Europe	770	179	721	161	7	11	721	161	7	11
Total Group	3,322	1,767	3,624	1,689	(8)	5	3,411	1,569	(3)	13

Life insurance new business APE sales decreased by 3 per cent (8 per cent on an actual exchange rate basis) to £3,322 million. **Life insurance new business profit** increased 13 per cent (5 per cent on an actual exchange rate basis) to £1,767 million reflecting improved economic returns across our businesses.

In **Asia**, new business profit was 11 per cent higher at £1,122 million, benefiting from product mix, pricing actions and positive momentum in prioritising regular premium health and protection business. Our strength in executing this strategy was reflected in a 19 per cent increase in health and protection new business profit. Both agency and bank channels delivered double-digit growth in new business profit.

In Hong Kong, new business profit increased by 14 per cent, on lower sales volumes, which is a clear indication of the success of our strategic emphasis on health and protection business alongside a more positive interest rate environment.

Outside Hong Kong our sales performance remains broad-based with seven countries delivering double digit new business profit growth. Of particular note were Singapore, where new business profit increased 20 per cent on higher volumes and positive mix effects, and China, where a 15 per cent growth in new business profit was achieved, driven by a higher weighting of regular premium business and product actions. Growth in new business profit in Thailand (up 43 per cent), Vietnam (up 17 per cent), Philippines (up 12 per cent) and Malaysia (up 8 per cent) also reflects our value focus. In Indonesia our agency-dominated distribution continues to experience challenging conditions, combined with the adverse impact of higher yields, contributing to a decline of 24 per cent in new business profit.

In the **US**, new business profit increased by 17 per cent to £466 million reflecting the combined effects of higher US interest rates and the benefit of US tax reform. Jackson's variable annuity APE sales declined 3 per cent compared with the prior period which had benefited from competitor 'buy-out' activity, and increased moderately excluding this effect. This, alongside lower institutional sales, led to an overall reduction in APE sales of 7 per cent.

In our **UK and Europe** life business, new business profit increased by 11 per cent, driven by higher sales and improved economics. Overall APE sales increased 7 per cent, with PruFund sales 7 per cent higher, led by further growth in individual pensions (up 13 per cent) and income drawdown business (up 16 per cent), partly offset by lower bond sales. This resulted in PruFund net flows of £4.4 billion, leading to an increase in PruFund assets under management in the period of 12 per cent to £40.3 billion (31 December 2017: £35.9 billion).

Free surplus generation[2,6]

	Actual exchange rate			Constant exchange rate	
	Half year 2018 £m	Half year 2017 £m	Change %	Half year 2017 £m	Change %
Asia	850	836	2	782	9
US	773	797	(3)	729	6
UK and Europe	824	784	5	784	5
Underlying free surplus generated from in-force life business and asset management before restructuring costs	2,447	2,417	1	2,295	7
Restructuring costs	(44)	(6)	(633)	(6)	(633)
Underlying free surplus generated from in-force life business and asset management	2,403	2,411	–	2,289	5
Investment in new business	(540)	(571)	5	(532)	(2)
Underlying free surplus generated	1,863	1,840	1	1,757	6
Market related movements, timing differences and other movements	(1,001)	(321)			
Profit attaching to corporate transactions	111	76			
Net cash remitted by business units	(1,111)	(1,230)			
Total movement in free surplus	(138)	365			
Free surplus at 30 June	7,440	6,931			

Free surplus generation is the financial metric we use to measure the internal cash generation of our business operations and is based on the capital regimes which apply locally in the various jurisdictions in which our life businesses operate. For life insurance operations it represents amounts maturing from the in-force business during the period, net of amounts reinvested in writing new business. For asset management it equates to post-tax IFRS operating profit for the period.

We drive free surplus generation by targeting markets and products that have low-strain, high-return and fast payback profiles and by aiming to deliver both good service and value to improve customer retention. Our ability to generate both high quality growth and cash is a distinctive feature of Prudential.

In the first half of 2018 underlying free surplus generation from our in-force life insurance and asset management business increased by 5 per cent to £2,403 million (level on an actual exchange rate basis). This reflects our growing scale and the capital-generative nature of our business model. In Asia, growth in the in-force life portfolio, combined with post-tax asset management profits from Eastspring, contributed to underlying in-force free surplus generation of £850 million, up 9 per cent. In the US, underlying in-force free surplus generation increased by 6 per cent reflecting growth in the in-force portfolio. In the UK and Europe, underlying in-force free surplus generation was 5 per cent higher at £824 million benefiting from higher M&G Prudential asset management profits and a £138 million post-tax insurance recovery related to the costs of reviewing internally vesting annuities sold without advice after 1 July 2008 for which a provision had previously been established.

Although new business profit increased by 13 per cent, the amount of free surplus that was invested in writing new business in the period increased by only 2 per cent to £540 million (2017: £532 million), partly reflecting a favourable shift in business mix.

Underlying free surplus generated, after investment in new business but before restructuring costs, increased by 8 per cent to £1,907 million, led by Asia up 14 per cent and the US 18 per cent higher. Total Group underlying free surplus generation after restructuring costs increased 6 per cent to £1,863 million.

Market movements (together with timing differences and other reserve movements) in the period have led to a reduction in free surplus of £1,001 million. This reflects in part bond losses from rising interest rates in many markets in Asia, losses on derivatives held to manage certain guarantees attaching to variable annuity products in the US and other timing differences. It also includes a negative £160 million impact from the increase in capital requirements in the US following changes announced by the NAIC in June as a result of the comprehensive US tax reform package enacted in December 2017.

After financing reinvestment in new business and funding cash remittances from the business units to Group, the closing value of free surplus in our life and asset management operations was £7.4 billion at 30 June 2018.

Business unit remittances[6,19]

	Actual exchange rate	
	Half year 2018 £m	Half year 2017 £m
Net cash remitted by business units:		
Asia	391	350
US	342	475
UK and Europe	341	390
Other UK (including Prudential Capital)	37	15
Net cash remitted by business units	1,111	1,230
Holding company cash at 30 June	2,210	2,657

We continue to manage cash flows across the Group with a view to achieving a balance between ensuring sufficient remittances are made to service central requirements (including paying the external dividend) and maximising value to shareholders through retention and reinvestment of capital in business opportunities.

Cash remitted to the corporate centre in the first half of 2018 amounted to £1,111 million (2017: £1,230 million). Asia's net remittance increased to £391 million (2017: £350 million), driven by ongoing business growth. Jackson's remittance was £342 million (2017: £475 million), and the UK and Europe remittance was £341 million (2017: £390 million).

Net cash remitted by the business units was used to meet central costs of £219 million (2017: £226 million) and pay the 2017 second interim ordinary dividend. Reflecting these and other movements in the period, total holding company cash at 30 June 2018 was £2,210 million compared with £2,264 million at the end of 2017.

Post-tax profit – EEV[6]

	Actual exchange rate			Constant exchange rate	
	Half year 2018 £m	Half year 2017 £m	Change %	Half year 2017 £m	Change %
Post-tax operating profit based on longer-term investment returns					
Asia					
Long-term business	1,753	1,641	7	1,519	15
Asset management	77	73	5	68	13
Total	1,830	1,714	7	1,587	15
US					
Long-term business	1,005	888	13	812	24
Asset management	(2)	(4)	50	(4)	50
Total	1,003	884	13	808	24
UK and Europe					
Long-term business	771	465	66	465	66
General insurance commission	15	14	7	14	7
Total insurance operations	786	479	64	479	64
Asset management	221	201	10	201	10
Total	1,007	680	48	680	48
Other income and expenditure[20]	(340)	(381)	11	(375)	9
Post-tax operating profit based on longer-term investment returns before restructuring costs	3,500	2,897	21	2,700	30
Restructuring costs[20]	(57)	(27)	(111)	(27)	(111)
Post-tax operating profit based on longer-term investment returns	3,443	2,870	20	2,673	29
Non-operating items:					
Short-term fluctuations in investment returns	(1,234)	739	n/a	707	n/a
Effect of changes in economic assumptions	592	(50)	n/a	(38)	n/a
Mark to market value on core structural borrowings	579	(262)	n/a	(262)	n/a
Loss attaching to corporate transactions	(412)	–	n/a	–	n/a
Post-tax profit for the period	2,968	3,297	(10)	3,080	(4)

EEV earnings per share

	Actual exchange rate			Constant exchange rate	
	Half year 2018 pence	**Half year 2017** pence	**Change** %	**Half year 2017** pence	**Change** %
Basic earnings per share based on post-tax operating profit	**133.8**	111.9	20	104.2	28
Basic earnings per share based on post-tax total profit	**115.3**	128.5	(10)	120.1	(4)

EEV operating profit

On an EEV basis, Group post-tax operating profit based on longer-term investment returns was 29 per cent higher (20 per cent on an actual exchange rate basis) at £3,443 million in the first half of 2018, equating to an overall annualised return on opening embedded value of 15 per cent. EEV operating profit includes £3,529 million (2017: £2,796 million) from the Group's life businesses, which is discussed further below, and the post-tax IFRS basis profit of the Group's asset management business of £296 million (2017: £265 million) and other net expenditure of £382 million (2017: £388 million).

EEV operating profit includes new business profit from the Group's life businesses, which increased by 13 per cent (5 per cent on an actual exchange rate basis) to £1,767 million and life in-force profit of £1,762 million, which was 44 per cent higher. In-force profit growth was driven by underlying growth in the in-force book, higher interest rates, the benefit of US tax reform and in the UK increased portfolio optimisation benefits and insurance recoveries related to our UK life business.

In **Asia**, EEV life operating profit was up 15 per cent to £1,753 million, reflecting growth in new business profit of 11 per cent to £1,122 million. In-force profit was 24 per cent higher at £631 million driven by growth in the in-force book with overall ongoing positive experience variances.

In the **US**, EEV life operating profit was up 24 per cent to £1,005 million, reflecting a 17 per cent increase in new business profit to £466 million and an increase in the contribution from in-force profit of 31 per cent to £539 million. The increase in in-force profit reflects the favourable impacts of a higher opening in-force balance, higher interest rates and the benefit of US tax reform.

In the **UK and Europe**, EEV life operating profit increased by 66 per cent to £771 million (2017: £465 million). The increase reflects an 11 per cent increase in new business profit to £179 million and an increase in in-force profit to £592 million (2017: £304 million). The in-force profit includes the post-tax benefit of a £138 million insurance recovery related to the costs and potential redress of reviewing internally vesting annuities sold without advice after 1 July 2008, alongside higher levels of portfolio optimisation which are expected to moderate in the second half of 2018.

EEV non-operating items

Negative short-term fluctuations of £1,234 million reflect bond losses in Asia following rising interest rates in a number of countries, together with lower than expected returns on equities and other investments held by the Group's with-profits and unit-linked business in Hong Kong, Singapore and the UK and separate account business in the US. It also includes the impact of market movements in the period on interest and equity derivatives held by the US business to manage market exposures arising from the guarantees provided on its annuity products.

Offsetting short-term fluctuations is a £592 million benefit from economic assumption changes, principally reflecting the benefit of higher interest rates on the future expected profits from the US variable annuity business and with-profits businesses in Hong Kong offset by the negative impact of a higher discount rate for a number of other products.

The loss attaching to corporate transactions of £412 million primarily relates to the reinsurance of the shareholder annuity portfolio to Rothesay Life. A more detailed explanation of this and the other corporate transactions occurring in the period are set out in note 15 of the EEV financial statements.

Capital position, financing and liquidity

Capital position

Analysis of movement in Group shareholder Solvency II surplus[21]

	2018 £bn	2017 £bn	
	Half year	Half year	Full year
Solvency II surplus at 1 January	13.3	12.5	12.5
Operating experience	1.8	1.7	3.6
Non-operating experience (including market movements)	–	–	(0.6)
UK annuities reinsurance transaction	0.1	–	–
Other capital movements:			
Subordinated debt redemption	–	–	(0.2)
Foreign currency translation impacts	0.1	(0.5)	(0.7)
Dividends paid	(0.8)	(0.8)	(1.2)
Model changes	(0.1)	–	(0.1)
Estimated Solvency II surplus at end of period	14.4	12.9	13.3

The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risk has resulted in the Group's shareholder Solvency II capital surplus being estimated at £14.4 billion[7,8] at 30 June 2018 (equivalent to a solvency ratio of 209 per cent) compared with £13.3 billion (202 per cent) at 31 December 2017.

Prudential's designation as a G-SII was reaffirmed on 21 November 2016. Although the Financial Stability Board did not publish a new list of G-SIIs in 2017, the policy measures set out in the Financial Stability Board's 2016 communication on G-SIIs continue to apply to the Group. As a result of this designation, Prudential is subject to additional regulatory requirements, including a requirement to submit enhanced risk management plans (such as a Group-wide Recovery Plan, a Systemic Risk Management Plan and a Liquidity Risk Management Plan) to a Crisis Management Group (CMG) comprised of an international panel of regulators.

Local statutory capital

All our subsidiaries continue to hold appropriate capital positions on a local regulatory basis. In the UK, at 30 June 2018, The Prudential Assurance Company Limited and its subsidiaries[22] had an estimated Solvency II shareholder surplus of £7.5 billion[23] (equivalent to a solvency ratio of 203 per cent) and a with-profits surplus[24] of £5.5 billion (equivalent to a solvency ratio of 244 per cent). In June 2018, the National Association of Insurance Commissioners (NAIC) in the US formally approved changes to risk-based capital factors that reflect the December 2017 US tax reform. Including the impact of these changes, capital generation in the first six months of 2018, and payment of a US$450 million remittance to Group, Jackson's risk-based capital ratio as estimated at 30 June 2018, remained above its 2017 year-end position of 409 per cent.

Debt portfolio

The Group continues to maintain a high-quality defensively positioned debt portfolio. Shareholders' exposure to credit is concentrated in the UK annuity portfolio and the US general account, mainly attributable to Jackson's fixed annuity portfolio. The credit exposure is well diversified and 98 per cent of our UK portfolio and 96 per cent of our US portfolio are investment grade[25]. During the first half of 2018 there were no default losses in the US or the UK portfolio and reported impairments were minimal in the US portfolio.

Financing and liquidity

Shareholders' net core structural borrowings

	30 June 2018 £m			30 June 2017 £m			31 December 2017 £m		
	IFRS basis	Mark to market value	EEV basis	IFRS basis	Mark to market value	EEV basis	IFRS basis	Mark to market value	EEV basis
Total borrowings of shareholder-financed operations	6,367	151	6,518	6,614	673	7,287	6,280	743	7,023
Less: Holding company cash and short-term investments	(2,210)	–	(2,210)	(2,657)	–	(2,657)	(2,264)	–	(2,264)
Net core structural borrowings of shareholder-financed operations	4,157	151	4,308	3,957	673	4,630	4,016	743	4,759
Gearing ratio*	21%			20%			20%		

* Net core structural borrowings as a proportion of IFRS shareholders' funds plus net debt, as set out in note II(d) of the Additional financial information.

Our financing and central liquidity position remained strong throughout the period. Our central cash resources amounted to £2.2 billion at 30 June 2018 (31 December 2017: £2.3 billion).

In addition to its net core structural borrowings of shareholder-financed operations set out above, the Group also has access to funding via the money markets and has in place a global commercial paper programme. As at 30 June 2018, we had issued commercial paper under this programme totalling US$1,189 million.

Prudential's holding company currently has access to £2.6 billion of syndicated and bilateral committed revolving credit facilities, provided by 19 major international banks, expiring in 2022 and 2023. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 30 June 2018. The medium-term note programme, the US shelf registration programme (platform for issuance of SEC registered public bonds in the US market), the commercial paper 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.

Shareholders' funds

	IFRS			EEV		
	2018 £m	2017 £m		2018 £m	2017 £m	
	Half year	Half year	Full year	Half year	Half year	Full year
Profit after tax for the period[26]	1,355	1,505	2,389	2,967	3,297	8,750
Exchange movements, net of related tax	69	(224)	(409)	523	(1,045)	(2,045)
Cumulative exchange gain of Korea life business recycled to profit and loss account	–	(61)	(61)	–	–	–
Unrealised gains and losses on Jackson fixed income securities classified as available-for-sale[27]	(908)	300	486	–	–	–
Dividends	(840)	(786)	(1,159)	(840)	(786)	(1,159)
Mark to market value movements on Jackson assets backing surplus and required capital	–	–	–	(32)	31	40
Other	119	49	175	127	55	144
Net (decrease) increase in shareholders' funds	(205)	783	1,421	2,745	1,552	5,730
Shareholders' funds at beginning of the period	16,087	14,666	14,666	44,698	38,968	38,968
Shareholders' funds at end of the period	15,882	15,449	16,087	47,443	40,520	44,698
Shareholders' value per share[28]	613p	597p	622p	1,830p	1,567p	1,728p
Return on shareholders' funds[29]	25%	24%	25%	15%	15%	17%

Group IFRS shareholders' funds at 30 June 2018 decreased by 1 per cent[13] to £15.9 billion (31 December 2017: £16.1 billion on an actual exchange rate basis). In the first six months of 2018 the Group generated profits after tax of £1.4 billion (2017: £1.5 billion), which were more than offset by dividend payments and unrealised losses on fixed income securities held by Jackson accounted for through other comprehensive income. In the first half of the period, UK sterling weakened relative to the US dollar and various Asian currencies. With approximately 48 per cent of the Group IFRS net assets (71 per cent of the Group's EEV net assets) denominated in non-sterling currencies, this generated a small positive exchange rate movement on net assets in the period.

The Group's EEV basis shareholders' funds increased by 6 per cent[13] to £47.4 billion (31 December 2017: £44.7 billion on an actual exchange rate basis). On a per share basis the Group's embedded value at 30 June 2018 equated to 1,830 pence, up from 1,728 pence at 31 December 2017.

Corporate transactions

Intention to demerge the Group's UK businesses from Prudential plc and sale of £12.0 billion[4] UK annuity portfolio

The Group is making progress on its previously announced intention to demerge its UK and Europe businesses from Prudential plc, resulting in two separately listed companies, and the preparatory transfer of the legal ownership of its Hong Kong insurance subsidiaries from The Prudential Assurance Company Limited (M&G Prudential's UK regulated insurance entity) to Prudential Corporation Asia Limited.

In March 2018, M&G Prudential announced the sale of £12.0 billion (as at 31 December 2017) of its shareholder-backed annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured these liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The reinsurance agreement became effective on 14 March 2018 and resulted in an IFRS pre-tax loss of £513 million.

These transactions above reduced the Group's EEV by £364 million which primarily reflects the loss of profits on the portion of annuity liabilities sold.

The impact on Group Solvency II capital position of the reinsurance transaction at 30 June 2018 is an increase in surplus of £0.1 billion. Further information on the solvency position of the Group and The Prudential Assurance Company Limited is set out in note II(f) of the Additional financial information.

Prior to the demerger, the Group expects to rebalance its debt capital across Prudential and M&G Prudential. This will include the ultimate holding company of M&G Prudential, when established, taking on new subordinated debt and Prudential plc redeeming some of its existing debt. A proportion of the proceeds of the debt that will ultimately be held by M&G Prudential will be used by Prudential plc to enable repayment of a portion of Prudential plc's existing debt. It is currently expected that the debt re-balancing will result in M&G Prudential's parent company holding up to half of the aggregate of the Group's current outstanding core structural borrowings (£6,367 million at 30 June 2018) and borrowings from short-term securities programmes[33], which together total £7,576 million at 30 June 2018.

Entrance into Thailand mutual fund market

In July 2018 Eastspring reached an agreement to initially acquire 65 per cent of TMB Asset Management Co., Ltd. ('TMBAM'), a leading asset management company in Thailand, from TMB Bank Public Company Limited ('TMB'). Eastspring has an option to increase its ownership to 100 per cent in the future. As part of this acquisition, Eastspring has also entered into a distribution agreement with TMB to provide best-in-class investment solutions to their customers.

The acquisition of TMBAM, the fifth-largest asset manager[30] in Thailand, with £10 billion[31] of assets under management which has grown by a market leading 26 per cent compound annual growth rate over the last three years, reinforces Prudential's commitment to the Thai market. The completion of the transaction is subject to local regulatory approval.

Dividend

As in previous years, the first interim dividend for 2018 has been calculated formulaically as one-third of the prior year's full year ordinary dividend. The Board has approved a first interim dividend for 2018 of 15.67 pence per share, which equates to an increase of 8 per cent over the 2017 first interim dividend.

The Group's dividend policy remains unchanged. The Board will maintain focus on delivering a growing ordinary dividend. In line with this policy, Prudential aims to grow the ordinary dividend by 5 per cent per annum. The potential for additional distributions will continue to be determined after taking into account the Group's financial flexibility across a broad range of financial metrics and an assessment of opportunities to generate attractive returns by investing in specific areas of the business.

Mark FitzPatrick
Chief Financial Officer

Notes

1 Increase stated on a constant exchange rate basis.
2 For insurance operations underlying free surplus generated represents amounts maturing from the in-force business during the period less investment in new business and excludes non-operating items. For asset management businesses it equates to post-tax IFRS operating profit for the period. Restructuring costs are presented separately from the underlying business unit amount. Further information is set out in note 10 of the EEV basis results.
3 US fee income represents asset management fees that vary with the size of the underlying policyholder funds, primarily separate account balances arising from variable annuity business, net of investment management expenses. See note I(a) of Additional financial information for basis of preparation.
4 Relates to £12.0 billion of IFRS shareholder annuity liabilities, valued as at 31 December 2017.
5 Represents M&G Prudential asset management external funds under management and internal funds included on the M&G Prudential long-term insurance business balance sheet.
6 The 2017 comparative results have been re-presented from those published previously, following reassessment of the Group's operating segments as described in note B1.3 of the IFRS financial statements.
7 Before allowing for first interim dividend.
8 The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency position includes management's calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
9 Refer to note B1.1 in IFRS financial statements for the breakdown of other income and expenditure and other non-operating items.
10 Includes Group's proportionate share of the liabilities and associated flows of the insurance joint ventures and associate in Asia.
11 Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders/withdrawals, maturities and deaths.
12 Includes unallocated surplus of with-profits business.
13 Comparison to 31 December 2017 on an actual exchange rate basis.
14 For basis of preparation see note I(a) of Additional financial information.
15 Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In half year 2018, the Group altered the presentation of its analysis of Asia operating profit drivers to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the margin analysis on a consistent basis as the rest of the Asia operations. Half year 2017 comparatives have been re-presented accordingly.
16 Includes Group's proportionate share in PPM South Africa and the Asia asset management joint ventures.
17 For our asset management business, the level of funds managed on behalf of third parties, which are not therefore recorded on the balance sheet, is a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing between those which are external to the Group and those held by the insurance business and included on the Group balance sheet. This is analysed in note II(b) of the Additional financial information.
18 Net inflows exclude Asia Money Market Fund (MMF) inflows of £665 million (2017: net inflows £449 million on an actual exchange rate basis). External funds under management exclude Asia MMF balances of £10,067 million (2017: £8,327 million on an actual exchange rate basis).
19 Net cash remitted by business units are included in the Holding company cash flow, which is disclosed in detail in note II(a) of the Additional financial information.
20 Refer to the EEV basis supplementary information – Post-tax operating profit based on longer-term investment returns and Post-tax summarised consolidated income statement for the breakdown of other income and expenditure and other non-operating items.
21 The methodology and assumptions used in calculating the Solvency II capital results are set out in note II(f) of Additional financial information.
22 The insurance subsidiaries of The Prudential Assurance Company Limited are Prudential General Insurance Hong Kong Limited, Prudential Hong Kong Limited, Prudential International Assurance plc and Prudential Pensions Limited.
23 The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The estimated solvency position includes management's estimate of calculation of UK transitional measures reflecting operating and market conditions at each valuation date.
24 The with-profits Solvency II surplus represents the Own Funds and the Solvency Capital Requirement of UK ring-fenced funds. The estimated solvency position includes the impact of recalculated transitionals at the valuation date.
25 Based on hierarchy of Standard & Poor's, Moody's and Fitch, where available and if unavailable, other rating agencies or internal ratings have been used.
26 Excluding profit for the year attributable to non-controlling interests.
27 Net of related charges to deferred acquisition costs and tax.
28 Closing IFRS shareholders' funds divided by issued shares, as set out in note II(e) of the Additional financial information. Closing EEV shareholders' funds divided by issued shares, as set out in note II(l) of the Additional financial information.
29 Annualised operating profit after tax and non-controlling interests, as a percentage of opening shareholders' funds, as set out in note II(c) of the Additional financial information and note II(k) of the Additional financial information. Half year profits are annualised by multiplying by two.
30 Source: TMB Investor factsheet (as of March 2018).
31 Assets under management as at 31 March 2018.
32 Other operations include Group Head Office and Asia Regional Head Office costs, Prudential Capital and Africa.
33 Comprising £1,209 million of commercial paper and Medium Term Notes.

Group Chief Risk Officer's report of the risks facing our business and how these are managed – James Turner

Enabling business growth and change through risk management

Our Group Risk Framework and risk appetite have allowed us to control our risk exposure successfully throughout the year. Our governance, processes and controls enable us to deal with uncertainty effectively, which is critical to the achievement of our strategy of helping our customers achieve their long-term financial goals.

This section explains the main risks inherent in our business and how we manage those risks, with the aim of ensuring an appropriate risk profile is maintained.

1 Introduction

Group structure

In August 2017, the Group announced its intention to combine M&G and our UK life business to form M&G Prudential, allowing the scale and capabilities in these businesses to be leveraged more effectively. In March 2018, the intention to demerge the combined business unit from the rest of the Group was announced, with the aim of focusing on meeting customers' rapidly evolving needs and to deliver long-term value to investors as two separate businesses.

The merger activity ongoing at M&G Prudential and its planned separation from the rest of the Group requires significant and complex changes. The Group Risk function is embedded within key workstreams and a clear view exists of the objectives, risks and dependencies involved in order to execute this change agenda. A mature and well-embedded risk framework is in place and, during this period of transition, the Group Risk function has a defined role in providing oversight, support and risk management, as well as providing objective challenge to ensure the Group remains within risk appetite. Looking further ahead, a key objective is that post demerger there are two strong, standalone risk functions in M&G Prudential and Prudential plc. The Group will continue to increase its risk management focus on Prudential Africa as the business there grows in materiality.

Societal developments

Focus in western economies is increasingly shifting from the goods and services businesses deliver to customers towards the way in which such business is conducted and how this impacts on the wider society. In undertaking its business, the Group actively considers the environmental, social and governance (ESG) impact of our activities. The risks and opportunities arising from these are broad and may initially seem unconnected. These connections are being made by Prudential as we manage and maintain the sustainability of the business for all our stakeholders, and risk management focus is increasing on the associated transition, reputational and liability risks. Stakeholder and regulatory expectations of the Group's ESG activities are also increasing. Recent regulatory developments such as the EU General Data Protection Regulation (GDPR) have underlined that personal data must be held securely and also that its use is transparent to the data owner. Risks around the security and use of personal data are actively managed by the Group, and the recent regulatory changes in data protection in the US and Europe have been incorporated into the principles against which the business requirements are defined.

The world economy

The global economy has seen steady and broad growth through the second half of 2017 and the first half of 2018, supported by accommodative monetary conditions around the world and improving economic data. Looking to the end of the first half of the year, some signs are appearing of a divergence between the US economy, which has remained relatively buoyant, and other economies around the world, which have started to show signs of slowdown. In the UK, the outcome of negotiations on the final terms of the UK's relationship with the EU is currently unknown. In the US, the Federal Reserve continues its process to normalise interest rates and monetary policy. However, the economic outlook for the world remains uncertain. There has been a long period of economic expansion (relative to recent historical levels) and there are certain risks to this trend which we are mindful of. These include the impact of tightening financial conditions and the anticipated withdrawal of central bank liquidity which may affect emerging economies and companies with high levels of debt in particular, which consequently may then have wider impacts. Political tensions in Europe, geopolitical developments and global trade tensions also pose risks to global growth.

Financial markets

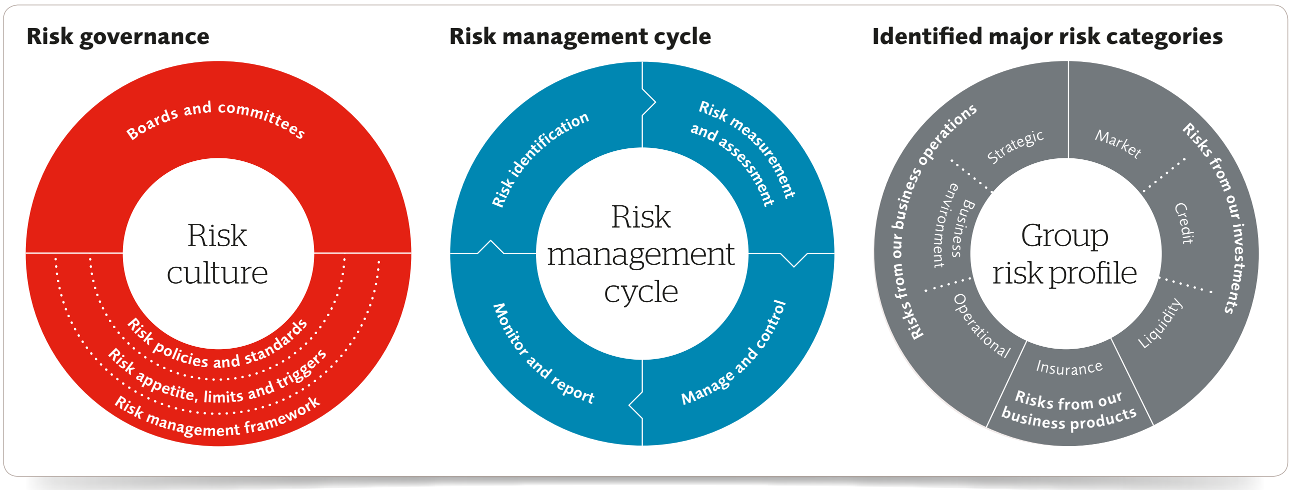
Asset valuations are currently quite high, particularly in the US, supported by some of the highest rates of earnings growth seen in recent years. Equity market volatility has remained low compared with historical levels, despite a spike in early February 2018. Interest rates have broadly increased since the middle of 2016, as central banks across the world gradually normalise monetary policy and move away from quantitative easing, although long-term interest rates have been less responsive which is leading to flattening yield curves. Credit spreads also remain narrow compared with historical levels, although some moderate widening has been seen since the beginning of the year. Financial markets remain particularly vulnerable to an abrupt change in sentiment or broad changes in trend, in particular if some of the risks to the global economy noted above were to materialise.

Political landscape

Events in recent years indicate that the world is in a period of global geopolitical transition and increasing uncertainty. Popular discontent appears to be one of the driving factors of political change, and the liberal norms and the role of multilateral rules-based institutions that underpin global order, such as the UN, NATO and WTO, appear to be evolving. Across the Group's key geographies, we are increasingly seeing national protectionism in trade and economic policies. As a global organisation, we develop plans to mitigate business risks arising from this shift and engage with national bodies where we can in order to ensure our policyholders are not adversely impacted. It is clear, however, that the full long-term impacts of these changes remain to be seen.

Regulations

Prudential operates in highly regulated markets across the globe, and the nature and focus of regulation and laws remains fluid. A number of national and international regulatory developments are in progress, with an increasing focus on systemic risks and macro-prudential policy. As well as managing the resulting changes and ensuring compliance that regulations require of us, changes in administration, particularly in the US, have resulted in uncertainty on the implementation of some regulatory policy initiatives that we are planning for, such as those purporting to introduce fiduciary obligations on distributors of investment products. Such developments will continue to be monitored at a national and global level and form part of Prudential's engagement with government policy teams and regulators.



2 Key internal, regulatory, economic and (geo)political events over the past 12 months

Q3 & 4 2017

UK elections
The UK Conservative Party begins Q3 with a confidence-and-supply arrangement with the Democratic Unionist Party, after a snap general election called by Prime Minister May in June 2017.

M&G and Prudential UK merger
In August 2017 the Group's intention to combine M&G and its UK life business to form M&G Prudential is announced, allowing better leveraging of our scale and capabilities.

Ransomware attacks
Companies and organisations reassess the traditional conceptions of the nature of potential cyber threats, after the systemic WannaCry and NotPetya ransomware attacks which occurred during Q2 2017.

US interest rates
The US Federal Reserve raises interest rates and announces a programme to normalise monetary policy.

South China Sea
Tensions in the South China Sea are elevated. US 'freedom of operation' exercises result in a temporary increase in proximity of American military to disputed islands in the South China Sea.

Catalonia referendum
In October 2017 Catalonia's independence referendum causes market turmoil in Spanish equities. Madrid takes measures to strengthen power in the region.

UK interest rates
In November 2017, the Bank of England raises base interest rates for the first time since 2007.

UK/EU negotiations
In December 2017 the UK and EU agree to move negotiations onto the future trading arrangements after the UK's exit from the bloc. This remains unclear, although an agreement on transitional arrangements was subsequently agreed in March 2018.

US tax
The US Tax and Jobs Act is signed into law by the US administration in December 2017 and it comes into force on 1 January 2018.

Q1 2018

Responsible investing
Eastspring becomes the third Prudential signatory, after M&G and PPMSA, to the UN Principles for Responsible Investment in February 2018.

M&G Prudential demerger
In March 2018 the intention to demerge M&G Prudential from the rest of the Group is announced. £12 billion of annuity liabilities in our UK and Europe business are reinsured to Rothesay Life Plc, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019.

US equity markets
US equity markets decline rapidly, triggering a global sell-off, with the Dow Jones Industrial Average falling by circa 3,000 points in just two weeks.

China Presidency
President Xi Jinping enters a second term in office in China after election by the National People's Congress in March 2018.

Italian elections
A coalition government is formed in Italy between the centre right League and anti-establishment Five Star Movement, after general elections in March 2018.

Trade tariffs
The US administration proposes initial trade tariff measures (with additional proposals announced over H1 2018), raising trade tensions with its key G7 partners and China.

Q2 2018

US fiduciary rule
The US Department of Labor's (DoL's) fiduciary rule is effectively ended after a decision in the US courts in March 2018. The deadline for the DoL to appeal lapses in June. Other proposals, such as the US Securities and Exchanges Commission's best interest standard, remain in progress.

RCEP talks
The 22nd round of talks on the Regional Comprehensive Economic Partnership (RCEP) are held in Singapore between 28 April and 8 May 2018, the goal being to create the world's largest economic bloc.

GDPR
The General Data Protection Regulation (GDPR) goes live in the EU on 25 May 2018, increasing the rights of individuals over the use of their personal information by companies.

Malaysia elections
The opposition Pakatan Harapan coalition win power in Malaysia following general elections held in May 2018.

North Korea talks
US President Trump and North Korean Chairman Kim Jong Un meet in Singapore on 12 June 2018 for a historic summit, where denuclearisation of the Korean peninsula is discussed.

Indonesia regulations
The Indonesia President approves regulations on 'grandfathering' foreign ownership of insurance companies.

3 Managing the risks in implementing our strategy

This section provides an overview of the Group's strategy, the significant risks arising from the delivery of this strategy and the risk management focus for the following 12 months. The risks outlined below, which are not exhaustive, are discussed in more detail in sections 5 and 6.

Our strategy	Significant risks in the delivery of the strategy	Risk management focus for the next 12 months
Asia **Significant protection gap and investment needs of the middle class.** Leading pan-regional franchise.	Persistency risk	Implementation of business initiatives to manage persistency risk including review of distribution channels and incentive structures. Ongoing experience monitoring.
	Morbidity risk	Implementation of business initiatives to manage morbidity risk including product repricing where required. Ongoing experience monitoring.
	Regulatory risk, including foreign ownership	Proactive engagement with national governments and regulators.
US **Transition of 'baby-boomers' into retirement.** Premier retirement income player.	Financial risks	Maintaining, and enhancing where necessary, appropriate risk limits, hedging strategies and Group oversight that are in place.
	Policyholder behaviour risk	Continued monitoring of policyholder behaviour experience and review of assumptions.
UK and Europe **'Savings gap' and ageing population in need of returns/income.** Well-recognised brands with a strong track record of a long-term conviction-led investment approach.	M&G Prudential merger and transformation risk	Managing the merger and transformation risks to the delivery of strategic, financial and operational objectives.
	Longevity risk	Continued oversight and experience analysis.
	Customer risk	Ongoing monitoring of embedded customer outcome indicators. Managing the customer risk implications from: merger and transformation activity; new product propositions and new regulatory requirements.
Group-wide **We have announced our intention to demerge our UK and Europe business, M&G Prudential, resulting in two separately listed companies with distinct investment prospects.**	Transformation risks around key change programmes	Managing the inter-connected execution risks from this transformation activity under the Group's transformation risk framework, as well as providing other risk management support and review. Ensuring both M&G Prudential and Prudential plc will have in place strong standalone risk functions after demerger.
	Information security and data privacy risks	Continuing the implementation of the Group's information security risk management strategy and defence plan. Ensuring full GDPR compliance across the Group.
	Group-wide regulatory risks	Engagement with regulators and industry groups on macro-prudential regulatory initiatives, international capital standards, and other initiatives with Group-wide impacts.
	Environmental, social and governance (ESG) risks	Continue to develop Group-wide understanding of material ESG factors, and ensure ongoing compliance with Group-wide ESG-relevant standards and policies. Engagement with key stakeholders and industry in development of ESG risk modelling and metrics.

4 Risk governance

a System of governance

Appropriately managed risks allow Prudential to take business opportunities and enable the growth of its business. Effective risk management is therefore fundamental in the execution of the Group's business strategy. Prudential's approach to risk management must be both well embedded and rigorous, and, as the economic and political environment in which we operate changes, it should also be sufficiently broad and dynamic to respond to these changes.

Prudential has in place a system of governance that promotes and embeds a clear ownership of risk, processes that link risk management to business objectives, a proactive Board and senior management providing oversight of risks, mechanisms and methodologies to review, discuss and communicate risks, and risk policies and standards to ensure risks are identified, measured, managed, monitored and reported.

How risk is defined

Prudential defines 'risk' as the uncertainty that is faced in implementing the Group's strategies and objectives successfully, and includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Group. Accordingly, material risks will be retained selectively when it is considered that there is value in doing so, and where it is consistent with the Group's risk appetite and philosophy towards risk-taking.

How risk is managed

Risk management is embedded across the Group through the Group Risk Framework, which details Prudential's risk governance, risk management processes and risk appetite. The Framework has been developed to monitor and manage the risks to our business and is owned by the Board. The aggregate Group exposure to its key risk drivers is monitored and managed by the Group Risk function which is responsible for reviewing, assessing, providing oversight and reporting on the Group's risk exposure and solvency position from the Group economic, regulatory and ratings perspectives.

In 2018 the Group has continued to update its policies and processes around new product approvals, management of critical third-party arrangements and oversight of model risks. Our transformation risk framework is being applied directly to manage programme delivery risks.

The following section provides more detail on our risk governance, risk culture and risk management process.

b Group Risk Framework

i Risk governance and culture

Prudential's risk governance comprises the Board, organisational structures, reporting relationships, delegation of authority, roles and responsibilities, and risk policies that the Group Head Office and the business units establish to make decisions and control their activities on risk-related matters. It includes individuals, Group-wide functions and committees involved in overseeing and managing risk.

The risk governance structure is led by the Group Risk Committee, supported by independent non-executives on risk committees of material subsidiaries. These committees monitor the development of the Group Risk Framework, which includes risk appetite, limits, and policies, as well as risk culture.

The Group Risk Committee reviews the Group Risk Framework and recommends changes to the Board to ensure that it remains effective in identifying and managing the risks faced by the Group. A number of core risk policies and standards support the Framework to ensure that risks to the Group are identified, assessed, managed and reported.

Culture is a strategic priority of the Board, who recognise its importance in the way that the Group does business. Risk culture is a subset of Prudential's broader organisational culture, which shapes the organisation-wide values that we use to prioritise risk management behaviours and practices.

An evaluation of risk culture forms part of the Group Risk Framework and in particular seeks to identify evidence that:

— Senior management in business units articulate the need for effective risk management as a way to realise long-term value and continuously support this through their actions;

— Employees understand and care about their role in managing risk – they are aware of and discuss risk openly as part of the way they perform their role; and

— Employees invite open discussion on the approach to the management of risk.

The Group Risk Committee also has a key role in providing advice to the Remuneration Committee on risk management considerations to be applied in respect of executive remuneration.

Prudential's Code of Conduct and Group Governance Manual include a series of guiding principles that govern the day-to-day conduct of all its people and any organisations acting on its behalf. This is supported by specific risk policies which require that the Group act in a responsible manner. This includes, but is not limited to, policies on anti-money laundering, financial crime and anti-bribery and corruption. The Group's outsourcing and third-party supply policy ensures that human rights and modern slavery considerations are embedded across all of its supplier and supply chain arrangements. Embedded procedures to allow individuals to speak out safely and anonymously against unethical behaviour and conduct are also in place.

ii The risk management cycle

The risk management cycle comprises processes to identify, measure and assess, manage and control, and monitor and report on our risks.

Risk identification covers Group-wide:
- Top down risk identification
- Bottom up risk identification
- Emerging risk identification

Risks are assessed in terms of materiality.

Material risks which are modelled are included in capital models, including ECap.

Risks which cannot be quantified are assessed qualitatively.

Risk reports provide monthly updates to the Group Executive Risk Committee, Group Risk Committee and Board on exposure against Board-approved risk appetite statements and limits.

Risk reports also provide updates on the Group top risks.

Risk processes that support the management and controlling of risk exposures include:
- Risk appetite and limits
- Financial incidents procedures
- Large risk approval process
- Global counterparty limit framework
- Own risk and solvency assessment
- Reverse stress testing

Risk identification

Group-wide risk identification takes place throughout the year as the Group's businesses undertake a comprehensive bottom-up process to identify, assess and document its risks. This concludes with an annual top-down identification of the Group's key risks, which considers those risks that have the greatest potential to impact the Group's operating results and financial condition and is used to inform risk reporting to the risk committees and the Board for the year.

Our risk identification process also includes the Group's Own Risk and Solvency Assessment (ORSA), as required under Solvency II, and horizon-scanning performed as part of our emerging risk management process.

In accordance with provision C.2.1 of the UK Code, the Directors perform a robust assessment of the principal risks facing the Company through the Group-wide risk identification process, Group ORSA report and the risk assessments done as part of the business planning review, including how they are managed and mitigated.

Reverse stress testing, which requires the Group to ascertain the point of business model failure, is another tool that helps us to identify the key risks and scenarios that may have a material impact on the Group.

The risk profile is a key output from the risk identification and risk measurement processes, and is used as a basis for setting Group-wide limits, management information, assessment of solvency needs, and determining appropriate stress and scenario testing. The Group's annual set of key risks are given enhanced management and reporting focus.

Risk measurement and assessment

All identified risks are assessed based on an appropriate methodology for that risk. All quantifiable risks which are material and mitigated by holding capital are modelled in the Group's internal model, which is used to determine capital requirements under Solvency II and our own economic capital basis. Governance arrangements are in place to support the internal model, including independent validation and processes and controls around model changes and limitations.

Risk management and control

The control procedures and systems established within the Group are designed to manage the risk of failing to meet business objectives reasonably and are detailed in the Group risk policies. These focus on aligning the levels of risk-taking with the achievement of business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The management and control of risks are set out in the Group risk policies, and form part of the holistic risk management approach under the Group's ORSA. These risk policies define:

- The Group's risk appetite in respect of material risks, and the framework under which the Group's exposure to those risks is limited;
- The processes to enable Group senior management to effect the measurement and management of the Group material risk profile in a consistent and coherent way; and
- The flows of management information required to support the measurement and management of the Group's material risks and to meet the needs of external stakeholders.

The methods and risk management tools we employ to mitigate each of our major categories of risks are detailed in the further risk information section below.

Risk monitoring and reporting
The identification of the Group's key risks informs the management information received by the Group risk committees and the Board. Risk reporting of key exposures against appetite is also included, as well as ongoing developments in other key and emerging risks.

iii Risk appetite, limits and triggers
The extent to which Prudential is willing to take risk in the pursuit of its business strategy and objective to create shareholder value is defined by a number of qualitative and quantitative expressions of risk appetite, operationalised through measures such as limits, triggers, thresholds and indicators. The Group Risk function is responsible for reviewing the scope and operation of these risk appetite measures at least annually to determine that they remain relevant. The Board approves all changes made to the Group's aggregate risk appetite, and has delegated authority to the Group Risk Committee to approve changes to the system of limits, triggers and indicators.

Group risk appetite is set with reference to economic and regulatory capital, liquidity and earnings volatility which is aimed at ensuring that an appropriate level of aggregate risk is taken. Appetite is also defined for the Group's risks. Further detail is included in sections 5 and 6, as well as covering risks to shareholders, including those from participating and third-party business. Group limits operate within these expressions of risk appetite to constrain material risks, while triggers and indicators provide further constraint and defined points for escalation.

Earnings volatility
The objectives of the Group's appetite and aggregate risk limits on earnings volatility seek to ensure that variability is consistent with the expectations of stakeholders; that the Group has adequate earnings (and cash flows) to service debt and expected dividends and to withstand unexpected shocks; and that earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies. The volatility of earnings is measured and monitored on IFRS operating profit and EEV operating profit bases, although IFRS and EEV total profits are also considered.

Liquidity
The objective of the Group's liquidity risk appetite is to ensure that the Group is able to generate sufficient cash resources to meet financial obligations as they fall due in business-as-usual and stressed scenarios. Risk appetite with respect to liquidity risk is measured using a Liquidity Coverage Ratio which considers the sources of liquidity against liquidity requirements under stress scenarios.

Capital requirements
Limits on capital requirements aim to ensure that the Group meets its internal economic capital requirements, achieves its desired target rating to meet its business objectives, and ensures that supervisory intervention is not required. The two measures used at the Group level are Solvency II capital requirements and internal economic capital (ECap) requirements. In addition, capital requirements are monitored on local statutory bases.

The Group Risk Committee is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with input on the risk/reward trade-offs implicit therein. This review is supported by the Group Risk function, which uses submissions from our local business units to calculate the Group's aggregated position (allowing for diversification effects between local business units) relative to the aggregate risk limits.

5 Summary risks

Broadly, the risks assumed across the Group can be categorised as those which arise as a result of our business operations, our investments and those arising from the nature of our products. Prudential is also exposed to broad risks which apply because of the global environment in which it operates. These risks, where they materialise, may have a financial impact on the Group, and could also impact on the performance of its products or the services it provides to customers and distributors, which gives rise to potential risks to its brand and reputation and has conduct risk implications. These risks are summarised on the right. The materiality of these risks, whether material at the level of the Group or its business units, is also indicated. The Group's disclosures covering risk factors can be found at the end of this document.

Macro risks

Some of the risks that the Group is exposed to are necessarily broad given the external influences which may impact on the business. These risks include:

Global economic conditions

Changes in global economic conditions can impact Prudential directly; for example, by leading to poor investment returns and fund performance, and increasing the cost of promises (guarantees) that have been made to customers.

Changes in economic conditions can also have an indirect impact on the Group; for example, leading to a decrease in the propensity for people to save and buy Prudential's products, as well as changing prevailing political attitudes towards regulation.

This is a risk which is considered material at the level of the Group.

Geopolitical risk

The geopolitical environment may have direct or indirect impacts on the Group, and has seen varying levels of volatility in recent years as seen by political developments in the UK, the US and the Eurozone.

Uncertainty in these regions, combined with conflict in the Middle East, elevated tensions in east Asia and the evolving situation in the Korean peninsula underline that geopolitical risks have potentially global and wide-ranging impacts; for example, through increased regulatory and operational risks, and changes to the economic environment.

Digital disruption

The emergence of advanced technologies such as artificial intelligence and blockchain is providing an impetus for companies to rethink their existing operating models and how they interact with their customers.

Digital disruption is considered from both an external and internal view. The external view considers the rise of new technologies and how this may impact on the insurance industry and Prudential's competitiveness within it, while the internal view considers the risks associated with the Group's internal developments in meeting digital change challenges and opportunities.

Prudential is embracing the opportunities from new technologies, and any risks which arise from them are closely monitored.

Risks from our investments

Credit risk

This is the potential for reduced value of Prudential's investments driven by the market's perceptions for potential for defaults of investment counterparties. The Group's asset portfolio also gives rise to invested credit risk. The assets backing the UK and Jackson annuity businesses mean credit risk is considered a material risk for these business units in particular.

Market risk

This is the potential for reduced value of Prudential's investments resulting from the volatility of asset prices, driven by fluctuations in equity prices, interest rates, foreign exchange rates and property prices.

In the Asia business, the main market risks arise from the value of fees from its fee-earning products. In the US, Jackson's fixed and variable annuity books are exposed to a variety of market risks due to the assets backing these policies. The UK business's market risk exposure arises from the valuation of the shareholders' proportion of the with-profits funds' future profits, which depends on equity, property and bond values.

M&G Prudential invests in a broad range of asset classes and its income is subject to the price volatility of global financial and currency markets.

Liquidity risk

This is the risk of not having sufficient liquid assets to meet obligations as they fall due, and we look at this under both normal and stressed conditions. This is a risk which is considered material at the level of the Group.

Risks from our products

Insurance risks

The nature of the products offered by Prudential exposes it to insurance risks, which form a significant part of the overall Group risk profile.

The insurance risks that the business is exposed to by virtue of its products include **longevity risk** (policyholders living longer than expected); **mortality risk** (policyholders with life protection dying); **morbidity risk** (policyholders with health protection becoming ill) and **persistency risk** (customers lapsing their policies, and a type of policyholder behaviour risk). The medical insurance business in Asia is also exposed to **medical inflation risk** (the increasing cost of medical treatments).

The pricing of Prudential's products requires it to make a number of assumptions, and deviations from these may impact its reported profitability. Across its business units, some insurance risks are more material than others.

Persistency and morbidity risks are among the most material insurance risks for the Asia business given the focus on health protection products in the region.

For M&G Prudential the most material insurance risk is longevity risk, driven by legacy annuity business.

The Jackson business is most exposed to policyholder behaviour risk, including persistency, which impacts the profitability of the variable annuity business and is influenced by market performance and the value of policy guarantees.

Risks from our business operations

Operational risks

The complexity of the Group and its activities means it faces a challenging operating environment, resulting from the high volume of transactions it processes, its people, processes and IT systems, and the extensive regulations under which it operates. Operational risk is the risk of loss or unintended gain from inadequate or failed processes, personnel, systems and external events, and can arise through business transformation; introducing new products; new technologies; engaging in third-party relationships; and entering into new markets and geographies. Implementing the business strategy requires interconnected change initiatives across the Group, the pace of which introduces further complexity. Such risks, if they materialise, could result in financial loss and/or reputational damage.

Operational risk is considered to be material at the level of the Group.

Information security and data privacy risks

These are significant considerations for Prudential, and include the continually evolving risk of malicious attack on its systems, network disruption as well as risks relating to data security, integrity, privacy and misuse. The size of its IT infrastructure and network, stakeholder expectations and high profile cyber security and data misuse incidents across industries means that these risks continue to be under high focus, and together are considered to be material at the level of the Group.

Regulatory risk

Prudential operates under the ever-evolving requirements set out by diverse regulatory, legal and tax regimes. The increasing shift towards macro-prudential regulation and the number of regulatory changes underway across Asia (in particular focusing on consumer protection) are key areas of focus, while both Jackson and M&G Prudential operate in highly regulated markets. Regulatory reforms can have a material impact on Prudential's businesses.

6 Further risk information

In reading the sections below, it is useful to understand that there are some risks that Prudential's policyholders assume by virtue of the nature of their products, and some risks that the Group and its shareholders assume. Examples of the latter include those risks arising from assets held directly by and for the Group or the risk that policyholder funds are exhausted. This report is focused mainly on risks to the shareholder, but will include those which arise indirectly through our policyholder exposures.

6.1 Risks from our investments

a Market risk

The main drivers of market risk in the Group are:

- Investment risk, which arises on holdings of equity and property investments, the prices of which can change depending on market conditions;
- Interest rate risk, which is driven by the valuation of the Group's assets (particularly the bonds that it invests in) and liabilities, which are dependent on market interest rates and exposes it to the risk of those moving in a way that is detrimental; and
- Foreign exchange risk, through translation of its profits and assets and liabilities denominated in various currencies, given the geographical diversity of the Group's business.

The main investment risk exposure arises from the portion of the profits from the UK with-profits funds which the shareholders are entitled to receive; the value of the future fees from the fee-earning products in the Asia business; and from the asset returns backing Jackson's variable annuities business. Further detail is provided below.

The Group's interest rate risk is driven in the UK business by the need to match the duration of its assets and liabilities; from the guarantees of some non-unit-linked investment products in Asia; and the cost of guarantees in Jackson's fixed, fixed index and variable annuity business. Further detail is provided below.

The Group has appetite for market risk where it arises from profit-generating insurance activities to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

The Group's market risks are managed and mitigated by the following:

- Our market risk policy;
- Risk appetite statements, limits and triggers;
- Our asset and liability management programmes;
- Hedging derivatives, including equity options and futures, interest rate swaps and swaptions and currency forwards;
- The monitoring and oversight of market risks through the regular reporting of management information; and
- Regular deep dive assessments.

Investment risk

In the UK business, the main investment risk arises from the assets held in the with-profits funds through the shareholders' proportion of the funds' declared bonuses and policyholder net investment gains (future transfers). This investment risk is driven mainly by equities held in the funds and some hedging to protect against a reduction in the value of these future transfers is performed outside the funds. The with-profits funds' Solvency II own funds, estimated at £9.4 billion as at 30 June 2018, helps to protect against market fluctuations and is protected partially against falls in equity markets through an active hedging programme within the fund.

In Asia, the shareholder exposure to equity price movements results from unit-linked products, where fee income is linked to the market value of the funds under management. Further exposure arises from with-profits businesses where bonuses declared are based broadly on historical and current rates of return from the Asia business's investment portfolios, which include equities.

In Jackson, investment risk arises from the assets backing customer policies. For spread-based business, including fixed annuities, these assets are generally bonds, and shareholder exposure comes from the minimum returns needed to meet the guaranteed rates that are offered to policyholders. For variable annuity business, these assets include both equities and bonds, and the main risk to the shareholder comes from the guaranteed benefits that can be included as part of these products. The exposure to this is controlled by using a derivative hedging programme, as well as through the use of reinsurance to pass on the risk to third-party reinsurers.

While accepting the equity exposure that arises on future fees, the Group has limited appetite for exposures to equity price movements to remain unhedged or for volatility within policyholder guarantees after taking into account any natural offsets and buffers within the business.

Interest rate risk

Some products that Prudential offer are sensitive to movements in interest rates. As part of the Group's ongoing management of this risk, a number of mitigating actions to the in-force business have been taken, as well as repricing and restructuring new business offerings in response to recent relatively low interest rates. Nevertheless, some sensitivity to interest rate movements is still retained.

The Group's appetite for interest rate risk is limited to where assets and liabilities can be tightly matched and where liquid assets or derivatives exist. Appetite for risk is limited where such liquid assets, derivatives or other offsets in the business to cover interest rate exposures do not exist.

In the UK insurance business, interest rate risk arises from the need to match the cash flows of its annuity obligations with those from its investments. Under Solvency II rules, interest rate risk also results from the requirement to include a balance sheet risk margin. The risk is managed by matching asset and liability durations as well as continually assessing the need for use of any derivatives. The with-profits business is also exposed to interest rate risk through some product guarantees. Such risk is largely borne by the with-profits fund itself although shareholder support may be required in extreme circumstances where the fund has insufficient resources to support the risk.

In Asia, exposure to interest rate risk arises from the guarantees of some non-unit-linked investment products. This exposure exists because of the potential for asset and liability mismatch which, although it is small and managed appropriately, cannot be eliminated.

Jackson is affected by interest rate movements to its fixed annuity, fixed index annuity and variable annuity book, mainly from the impact on the cost of guarantees to the shareholder in these products which may increase when interest rates fall. The level of sales of variable annuity products with guaranteed living benefits is actively monitored, and the risk limits we have in place helps to ensure comfort with the level of interest rate and market risks incurred as a result. Derivatives are also used to provide some protection.

Foreign exchange risk

The geographical diversity of Prudential's businesses means that it has some exposure to the risk of foreign exchange rate fluctuations. The operations in the US and Asia, which represent a large proportion of operating profit and shareholders' funds, generally write policies and invest in assets in local currencies. Although this limits the effect of exchange rate movements on local operating results, it can lead to fluctuations in the Group financial statements when results are reported in UK sterling. This risk is accepted within our appetite for foreign exchange risk.

The Group has no appetite for foreign exchange risk in cases where a surplus arises in an overseas operation which is to be used to support Group capital, or where a significant cash payment is due from an overseas subsidiary to the Group. This currency exposure is hedged where it is believed to be favourable economically to do so. Further, the Group generally does not have appetite for significant direct shareholder exposure to foreign exchange risks in currencies outside the countries in which it operates, but it does have some appetite for this on fee income and on non-sterling investments within the with-profits funds. Where foreign exchange risk arises outside appetite, currency borrowings, swaps and other derivatives are used to manage the exposure.

b Credit risk

Prudential invests in bonds that provide a regular, fixed amount of interest income (fixed income assets) in order to match the payments needed to policyholders. It also enters into reinsurance and derivative contracts with third parties to mitigate various types of risk, as well as holding cash deposits at certain banks. As a result, it is exposed to credit risk and counterparty risk across its business.

Credit risk is the potential for reduction in the value of investments which results from the perceived level of risk of an investment issuer being unable to meet its obligations (defaulting). Counterparty risk is a type of credit risk and relates to the risk that the counterparty to any contract entered into is unable to meet their obligations causing the Group to suffer loss.

The Group has some appetite to take credit risk where it arises from profit-generating insurance activities, to the extent that it remains part of a balanced portfolio of sources of income for shareholders and is compatible with a robust solvency position.

A number of risk management tools are used to manage and mitigate this credit risk, including the following:

- A credit risk policy and dealing and controls policy;
- Risk appetite statements and limits that have been defined on issuers, and counterparties;
- Collateral arrangements for derivative, secured lending reverse repurchase and reinsurance transactions;
- The Group Credit Risk Committee's oversight of credit and counterparty credit risk and sector and/or name-specific reviews;
- Regular assessments; and
- Close monitoring or restrictions on investments that may be of concern.

Debt and loan portfolio

Prudential's UK business is exposed mainly to credit risk on fixed income assets in the shareholder-backed portfolio. At 30 June 2018, this portfolio contained fixed income assets worth £22.1 billion. M&G Prudential's debt portfolio reduced by £12.1 billion following the transfer of fixed income assets to Rothesay Life as part of the reinsurance agreement announced in March 2018. Credit risk arising from a further £57.6 billion of fixed income assets is borne largely by the with-profits funds, to which shareholders are not exposed directly although under extreme circumstances shareholder support may be required if the fund is unable to meet payments as they fall due.

Credit risk also arises from the debt portfolio in the Asia business, the value of which was £42.3 billion at 30 June 2018. The majority (68 per cent) of the portfolio is in unit-linked and with-profits funds and so exposure of shareholders to this component is minimal. The remaining 32 per cent of the debt portfolio is held to back the shareholder business.

In the general account of the Jackson business £36.1 billion of fixed income assets are held to support shareholder liabilities including those from our fixed annuities, fixed index annuities and life insurance products.

The shareholder-owned debt and loan portfolio of the Group's other operations was £2.3 billion as at 30 June 2018.

Further details of the composition and quality of our debt portfolio, and exposure to loans, can be found in the IFRS financial statements.

Group sovereign debt

Prudential also invests in bonds issued by national governments. This sovereign debt represented 20 per cent or £14.4 billion of the shareholder debt portfolio as at 30 June 2018 (31 December 2017: 19 per cent or £16.5 billion). 6 per cent of this was rated AAA and 88 per cent was considered investment grade (31 December 2017: 90 per cent investment grade).

The particular risks associated with holding sovereign debt are detailed further in our disclosures on risk factors.

The exposures held by the shareholder-backed business and with-profits funds in sovereign debt securities at 30 June 2018 are given in note C3.2(f) of the Group's IFRS financial statements.

Bank debt exposure and counterparty credit risk

Prudential's exposure to banks is a key part of its core investment business, as well as being important for the hedging and other activities undertaken to manage its various financial risks. Given the importance of its relationship with its banks, exposure to the sector is considered a material risk for the Group.

The exposures held by the shareholder-backed business and with-profits funds in bank debt securities at 30 June 2018 are given in note C3.2(f) of the Group's IFRS financial statements.

The exposure to derivative counterparty and reinsurance counterparty credit risk is managed using an array of risk management tools, including a comprehensive system of limits. Where appropriate, Prudential reduces its exposure, buys credit protection or uses additional collateral arrangements to manage its levels of counterparty credit risk.

At 30 June 2018, shareholder exposures by rating and sector[1] are shown below:

- 95 per cent of the shareholder portfolio is investment grade rated. In particular, 66 per cent of the portfolio is rated A- and above (or equivalent); and
- The Group's shareholder portfolio is well diversified: no individual sector makes up more than 15 per cent of the total portfolio (excluding the financial and sovereign sectors).

c *Liquidity risk*

Prudential's liquidity risk arises from the need to have sufficient liquid assets to meet policyholder and third-party payments as they fall due. This incorporates the risk arising from funds composed of illiquid assets and results from a mismatch between the liquidity profile of assets and liabilities. Liquidity risk may impact on market conditions and valuation of assets in a more uncertain way than for other risks like interest rate or credit risk. It may arise, for example, where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or where redemption requests are made against Prudential external funds.

Prudential has no appetite for liquidity risk, ie for any business to have insufficient resources to cover its outgoing cash flows, or for the Group as a whole to not meet cash flow requirements from its debt obligations under any plausible scenario.

The Group has significant internal sources of liquidity, which are sufficient to meet all of our expected cash requirements for at least 12 months from the date the financial statements are approved, without having to resort to external sources of funding. The Group has a total of £2.6 billion of undrawn committed facilities that can be made use of, expiring in 2022 and 2023. Access to further liquidity is available through the debt capital markets and an extensive commercial paper programme in place, and Prudential has maintained a consistent presence as an issuer in the market for the last decade.

A number of risk management tools are used to manage and mitigate this liquidity risk, including the following:

- The Group's liquidity risk policy;
- Risk appetite statements, limits and triggers;
- Regular assessment at Group and business units of Liquidity Coverage Ratios which are calculated under both base case and stressed scenarios and are reported to committees and the Board;
- The Group's Liquidity Risk Management Plan, which includes details of the Group Liquidity Risk Framework as well as gap analysis of liquidity risks and the adequacy of available liquidity resources under normal and stressed conditions;
- Regular stress testing;
- Our contingency plans and identified sources of liquidity;
- The Group's ability to access the money and debt capital markets;
- Regular deep dive assessments; and
- The Group's access to external committed credit facilities.

6.2 Risks from our products

a *Insurance risk*

Insurance risk makes up a significant proportion of Prudential's overall risk exposure. The profitability of its businesses depends on a mix of factors including levels of, and trends in, mortality (policyholders dying), morbidity (policyholders becoming ill) and policyholder behaviour (variability in how customers interact with their policies, including utilisation of withdrawals, take-up of options and guarantees and persistency, ie lapsing of policies), and increases in the costs of claims, including the level of medical expenses increases over and above price inflation (claim inflation).

The Group has appetite for retaining insurance risks in order to create shareholder value in the areas where it believes it has expertise and controls to manage the risk and can support such risk with its capital and solvency position.

The principal drivers of the Group's insurance risk vary across its business units. At M&G Prudential, this is predominantly longevity risk. Across Asia, where a significant volume of health protection business is written, the most significant insurance risks are morbidity risk, persistency risk, as well as medical inflation risk. In Jackson, policyholder behaviour risk is particularly material, especially in the take up of options and guarantees on variable annuity business.

The Group manages longevity risk in various ways. Longevity reinsurance is a key tool in managing this risk. In March 2018, the Group's longevity risk exposure was significantly reduced by reinsuring £12 billion in UK annuity liabilities to Rothesay Life, pursuant to a full Part VII transfer of these liabilities planned for 2019. Although Prudential has withdrawn from selling new UK annuity business, given its significant annuity portfolio the assumptions it makes about future rates of improvement in mortality rates remain key to the measurement of its insurance liabilities and to its assessment of any reinsurance transactions. Prudential continues to conduct research into longevity risk using both experience from its annuity portfolio and industry data. Although the general consensus in recent years is that people are living longer, there is considerable volatility in year-on-year longevity experience, which is why it needs expert judgement in setting its longevity basis.

Prudential's morbidity risk is mitigated by appropriate underwriting when policies are issued and claims are received. Our morbidity assumptions reflect our recent experience and expectation of future trends for each relevant line of business.

In Asia, Prudential writes significant volumes of health protection business, and so a key assumption is the rate of medical inflation, which is often in excess of general price inflation. There is a risk that the expenses of medical treatment increase more than expected, so the medical claim cost passed on to Prudential is higher than anticipated. Medical expense inflation risk is best mitigated by retaining the right to reprice our products each year and by having suitable overall claim limits within its policies, either limits per type of claim or in total across a policy.

The Group's persistency assumptions reflect similarly a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. Persistency risk is mitigated by appropriate training and sales processes and managed locally post-sale through regular experience monitoring and the identification of common characteristics of business with high lapse rates. Where appropriate, allowance is made for the relationship (either assumed or observed historically) between persistency and investment returns and any additional risk is accounted for. Modelling this dynamic policyholder behaviour is particularly important when assessing the likely take-up rate of options embedded within certain products. The effect of persistency on the Group's financial results can vary but depends mostly on the value of the product features and market conditions.

Prudential's insurance risks are managed and mitigated using the following:

- The Group's insurance and underwriting risk policies;
- The risk appetite statements, limits and triggers;
- Using longevity, morbidity and persistency assumptions that reflect recent experience and expectation of future trends, and industry data and expert judgement where appropriate;
- Using reinsurance to mitigate longevity and morbidity risks;
- Ensuring appropriate medical underwriting when policies are issued and appropriate claims management practices when claims are received in order to mitigate morbidity risk;
- Maintaining the quality of sales processes and using initiatives to increase customer retention in order to mitigate persistency risk;
- Using product repricing and other claims management initiatives in order to mitigate medical expense inflation risk; and
- Regular deep dive assessments.

6.3 Risks from our business operations

a Non-financial risks

In the course of doing business, the Group is exposed to non-financial risks arising from its operations, the business environment and its strategy. The main risks across these areas are detailed below.

Operational risks

Prudential defines operational risk as the risk of loss (or unintended gain or profit) arising from inadequate or failed internal processes, personnel or systems, or from external events. This includes employee error, model error, system failures, fraud or some other event which disrupts business processes or has a detrimental impact to customers. Processes are established for activities across the scope of our business, including operational activity, regulatory compliance, and those supporting environmental, social and governance (ESG) activities more broadly, any of which can expose us to operational risks.

Prudential has no appetite for material losses (direct or indirect) suffered as a result of failing to develop, implement or monitor appropriate controls to manage operational risks.

A large volume of complex transactions are processed by the Group across a number of diverse products, and are subject to a high number of varying legal, regulatory and tax regimes. A number of important third-party relationships also exist which provide the distribution and processing of Prudential's products, both as market counterparties and as outsourcing partners. M&G Prudential outsources several operations, including a significant part of its back office, customer facing functions and a number of IT functions. These third-party arrangements help Prudential to provide a high level and cost-effective service to our customers, but they also make us reliant on the operational performance of our outsourcing partners.

The performance of the Group's core business activities places reliance on the IT infrastructure that supports day-to-day transaction processing. The IT environment must also be secure and an increasing cyber risk threat needs to be addressed as the Group's digital footprint increases – see separate information security risk section below. The risk that Prudential's IT infrastructure does not meet these requirements is a key area of focus for the Group, particularly the risk that legacy infrastructure supporting core activities/processes affects business continuity or impacts on business growth.

Operational challenges also exist in keeping pace with regulatory changes. This requires implementing processes to ensure we are, and remain, compliant on an ongoing basis, including regular monitoring and reporting. The high rate of global regulatory change, in an already complex regulatory landscape, increases the risk of non-compliance due to a failure to identify, interpret correctly, implement and/or monitor regulatory compliance. See Global regulatory and political risk section below. Legislative developments over recent years, together with enhanced regulatory oversight and increased capability to issue sanctions, have resulted in a complex regulatory environment that may lead to breaches of varying magnitude if the Group's business-as-usual operations are not compliant. As well as prudential regulation, the Group focuses on conduct regulation, including those related to sales practice and anti-money laundering, bribery and corruption. There is a particular focus on regulations related to the latter in newer/emerging markets.

ESG and climate change risks

The business environment Prudential operates in has become increasingly complex over the years. The political, environmental, societal, technological, legal and economic landscape is highly dynamic and uncertain. Changes and developments on the horizon may result in emerging risks to the business which are monitored under our Emerging Risk Framework.

The Group maintains active engagement with its shareholders, governments, policymakers and regulators in its key markets, as well as with international institutions. This introduces expectations for the Group to act and respond to ESG matters in a certain manner. The perception that key stakeholders have of Prudential and its businesses is crucial in forming and maintaining a robust brand and reputation. As such, the Group's operational risk framework explicitly incorporates ESG as a component of its social and environmental responsibility, brand management and external communications within its framework. This is further strengthened by factoring considerations for reputational impacts when the materiality of operational risks are assessed.

The climate risk landscape continues to evolve and is moving up the agenda of many regulators, governments, non-governmental organisations and investors. Examples of this include the US Department of Labor's decision to change its guidance to pension fund fiduciaries to allow them to factor ESG issues into investment decisions; Hong Kong Stock Exchange listing rules requiring listed companies to provide a high-level discussion of ESG approaches and activities in external disclosures, and the Financial Stability Board's (FSB's) Task Force for Climate-related Financial Disclosures.

Group Chief Risk Officer's report of the risks facing our business and how these are managed continued

The increased regulatory focus on environmental issues not only reflects existing commitments, for example in the UK under the 2008 Climate Change Act, but also a heightened societal awareness of climate change as a pressing global concern. Regulatory and stakeholder interest in environmental matters is expected to increase as climate change moves higher up governmental agendas. This increase in focus creates a number of potential near-term risks. These include:

- Investment risk in the form of physical risk to assets and 'transition risk', ie the risk that an abrupt, unexpected tightening of carbon emission policies lead to a disorderly repricing of carbon-intensive assets;
- Liability risk, if the Group is unable to demonstrate sufficiently that it has acted to mitigate exposure to climate change-related risk; and
- Reputational risks, where the Group's actions could affect external perceptions of our brand and corporate citizenship.

The Group has established a Group-wide Responsible Investment Advisory Committee with designated responsibility to oversee Prudential's responsible investment activities as both asset owners and asset managers.

Physical impacts of climate change could also arise, driven by specific climate-related events such as natural disasters. These impacts are mitigated through the Group's crisis management and disaster recovery plans.

Strategic and transformation risks

As with all risks, strategic risk requires a forward-looking approach to risk management. A key part of Prudential's approach are the risk assessments performed as part of the Group's annual strategic planning process, which supports the identification of potential future threats and the initiatives needed to address them, as well as competitive opportunities. The impact on the Group's businesses and its risk profile is also assessed to ensure that strategic initiatives are within the Group's overall risk appetite.

Implementation of the Group's strategy and the need to comply with emerging regulation has resulted in a significant portfolio of transformation and change initiatives, which may further increase in the future. In particular the intention to demerge the UK and Europe business from the rest of the Group has resulted in a substantial change programme which needs to be managed at the same time that other material transformation programmes are being delivered. The scale and the complexity of the transformation programmes could impact business operations and customers, and has the potential for reputational damage if these programmes fail to deliver their objectives. Implementing further strategic initiatives may amplify these risks.

Other significant change initiatives are occurring across the Group. The volume, scale and complexity of these programmes increase the likelihood and potential impact of risks associated with:

- Dependencies between multiple projects;
- The organisational ability to absorb change being exceeded;
- Unrealised business objectives/ benefits; and
- Failures in project design and execution.

Group-wide framework and risk management for operational risk

The risks detailed above form key elements of the Group's operational risk profile. In order to identify, assess, manage, control and report effectively on all operational risks across the business, a Group-wide operational risk framework is in place. The key components of the framework are:

- Application of a risk and control assessment (RCA) process, where operational risk exposures are identified and assessed as part of a periodical cycle. The RCA process considers a range of internal and external factors, including an assessment of the control environment, to determine the business's most significant risk exposures on a prospective basis;
- An internal incident capture process, which identifies, quantifies and monitors remediation conducted through application of action plans for risk events that have occurred across the business;
- A scenario analysis process for the quantification of extreme, yet plausible manifestations of key operational risks across the business on a forward-looking basis. This is carried out at least annually and supports external and internal capital requirements as well as informing risk activity across the business; and
- An operational risk appetite framework that articulates the level of operational risk exposure the business is willing to tolerate and sets out escalation processes for breaches of appetite.

Outputs from these processes and activities performed by individual business units are monitored by the Group Risk function, which provides an aggregated view of risk profile across the business to the Group Risk Committee and Board.

These core framework components are embedded across the Group via the Group Operational Risk Policy and Standards documents, which sets out the key principles and minimum standards for the management of operational risk across the Group.

The Group operational risk policy, standards and operational risk appetite framework sit alongside other risk policies and standards that individually engage with key operational risks, including outsourcing and third-party supply, business continuity, technology and data, and operations processes.

These policies and standards include subject matter expert-led processes that are designed to identify, assess, manage and control operational risks, including the application of:

- A transformation risk framework that assesses, manages and reports on the end-to-end transformation life cycle, project prioritisation and the risks, interdependencies and possible conflicts arising from a large portfolio of transformation activities;
- Internal and external review of cyber security capability;
- Regular updating and testing of elements of disaster recovery plans and the Critical Incident Procedure process;
- Group and business unit-level compliance oversight and testing in respect of adherence with in-force regulations;

- Regulatory change teams in place to assist the business in proactively adapting and complying with regulatory developments;
- A framework in place for emerging risk identification and analysis in order to capture, monitor and allow us to prepare for operational risks that may crystallise beyond the short-term horizon;
- Corporate insurance programmes to limit the financial impact of operational risks; and
- Reviews of key operational risks and challenges within Group and business unit business plans.

These activities are fundamental in maintaining an effective system of internal control, and as such outputs from these also inform core RCA, incident capture and scenario analysis processes and reporting on operational risk. Furthermore, they also ensure that operational risk considerations are embedded in key business decision-making, including material business approvals and in setting and challenging the Group's strategy.

b Global regulatory and political risk

Regulatory and political risks may impact on Prudential's business or the way in which it is conducted. This covers a broad range of risks including changes in government policy and legislation, capital control measures, new regulations at either national or international level, and specific regulator interventions or actions.

Recent shifts in the focus of some governments toward more protectionist or restrictive economic and trade policies could impact on the degree and nature of regulatory changes and Prudential's competitive position in some geographic markets. This could take effect, for example, through increased friction in cross-border trade, capital controls or measures favouring local enterprises such as changes to the maximum level of non-domestic ownership by foreign companies. These developments continue to be monitored by the Group at a national and global level and these considerations form part of the Group's ongoing engagement with government policy teams and regulators.

National and regional efforts to curb systemic risk and promote financial stability are also underway in certain jurisdictions in which Prudential operates, including the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US, the work of the FSB on G-SIIs and the Insurance Capital Standard being developed by the International Association of Insurance Supervisors (IAIS). There are also a number of ongoing policy initiatives and regulatory developments that are having, and will continue to have, an impact on the way Prudential is supervised. These include addressing Financial Conduct Authority (FCA) reviews, ongoing engagement with the Prudential Regulation Authority (PRA), and the work of the FSB and standard-setting institutions such as the IAIS. Decisions taken by regulators, including those related to solvency requirements, corporate or governance structures, capital allocation and risk management may have an impact on our business.

There has, in recent years, been regulatory focus in the UK on insurance products and market practices which may have adversely impacted customers, including the FCA's Legacy Review and Thematic Review of Annuity Sales Practices. The management of customer risk remains a key focus of management in the UK business. Merger and transformation activity, new product propositions and new regulatory requirements may also have customer risk implications which are monitored.

The International Association of Insurance Supervisors (IAIS) has designated Prudential as a G-SII, which means that it has additional regulatory requirements to comply with, including being subject to enhanced Group-wide supervision and having in place effective resolution planning, as well as a Systemic Risk Management Plan, a Recovery Plan and a Liquidity Risk Management Plan. The IAIS has launched a public interim consultation on an activities-based approach to systemic risk. Following the feedback from this, a second consultation with proposals for policy measures is due to be launched in 2018. Any changes to the designation methodology are expected to be implemented in 2019.

An international Insurance Capital Standard (ICS) is also being developed by the IAIS as part of ComFrame – the common framework for the supervision of Internationally Active Insurance Groups (IAIGs). ComFrame will more generally establish a set of common principles and standards designed to assist supervisors in addressing risks that arise from insurance groups with operations in multiple jurisdictions.

As part of the G-SII regime, the IAIS is also considering the introduction of enhanced capital requirements in the form of a Higher Loss Absorbency (HLA) measure (planned to come into force in 2022). The HLA is intended to be based on the ICS, implementation of which will be conducted in two phases: a five-year monitoring phase followed by an implementation phase.

In May 2017, the International Accounting Standards Board (IASB) published IFRS 17 which will introduce fundamental changes to the statutory reporting of insurance entities that prepare accounts according to IFRS from 2021. This is expected to, among other things, include altering the timing of IFRS profit recognition, and the implementation of the standard is likely to require changes to the Group's IT, actuarial and finance systems.

In March 2018, the UK and EU agreed the terms of a transition agreement for the UK's exit from the bloc, which will last from the termination of the UK's membership of the EU (at 11.00pm GMT 29 March 2019) until 31 December 2020 (although a legally binding text is yet to be agreed). The outcome of negotiations on the final terms of the UK's relationship with the EU remains highly uncertain and the potential for a disorderly exit from the EU by the UK without a negotiated agreement may increase volatility in the markets where we operate, creating the potential for a general downturn in economic activity. Uncertainty also exists on the future applicability of the Solvency II regime in the UK after it leaves the EU. At the same time, the European Commission is currently reviewing some aspects of the Solvency II legislation, which is expected to continue until 2021 and covers, among other things, a review of the Long Term Guarantee measures (on which EIOPA is expected to report later in 2018).

The Group's diversification by geography, currency, product and distribution should reduce some of the potential impact of the UK's exit. M&G Prudential, due to the geographical location of both its businesses and its customers, has most potential to be affected, although the extent of the impact will depend in part on the nature of the arrangements that are put in place between the UK and the EU. Contingency plans were developed ahead of the referendum by business units and operations that may be impacted immediately by a vote to withdraw the UK from the EU, and these plans have been enacted since the referendum result. Significant work has also since been undertaken to ensure that Prudential's business, and in particular its customer base, is not unduly affected by the decision of the UK to exit from the EU.

In the US, various initiatives are underway to introduce fiduciary obligations for distributors of investment products, which may reshape the distribution of retirement products. Jackson has introduced fee-based variable annuity products in response to the potential introduction of such rules, and we anticipate that the business's strong relationships with distributors, history of product innovation and efficient operations should further mitigate any impacts.

The US National Association of Insurance Commissioners (NAIC) is continuing its industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and risk management, which will have an impact on the Jackson business, which continues to be engaged in the consultation and testing process. The NAIC also has an ongoing review of the C-1 bond factors in the required capital calculation, on which further information is expected to be provided in due course. Preparations by Prudential to manage the impact of these reforms will continue.

On 27 July 2017, the UK's FCA announced that it will no longer persuade, or use its powers to compel, panel banks to submit rates for the calculation of LIBOR after 2021. The discontinuation of LIBOR in its current form or a change to alternative benchmark rates could, among other things, impact the Group through an adverse effect on the value of Prudential's assets and liabilities which are linked to or which reference LIBOR, a reduction in market liquidity during any period of transition and increased legal and conduct risks to the Group arising from changes required to documentation and its related obligations to its stakeholders.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. New local capital rules and requirements could be introduced in these and other regulatory regimes that challenge legal or ownership structures, current sales practices, or could be applied to sales made prior to their introduction retrospectively, which could have a negative impact on Prudential's business or reported results.

Risk management and mitigation of regulatory and political risk at Prudential includes the following:

- Risk assessment of the Business Plan which includes consideration of current strategies;
- Close monitoring and assessment of our business environment and strategic risks;
- The consideration of risk themes in strategic decisions; and
- Ongoing engagement with national regulators, government policy teams and international standard setters.

c Information security risk and data privacy

Information security risk remains an area of heightened focus after a number of recent high-profile attacks and data losses across industries. Criminal capability in this area is maturing and industrialising, with an increased level of understanding of complex financial transactions which increases the risks to the financial services industry. The threat landscape is continuously evolving, and the systemic risk of sophisticated but untargeted attacks is rising, particularly during times of heightened geopolitical tensions.

Recent developments in data protection worldwide (such as the EU General Data Protection Regulation that came into force in May 2018) increases the financial and reputational implications for Prudential of a breach of its (or third-party suppliers') IT systems. As well as data protection, increasingly stakeholder expectations are that companies and organisations use personal information in a transparent and appropriate way. Given this, both information security and data privacy are key risks for the Group. As well as preventative risk management, it is fundamental that robust critical recovery systems are in place in the event of a successful attack on the Group's systems, breach of information security or failure of its systems in order to retain its customer relationships and trusted reputation.

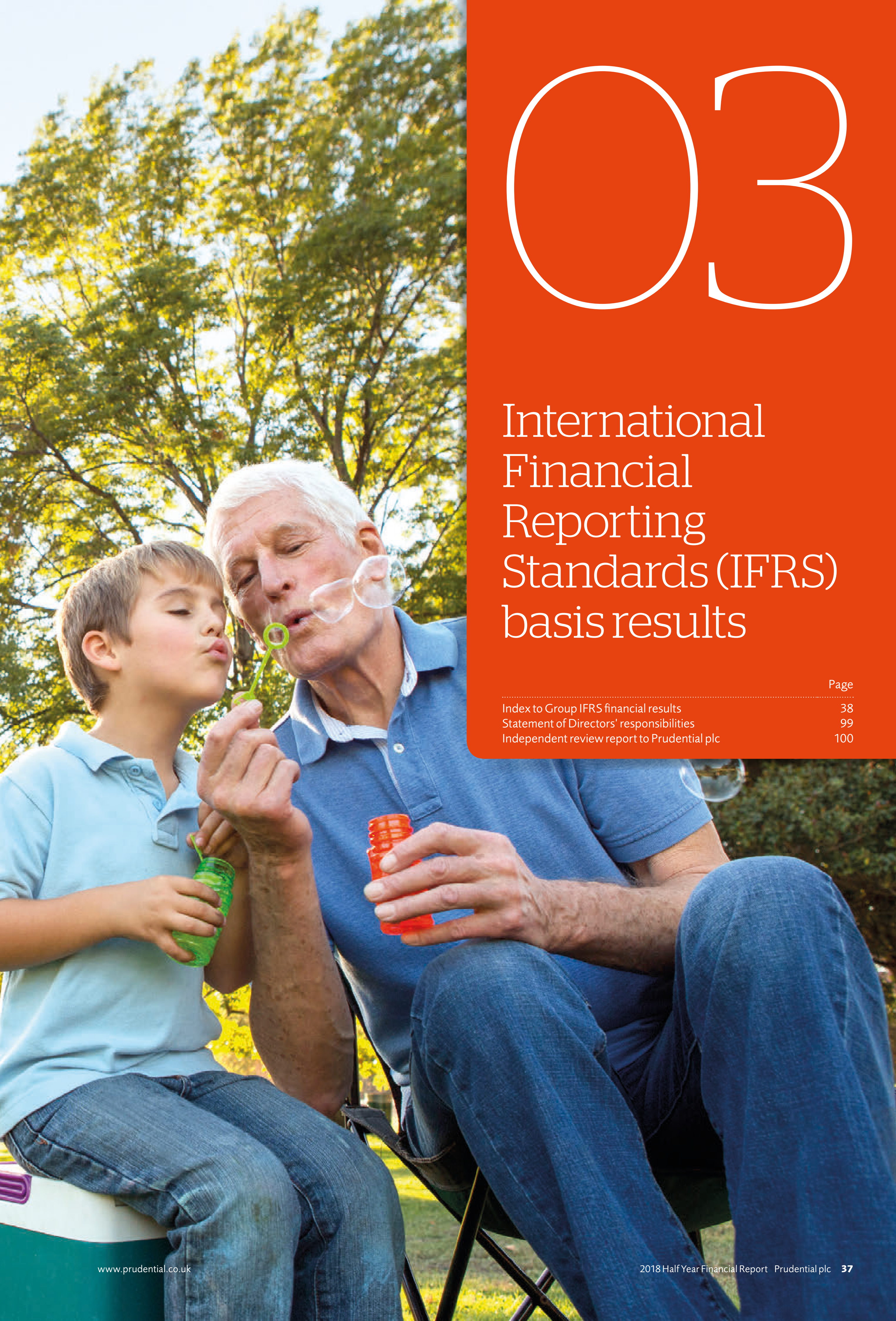
The core objectives of the Group's Cyber Risk Management Strategy are: to develop a comprehensive situational awareness of its business in cyberspace; to proactively engage cyber attackers to minimise harm to its business; and to enable the business to grow confidently and safely in cyberspace.

The Group's Cyber Defence Plan consists of a number of elements, including developing our ability to deal with incidents; alignment with our digital transformation strategy; and increasing information security risk oversight and assurance to the Board. Progress has been made in all of these across 2017 and 2018. Protecting our customers remains core to Prudential's business, and the successful delivery of the Plan will reinforce its capabilities to continue doing so in cyberspace as it transitions to a digital business.

The Board receives periodic updates on information security risk management throughout the year. Group functions work with the business units to address risks locally within the national and regional context of each business, following the strategic direction laid out in the Cyber Risk Management Strategy and managed through the execution of the Cyber Defence Plan.

James Turner
Group Chief Risk Officer

Note
1 Based on hierarchy of Standard & Poor's, Moody's and Fitch, where available and if unavailable, other rating agencies or internal ratings have been used.



03

International Financial Reporting Standards (IFRS) basis results

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Condensed consolidated income statement

	Note	2018 £m Half year	2017 £m Half year	2017 £m Full year
Gross premiums earned		21,341	22,105	44,005
Outward reinsurance premiums*		(12,961)	(947)	(2,062)
Earned premiums, net of reinsurance		8,380	21,158	41,943
Investment return		1,434	20,629	42,189
Other income†		1,105	1,137	2,258
Total revenue, net of reinsurance	B1.4	10,919	42,924	86,390
Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance		(4,507)	(35,442)	(72,532)
Acquisition costs and other expenditure†	B2	(4,535)	(5,245)	(9,993)
Finance costs: interest on core structural borrowings of shareholder-financed operations		(189)	(216)	(425)
(Loss) gain on disposal of businesses and corporate transactions	D1	(57)	61	223
Re-measurement of the sold Korea life business		–	5	5
Total charges, net of reinsurance and (loss) gain on disposal of businesses		(9,288)	(40,837)	(82,722)
Share of profits from joint ventures and associates, net of related tax		102	120	302
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*‡		1,733	2,207	3,970
Less tax charge attributable to policyholders' returns		(33)	(393)	(674)
Profit before tax attributable to shareholders	B1.1	1,700	1,814	3,296
Total tax charge attributable to policyholders and shareholders	B4	(377)	(702)	(1,580)
Adjustment to remove tax charge attributable to policyholders' returns		33	393	674
Tax charge attributable to shareholders' returns	B4	(344)	(309)	(906)
Profit for the period		1,356	1,505	2,390

Attributable to:	2018 £m Half year	2017 £m Half year	2017 £m Full year
Equity holders of the Company	1,355	1,505	2,389
Non-controlling interests	1	–	1
Profit for the period	1,356	1,505	2,390

Earnings per share (in pence)	Note	2018 Half year	2017 Half year	2017 Full year
Based on profit attributable to the equity holders of the Company:	B5			
Basic		52.7p	58.7p	93.1p
Diluted		52.6p	58.6p	93.0p

Dividends per share (in pence)	Note	2018 Half year	2017 Half year	2017 Full year
Dividends relating to reporting period:	B6			
First interim ordinary dividend		15.67p	14.50p	14.50p
Second interim ordinary dividend		–	–	32.50p
Total		15.67p	14.50p	47.00p
Dividends paid in reporting period:	B6			
Current year first interim ordinary dividend		–	–	14.50p
Second interim ordinary dividend for prior year		32.50p	30.57p	30.57p
Total		32.50p	30.57p	45.07p

* Outward reinsurance premiums of £(12,961) million includes the £(12,130) million paid during the period in respect of the reinsurance of the UK annuity portfolio. See note D1 for further details.

† The half year and full year 2017 comparative results have been re-presented from those previously published for the deduction of certain expenses against revenue following the adoption of IFRS 15 (see note A2).

‡ This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.
This is principally because the corporate taxes of the Group include those on the income of consolidated with-profits and unit-linked funds that, through adjustments to benefits, are borne by policyholders. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure is not representative of pre-tax profits attributable to shareholders. Profit before all taxes is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of The Prudential Assurance Company Limited ('PAC') with-profits fund after adjusting for taxes borne by policyholders.

Condensed consolidated statement of comprehensive income

	Note	2018 £m	2017 £m	
		Half year	Half year	Full year
Profit for the period		1,356	1,505	2,390
Other comprehensive income (loss):				
Items that may be reclassified subsequently to profit or loss				
Exchange movements on foreign operations and net investment hedges:				
Exchange movements arising during the period		67	(220)	(404)
Cumulative exchange gain of the sold Korea life business recycled through profit and loss	D1	–	(61)	(61)
Related tax		2	(4)	(5)
		69	(285)	(470)
Net unrealised valuation movements on securities of US insurance operations classified as available-for-sale:				
Net unrealised holding (losses) gains arising during the period		(1,392)	565	591
(Deduct net gains) Add back net losses included in the income statement on disposal and impairment		(29)	(34)	26
Total	C3.2(c)	(1,421)	531	617
Related change in amortisation of deferred acquisition costs	C5(b)	272	(69)	(76)
Related tax		241	(162)	(55)
		(908)	300	486
Total		(839)	15	16
Items that will not be reclassified to profit or loss				
Shareholders' share of actuarial gains and losses on defined benefit pension schemes:				
Gross		81	53	104
Related tax		(14)	(7)	(15)
		67	46	89
Other comprehensive (loss) income for the period, net of related tax		(772)	61	105
Total comprehensive income for the period		584	1,566	2,495

	2018 £m	2017 £m	
Attributable to:	Half year	Half year	Full year
Equity holders of the Company	583	1,566	2,494
Non-controlling interests	1	–	1
Total comprehensive income for the period	584	1,566	2,495

Condensed consolidated statement of changes in equity

	Note	Share capital note C9	Share premium note C9	Retained earnings	Translation reserve	Available-for-sale securities reserves	Shareholders' equity	Non-controlling interests	Total equity
		Period ended 30 June 2018 £m							
Reserves									
Profit for the period		–	–	1,355	–	–	1,355	1	1,356
Other comprehensive income (loss)		–	–	67	69	(908)	(772)	–	(772)
Total comprehensive income (loss) for the period		–	–	1,422	69	(908)	583	1	584
Dividends	B6	–	–	(840)	–	–	(840)	–	(840)
Reserve movements in respect of share-based payments		–	–	(9)	–	–	(9)	–	(9)
Share capital and share premium									
New share capital subscribed	C9	–	6	–	–	–	6	–	6
Treasury shares									
Movement in own shares in respect of share-based payment plans		–	–	28	–	–	28	–	28
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		–	–	27	–	–	27	–	27
Net increase (decrease) in equity		–	6	628	69	(908)	(205)	1	(204)
At beginning of period		129	1,948	12,326	840	844	16,087	7	16,094
At end of period		129	1,954	12,954	909	(64)	15,882	8	15,890

	Note	Share capital note C9	Share premium note C9	Retained earnings	Translation reserve	Available-for-sale securities reserves	Shareholders' equity	Non-controlling interests	Total equity
		Period ended 30 June 2017 £m							
Reserves									
Profit for the period		–	–	1,505	–	–	1,505	–	1,505
Other comprehensive income (loss)		–	–	46	(285)	300	61	–	61
Total comprehensive income (loss) for the period		–	–	1,551	(285)	300	1,566	–	1,566
Dividends	B6	–	–	(786)	–	–	(786)	–	(786)
Reserve movements in respect of share-based payments		–	–	22	–	–	22	–	22
Share capital and share premium									
New share capital subscribed	C9	–	10	–	–	–	10	–	10
Treasury shares									
Movement in own shares in respect of share-based payment plans		–	–	(12)	–	–	(12)	–	(12)
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		–	–	(17)	–	–	(17)	–	(17)
Net increase (decrease) in equity		–	10	758	(285)	300	783	–	783
At beginning of period		129	1,927	10,942	1,310	358	14,666	1	14,667
At end of period		129	1,937	11,700	1,025	658	15,449	1	15,450

		Year ended 31 December 2017 £m							
	Note	Share capital note C9	Share premium note C9	Retained earnings	Translation reserve	Available-for-sale securities reserves	Shareholders' equity	Non-controlling interests	Total equity
Reserves									
Profit for the year		–	–	2,389	–	–	2,389	1	2,390
Other comprehensive income (loss)		–	–	89	(470)	486	105	–	105
Total comprehensive income (loss) for the year		–	–	2,478	(470)	486	2,494	1	2,495
Dividends	B6	–	–	(1,159)	–	–	(1,159)	–	(1,159)
Reserve movements in respect of share-based payments		–	–	89	–	–	89	–	89
Change in non-controlling interests		–	–	–	–	–	–	5	5
Share capital and share premium									
New share capital subscribed	C9	–	21	–	–	–	21	–	21
Treasury shares									
Movement in own shares in respect of share-based payment plans		–	–	(15)	–	–	(15)	–	(15)
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS		–	–	(9)	–	–	(9)	–	(9)
Net increase (decrease) in equity		–	21	1,384	(470)	486	1,421	6	1,427
At beginning of year		129	1,927	10,942	1,310	358	14,666	1	14,667
At end of year		129	1,948	12,326	840	844	16,087	7	16,094

Condensed consolidated statement of financial position

	Note	2018 £m	2017 £m	
		30 Jun	30 Jun	31 Dec
Assets				
Goodwill	C5(a)	1,620	1,501	1,482
Deferred acquisition costs and other intangible assets	C5(b)	11,359	10,757	11,011
Property, plant and equipment		951	727	789
Reinsurers' share of insurance contract liabilities		9,620	9,709	9,673
Deferred tax assets	C7	2,435	4,105	2,627
Current tax recoverable		626	700	613
Accrued investment income		2,574	2,887	2,676
Other debtors		3,519	3,417	2,963
Investment properties		17,605	15,218	16,497
Investment in joint ventures and associates accounted for using the equity method		1,554	1,293	1,416
Loans	C3.3	16,922	16,952	17,042
Equity securities and portfolio holdings in unit trusts		229,707	210,437	223,391
Debt securities	C3.2	160,305	170,793	171,374
Derivative assets		3,428	3,789	4,801
Other investments		6,059	5,566	5,622
Deposits		12,412	13,353	11,236
Assets held for sale*		12,024	33	38
Cash and cash equivalents		8,450	9,893	10,690
Total assets	C1	501,170	481,130	493,941
Equity				
Shareholders' equity		15,882	15,449	16,087
Non-controlling interests		8	1	7
Total equity		15,890	15,450	16,094
Liabilities				
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(a)	405,482	398,980	411,243
Unallocated surplus of with-profits funds	C4.1(a)	17,283	15,090	16,951
Core structural borrowings of shareholder-financed operations	C6.1	6,367	6,614	6,280
Operational borrowings attributable to shareholder-financed operations	C6.2(a)	1,618	2,096	1,791
Borrowings attributable to with-profits operations	C6.2(b)	3,589	3,336	3,716
Obligations under funding, securities lending and sale and repurchase agreements		7,128	6,408	5,662
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		9,358	8,577	8,889
Deferred tax liabilities	C7	4,443	5,683	4,715
Current tax liabilities		415	743	537
Accruals, deferred income and other liabilities		13,551	14,524	14,185
Provisions		920	759	1,123
Derivative liabilities		3,149	2,870	2,755
Liabilities held for sale	D1	11,977	–	–
Total liabilities	C1	485,280	465,680	477,847
Total equity and liabilities		501,170	481,130	493,941

* Assets held for sale of £12,024 million includes £11,977 million in respect of the reinsured UK annuity business (see note D1).

Included within equity securities and portfolio holdings in unit trusts, debt securities and other investments are £8,993 million of lent securities as at 30 June 2018 (30 June 2017: £9,182 million; 31 December 2017: £8,232 million).

Condensed consolidated statement of cash flows

	Note	2018 £m Half year	2017 £m Half year	2017 £m Full year
Cash flows from operating activities				
Profit before tax *(being tax attributable to shareholders' and policyholders' returns)* note (i)		1,733	2,207	3,970
Other non-investment and non-cash assets		(389)	(550)	(49,771)
Investments		7,616	(26,539)	(968)
Policyholder liabilities (including unallocated surplus)		(10,725)	21,597	44,877
Other liabilities (including operational borrowings)		568	3,390	3,360
Other items note (ii)		466	(15)	152
Net cash flows from operating activities		(731)	90	1,620
Cash flows from investing activities				
Net cash outflows from purchases and disposals of property, plant and equipment		(167)	(56)	(134)
Net cash (outflows) inflows from corporate transactions note (iii)		(248)	813	950
Net cash flows from investing activities		(415)	757	816
Cash flows from financing activities				
Structural borrowings of the Group:				
Shareholder-financed operations: note (iv)	C6.1			
Issue of subordinated debt, net of costs		–	–	565
Redemption of subordinated debt		–	–	(751)
Interest paid		(187)	(207)	(369)
With-profits operations: note (v)	C6.2			
Redemption of subordinated debt		(100)	–	–
Interest paid		(4)	(4)	(9)
Equity capital:				
Issues of ordinary share capital		6	10	21
Dividends paid		(840)	(786)	(1,159)
Net cash flows from financing activities		(1,125)	(987)	(1,702)
Net (decrease) increase in cash and cash equivalents		(2,271)	(140)	734
Cash and cash equivalents at beginning of period		10,690	10,065	10,065
Effect of exchange rate changes on cash and cash equivalents		31	(32)	(109)
Cash and cash equivalents at end of period		8,450	9,893	10,690

Notes

(i) This measure as explained in the footnote to the income statement is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.

(ii) The adjusting items to profit before tax included within other items are adjustments in respect of non-cash items together with operational interest receipts and payments, dividend receipts and tax paid.

(iii) Net cash flows for corporate transactions are for distribution rights and the acquisition and disposal of businesses (including private equity and other subsidiaries acquired by with-profits funds for investment purposes).

(iv) Structural borrowings of shareholder-financed operations exclude borrowings to support short-term fixed income securities programmes, non-recourse borrowings of investment subsidiaries of shareholder-financed operations and other borrowings of shareholder-financed operations. Cash flows in respect of these borrowings are included within cash flows from operating activities. The changes in the carrying value of the structural borrowings of shareholder-financed operations during half year 2018 are analysed as follows:

	Cash movements £m			Non-cash movements £m		
	Balance at beginning of period	Issue of debt	Redemption of debt	Foreign exchange movement	Other movements	Balance at end of period
Half year 2018	6,280	–	–	83	4	6,367
Half year 2017	6,798	–	–	(191)	7	6,614
Full year 2017	6,798	565	(751)	(341)	9	6,280

(v) Interest paid on structural borrowings of with-profits operations relate solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds, which contribute to the solvency base of the Scottish Amicable Insurance Fund (SAIF), a ring-fenced sub-fund of the PAC with-profits fund. These bonds were redeemed in full on 30 June 2018. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

A Background

A1 Basis of preparation, audit status and exchange rates

These condensed consolidated interim financial statements for the six months ended 30 June 2018 have been prepared in accordance with IAS 34 'Interim Financial Reporting' as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). The Group's policy for preparing this interim financial information is to use the accounting policies adopted by the Group in its last consolidated financial statements, as updated by any changes in accounting policies it intends to make in its next consolidated financial statements as a result of new or amended IFRS and other policy improvements. EU-endorsed IFRS may differ from IFRSs issued by the IASB if, at any point in time, new or amended IFRS have not been endorsed by the EU. At 30 June 2018, there were no unendorsed standards effective for the period ended 30 June 2018 which impact the condensed consolidated financial statements of the Group, and there were no differences between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to the Group.

The IFRS basis results for the 2018 and 2017 half years are unaudited. The 2017 full year IFRS basis results have been derived from the 2017 statutory accounts. The auditors have reported on the 2017 statutory accounts which have been delivered to the Registrar of Companies. The auditors' report was: (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The exchange rates applied for balances and transactions in currencies other than the presentational currency of the Group, pounds sterling (GBP), were:

	Closing rate at 30 Jun 2018	Average for the 6 months to 30 Jun 2018	Closing rate at 30 Jun 2017	Average for the 6 months to 30 Jun 2017	Closing rate at 31 Dec 2017	Average for the 12 months to 31 Dec 2017
Local currency: £						
Hong Kong	**10.36**	**10.78**	10.14	9.80	10.57	10.04
Indonesia	**18,919.18**	**18,938.64**	17,311.76	16,793.63	18,353.44	17,249.38
Malaysia	**5.33**	**5.42**	5.58	5.53	5.47	5.54
Singapore	**1.80**	**1.83**	1.79	1.77	1.81	1.78
China	**8.75**	**8.76**	8.81	8.66	8.81	8.71
India	**90.46**	**90.37**	83.96	82.77	86.34	83.90
Vietnam	**30,310.96**	**31,329.01**	29,526.43	28,612.70	30,719.60	29,279.71
Thailand	**43.74**	**43.66**	44.13	43.72	44.09	43.71
US	**1.32**	**1.38**	1.30	1.26	1.35	1.29

Certain notes to the financial statements present half year 2017 comparative information at constant exchange rates (CER), in addition to the reporting at actual exchange rates (AER) used throughout the condensed consolidated financial statements. AER are actual historical exchange rates for the specific accounting period, being the average rates over the period for the income statement and the closing rates at the balance sheet date for the balance sheet. CER results are calculated by translating prior period results using the current period foreign exchange rate ie current period average rates for the income statement and current period closing rates for the balance sheet.

The accounting policies applied by the Group in determining the IFRS basis results in this report are the same as those previously applied in the Group's consolidated financial statements for the year ended 31 December 2017, as disclosed in the 2017 statutory accounts, aside from those discussed in note A2 below.

A2 New accounting pronouncements in 2018

IFRS 15, 'Revenue from Contracts with Customers'

The Group has adopted IFRS 15, 'Revenue from Contracts with Customers' from 1 January 2018. This standard provides a single framework to recognise revenue for contracts with different characteristics and overrides the revenue recognition requirements previously provided in other standards. The contracts excluded from the scope of this standard include:

- Lease contracts within the scope of IAS 17 'Leases';
- Insurance contracts within the scope of IFRS 4 'Insurance Contracts'; and
- Financial instruments within the scope of IAS 39 'Financial Instruments'.

As a result, the main impacts of IFRS 15 in the context of Prudential's business are to the recognition of revenue in respect of asset management contracts and investment contracts that do not contain discretionary participating features but do include investment management services.

A2 New accounting pronouncements in 2018 continued

IFRS 15, 'Revenue from Contracts with Customers' continued

In accordance with the transition provisions in IFRS 15, the Group has adopted the standard using the full retrospective method for all periods presented. Adoption of the standard has not resulted in a restatement of the Group's profit for the periods presented or shareholders' equity. A minor reclassification has been made to the consolidated income statement to present certain expenses as a deduction against revenue, for example rebates to clients of asset management fees. Revenue has been reduced by £82 million in half year 2018 (half year 2017: £85 million; full year 2017: £172 million).

IFRS 9, 'Financial Instruments'

The IASB published a complete version of IFRS 9 in July 2014 and the standard is mandatorily effective for annual periods beginning on or after 1 January 2018.

In September 2016, the IASB published amendments to IFRS 4, 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' to address the temporary consequences of the different effective dates of IFRS 9 and IFRS 17, 'Insurance Contracts'. The amendments include an optional temporary exemption from applying IFRS 9 and the associated amendments until IFRS 17 comes into effect in 2021. This temporary exemption is available to companies whose predominant activity is to issue insurance contracts based on meeting the eligibility criteria as at 31 December 2015 as set out in the amendments. The Group met the eligibility criteria and will defer the adoption of IFRS 9 to 1 January 2021.

Other new accounting pronouncements

In addition to the above, the IASB has also issued the following new accounting pronouncements to be effective for 1 January 2018:

- IFRIC 22, 'Foreign Currency Transactions and Advance consideration';
- Classification and measurement of share-based payment transactions (Amendments to IFRS 2, 'Share-based payment');
- Transfers of Investment Property (Amendments to IAS 40, 'Investment property'); and
- Annual Improvements to IFRSs 2014-2016 Cycle.

These pronouncements have had no effect on the Group financial statements.

B Earnings performance

B1 Analysis of performance by segment

B1.1 Segment results – profit before tax

		2018 £m	2017* £m		%		2017 £m
	Note	Half year	AER Half year note (v)	CER Half year note (v)	Half year 2018 vs half year 2017 AER note (v)	Half year 2018 vs half year 2017 CER note (v)	AER Full year
Asia							
Insurance operations	B3(a)	927	870	812	7%	14%	1,799
Asset management		89	83	79	7%	13%	176
Total Asia		1,016	953	891	7%	14%	1,975
US							
Jackson (US insurance operations)		1,001	1,079	988	(7)%	1%	2,214
Asset management		1	(6)	(6)	117%	117%	10
Total US		1,002	1,073	982	(7)%	2%	2,224
UK and Europe							
UK and Europe insurance operations:	B3(b)						
Long-term business		487	480	480	1%	1%	861
General insurance commission note (i)		19	17	17	12%	12%	17
Total UK and Europe insurance operations		506	497	497	2%	2%	878
UK and Europe asset management note (vi)		272	248	248	10%	10%	500
Total UK and Europe		778	745	745	4%	4%	1,378
Total segment profit		2,796	2,771	2,618	1%	7%	5,577
Restructuring costs note (iii)		(62)	(31)	(31)	(100)%	(100)%	(103)
Other income and expenditure:							
Investment return and other income		33	6	6	450%	450%	11
Interest payable on core structural borrowings		(189)	(216)	(216)	13%	13%	(425)
Corporate expenditure note (ii)		(173)	(172)	(166)	(1)%	(4)%	(361)
Total other income and expenditure		(329)	(382)	(376)	14%	13%	(775)
Operating profit based on longer-term investment returns	B1.3	2,405	2,358	2,211	2%	9%	4,699
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	(113)	(573)	(523)	80%	78%	(1,563)
Amortisation of acquisition accounting adjustments note (iv)		(22)	(32)	(29)	31%	24%	(63)
(Loss) gain on disposal of businesses and corporate transactions	D1	(570)	61	61	n/a	n/a	223
Profit before tax		1,700	1,814	1,720	(6)%	(1)%	3,296
Tax charge attributable to shareholders' returns	B4	(344)	(309)	(295)	(11)%	(17)%	(906)
Profit for the period		1,356	1,505	1,425	(10)%	(5)%	2,390
Attributable to:							
Equity holders of the Company		1,355	1,505	1,425	(10)%	(5)%	2,389
Non-controlling interests		1	–	–	n/a	n/a	1

B1 Analysis of performance by segment continued

B1.1 Segment results – profit before tax continued

Basic earnings per share (in pence)	Note	2018 Half year	2017 AER Half year note (v)	2017 CER Half year note (v)	% Half year 2018 vs half year 2017 AER note (v)	% Half year 2018 vs half year 2017 CER note (v)	2017 AER Full year note (v)
	B5						
Based on operating profit based on longer-term investment returns		76.8p	70.0p	65.7p	10%	17%	145.2p
Based on profit for the period		52.7p	58.7p	55.6p	(10)%	(5)%	93.1p

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Notes

(i) General insurance commission represents the commission receivable net of expenses for Prudential-branded general insurance products in connection with the arrangement to transfer the UK general insurance business to Churchill in 2002.

(ii) Corporate expenditure as shown above is primarily for Group Head Office and Asia Regional Head Office.

(iii) Restructuring costs are incurred primarily in the UK, Europe and Asia and represent the costs of business transformation and integration costs.

(iv) Amortisation of acquisition accounting adjustments principally relate to the REALIC business of Jackson which was acquired in 2012.

(v) For definitions of AER and CER refer to note A1.

(vi) UK and Europe asset management operating profit based on longer-term investment returns:

	2018 £m Half year	2017 £m Half year	2017 £m Full year
Asset management fee income	552	491	1,027
Other income	1	4	7
Staff costs	(190)	(166)	(400)
Other costs	(107)	(95)	(202)
Underlying profit before performance-related fees	256	234	432
Share of associate results	8	8	15
Performance-related fees	8	6	53
Total UK and Europe asset management operating profit based on longer-term investment returns	272	248	500

B1.2 Short-term fluctuations in investment returns on shareholder-backed business

	2018 £m Half year	2017 £m Half year*	2017 £m Full year
Asia[note (i)]	(326)	41	(1)
US[note (ii)]	244	(754)	(1,568)
UK and Europe[note (iii)]	(122)	42	(14)
Other operations[note (iv)]	91	98	20
Total	(113)	(573)	(1,563)

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Notes

(i) *Asia operations*
In Asia, the negative short-term fluctuations of £(326) million principally reflect net value movements on shareholders' assets and related liabilities following increases in bond yields during the period (half year 2017: positive £41 million; full year 2017: negative £(1) million).

(ii) *US operations*
The short-term fluctuations in investment returns for US insurance operations are reported net of the related charge for amortisation of deferred acquisition costs of £(199) million as shown in note C5 (half year 2017: credit of £231 million; full year 2017: credit of £462 million) and comprise amounts in respect of the following items:

	2018 £m Half year	2017 £m Half year	2017 £m Full year
Net equity hedge result[note (a)]	383	(782)	(1,490)
Other than equity-related derivatives[note (b)]	(183)	12	(36)
Debt securities[note (c)]	6	5	(73)
Equity-type investments: actual less longer-term return	31	1	12
Other items	7	10	19
Total	244	(754)	(1,568)

Notes

(a) Net equity hedge result

The purpose of the inclusion of this item in short-term fluctuations in investment returns is to segregate the amount included in pre-tax profit that relates to the accounting effect of market movements on both the measured value of guarantees in Jackson's variable annuity and fixed index annuity products and on the related derivatives used to manage the exposures inherent in these guarantees. The level of fees recognised in non-operating profit is determined by reference to that allowed for within the reserving basis. Both FAS 157 and SOP 03-01 reserving methods require an entity to determine the total fee ('the fee assessment') that is expected to fund future projected benefit payments arising using the assumptions applicable for that method. FAS 157 requires this fee assessment to be fixed at the time of issue. It is this fee assessment that is recognised within non-operating profit to match the relevant movement in the guarantee liability, which is also recognised in non-operating profit. As the Group applies US GAAP for the measured value of the product guarantees this item also includes asymmetric impacts where the measurement bases of the liabilities and associated derivatives used to manage the Jackson annuity business differ. For further details, please refer to note B1.3(c) of the Group's consolidated financial statements for the year ended 31 December 2017.

The net equity hedge result therefore includes significant accounting mismatches and other factors that detract from the presentation of an economic result. These other factors include:

- The variable annuity guarantees and fixed index annuity embedded options being only partially fair valued under 'grandfathered' US GAAP;
- The interest rate exposure being managed through the other than equity-related derivative programme explained in note (b) below; and
- Jackson's management of its economic exposures for a number of other factors that are treated differently in the accounting frameworks such as future fees and assumed volatility levels.

The net equity hedge result (net of related DAC amortisation in accordance with the policy that DAC is amortised in line with emergence of margins) can be summarised as follows:

	2018 £m	**2017** £m	
	Half year	**Half year**	**Full year**
Fair value movements on equity hedge instruments*	(375)	(1,126)	(1,871)
Accounting value movements on the variable and fixed index annuity guarantee liabilities	505	111	(99)
Fee assessments net of claim payments	253	233	480
Total	383	(782)	(1,490)

* Held to manage equity exposures of the variable annuity guarantees and fixed index annuity options.

(b) Other than equity-related derivatives

The fluctuations for this item comprise the net effect of:

- Fair value movements on free-standing, other than equity-related derivatives;
- Fair value movements on the Guaranteed Minimum Income Benefit (GMIB) reinsurance asset that are not matched by movements in the underlying GMIB liability, which is not fair valued; and
- Related amortisation of DAC.

The free-standing, other than equity-related derivatives, are held to manage interest rate exposures and durations within the general account and the variable annuity guarantees and fixed index annuity embedded options described in note (a) above. Accounting mismatches arise because of differences between the measurement basis and presentation of the derivatives, which are fair valued with movements recorded in the income statement, and the exposures they are intended to manage.

(c) Short-term fluctuations related to debt securities

	2018 £m	**2017** £m	
	Half year	**Half year**	**Full year**
Short-term fluctuations relating to debt securities			
(Charges) credits in the period:			
Losses on sales of impaired and deteriorating bonds	(1)	(2)	(3)
Bond write-downs	(2)	(1)	(2)
Recoveries/reversals	18	7	10
Total credits in the period	15	4	5
Less: Risk margin allowance deducted from operating profit based on longer-term investment returns[note]	38	46	86
	53	50	91
Interest-related realised (losses) gains:			
Gains (losses) arising in the period	8	23	(43)
Less: Amortisation of gains and losses arising in current and prior periods to operating profit based on longer-term investment returns	(57)	(72)	(140)
	(49)	(49)	(183)
Related amortisation of deferred acquisition costs	2	4	19
Total short-term fluctuations related to debt securities	6	5	(73)

B1 Analysis of performance by segment continued

B1.2 Short-term fluctuations in investment returns on shareholder-backed business continued

Note

The debt securities of Jackson are held in the general account of the business. Realised gains and losses are recorded in the income statement with normalised returns included in operating profit with variations from year to year included in the short-term fluctuations category. The risk margin reserve charge for longer-term credit-related losses included in operating profit based on longer-term investment returns of Jackson for half year 2018 is based on an average annual risk margin reserve of 19 basis points (half year 2017: 21 basis points; full year 2017: 21 basis points) on average book values of US$54.9 billion (half year 2017: US$55.8 billion; full year 2017: US$55.3 billion) as shown below:

	Half year 2018				Half year 2017				Full year 2017			
Moody's rating category (or equivalent under NAIC ratings of mortgage-backed securities)	**Average book value**	**RMR**	**Annual expected loss**		**Average book value**	**RMR**	**Annual expected loss**		**Average book value**	**RMR**	**Annual expected loss**	
	US$m	%	US$m	£m	US$m	%	US$m	£m	US$m	%	US$m	£m
A3 or higher	26,260	0.11	(29)	(21)	27,848	0.13	(35)	(28)	27,277	0.12	(33)	(25)
Baa1, 2 or 3	27,337	0.20	(57)	(41)	26,601	0.23	(60)	(47)	26,626	0.22	(58)	(45)
Ba1, 2 or 3	978	1.01	(10)	(7)	1,052	1.03	(11)	(9)	1,046	1.03	(11)	(8)
B1, 2 or 3	309	2.61	(8)	(6)	311	2.75	(9)	(7)	318	2.70	(9)	(7)
Below B3	11	3.71	–	–	27	3.80	(1)	(1)	23	3.78	(1)	(1)
Total	54,895	0.19	(104)	(75)	55,839	0.21	(116)	(92)	55,290	0.21	(112)	(86)
Related amortisation of deferred acquisition costs (see below)			22	15			22	17			21	15
Risk margin reserve charge to operating profit for longer-term credit-related losses			(82)	(60)			(94)	(75)			(91)	(71)

Consistent with the basis of measurement of insurance assets and liabilities for Jackson's IFRS results, the charges and credits to operating profits based on longer-term investment returns are partially offset by related amortisation of deferred acquisition costs.

In addition to the accounting for realised gains and losses described above for Jackson general account debt securities, included within the statement of other comprehensive income is a pre-tax charge of £(1,149) million for net unrealised losses on debt securities classified as available-for-sale net of related amortisation of deferred acquisition costs (half year 2017: credit of £462 million for net unrealised gains; full year 2017: credit of £541 million for net unrealised gains). Temporary market value movements do not reflect defaults or impairments. Additional details of the movement in the value of the Jackson portfolio are included in note C3.2(b).

(iii) *UK and Europe operations*

The negative short-term fluctuations in investment returns for UK and Europe operations of £(122) million (half year 2017: positive £42 million; full year 2017: negative £(14) million) include net unrealised movements on fixed income assets supporting the capital of the shareholder-backed annuity business.

(iv) *Other operations*

Short-term fluctuations in investment returns for other operations of positive £91 million (half year 2017: positive £98 million; full year 2017: positive £20 million) include unrealised value movements on financial instruments held outside of the main life operations.

B1.3 Determining operating segments and performance measure of operating segments

Operating segments

The Group's operating segments for financial reporting are defined and presented in accordance with IFRS 8, 'Operating Segments' on the basis of the management reporting structure and its financial management information.

Under the Group's management and reporting structure its chief operating decision maker is the Group Executive Committee (GEC). In the management structure, responsibility is delegated to the Chief Executive Officers of Prudential Corporation Asia, the North American Business Unit and M&G Prudential for the day-to-day management of their business units (within the framework set out in the Group Governance Manual). Financial management information used by the GEC aligns to these three business segments. These operating segments derive revenue from both long-term insurance and asset management activities.

Operations which do not form part of any business unit are reported as 'Unallocated to a segment'. These include Group Head Office and Asia Regional Head Office costs. Prudential Capital and Africa operations do not form part of any operating segment under the structure, and their assets and liabilities and profit/loss before tax are not material to the overall financial position of the Group. Prudential Capital and Africa operations are therefore reported as 'Unallocated to a segment'.

The Group reassessed its segments in the second half of 2017 following the combination of the Group's UK insurance business and M&G to form M&G Prudential. Comparative segmental information for half year 2017 has been re-presented on a basis consistent with the current period.

Performance measure

The performance measure of operating segments utilised by the Company is IFRS operating profit attributable to shareholders based on longer-term investment returns. This measurement basis distinguishes operating profit based on longer-term investment returns from other constituents of the total profit as follows:

— Short-term fluctuations in investment returns on shareholder-backed business;
— Amortisation of acquisition accounting adjustments arising on the purchase of business. This comprises principally the charge for the adjustments arising on the purchase of REALIC in 2012; and
— Profit/loss attaching to corporate transactions, such as disposals undertaken in the period.

The determination of operating profit based on longer-term investment returns for investment and liability movements is as described in note B1.3 of the Group's consolidated financial statements for the year ended 31 December 2017.

For Group debt securities at 30 June 2018, the level of unamortised interest-related realised gains and losses related to previously sold bonds and have yet to be amortised to operating profit was a net gain of £818 million (30 June 2017: net gain of £876 million; 31 December 2017: net gain of £855 million).

For equity-type securities, the longer-term rates of return applied by the non-linked shareholder-financed insurance operations of Asia and the US to determine the amount of investment return included in operating profit are as follows:

— For Asia insurance operations, investments in equity securities held for non-linked shareholder-financed operations amounted to £1,622 million as at 30 June 2018 (30 June 2017: £1,535 million; 31 December 2017: £1,759 million). The rates of return applied for 2018 ranged from 5.1 per cent to 17.2 per cent (30 June 2017: 4.7 per cent to 17.2 per cent; 31 December 2017: 5.0 per cent to 17.2 per cent) with the rates applied varying by business unit.
— For US insurance operations, at 30 June 2018, the equity-type securities for non-separate account operations amounted to £1,187 million (30 June 2017: £1,256 million; 31 December 2017: £946 million). The longer-term rates of return for income and capital applied in 2018 and 2017, which reflect the combination of the average risk-free rates over the period and appropriate risk premiums, are as follows:

	2018	2017	
	Half year	Half year	Full year
Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds	6.7% to 7.0%	6.2% to 6.5%	6.1% to 6.5%
Other equity-type securities such as investments in limited partnerships and private equity funds	8.7% to 9.0%	8.2% to 8.5%	8.1% to 8.5%

B1.4 Additional segmental analysis of revenue

The additional segmental analysis of revenue net of outward reinsurance premiums is as follows:

	Half year 2018 £m					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (central operations)	Group total
Gross premiums earned	7,736	7,036	6,555	21,327	14	21,341
Outward reinsurance premiums[note (i)]	(222)	(141)	(12,598)	(12,961)	–	(12,961)
Earned premiums, net of reinsurance	7,514	6,895	(6,043)	8,366	14	8,380
Other income[note (ii)]	157	44	890	1,091	14	1,105
Total external revenue[note (iv)]	7,671	6,939	(5,153)	9,457	28	9,485
Intra-group revenue	20	32	1	53	(53)	–
Interest income	513	940	1,530	2,983	26	3,009
Other investment return	(1,703)	1,486	(1,478)	(1,695)	120	(1,575)
Total revenue, net of reinsurance	6,501	9,397	(5,100)	10,798	121	10,919

B1 Analysis of performance by segment continued

B1.4 Additional segmental analysis of revenue continued

	Half year 2017* £m					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (central operations)	Group total
Gross premiums earned	7,697	7,997	6,411	22,105	–	22,105
Outward reinsurance premiums	(243)	(168)	(536)	(947)	–	(947)
Earned premiums, net of reinsurance	7,454	7,829	5,875	21,158	–	21,158
Other income note (ii),(iii)	159	374	580	1,113	24	1,137
Total external revenue note (iv)	7,613	8,203	6,455	22,271	24	22,295
Intra-group revenue	19	31	2	52	(52)	–
Interest income	486	1,082	1,754	3,322	33	3,355
Other investment return	4,317	7,254	5,609	17,180	94	17,274
Total revenue, net of reinsurance	12,435	16,570	13,820	42,825	99	42,924

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

	Full year 2017 £m					
	Asia	US	UK and Europe	Total segment	Unallocated to a segment (central operations)	Group total
Gross premiums earned	15,688	15,164	13,126	43,978	27	44,005
Outward reinsurance premiums	(656)	(352)	(1,050)	(2,058)	(4)	(2,062)
Earned premiums, net of reinsurance	15,032	14,812	12,076	41,920	23	41,943
Other income note (ii),(iii)	307	669	1,234	2,210	48	2,258
Total external revenue note (iv)	15,339	15,481	13,310	44,130	71	44,201
Intra-group revenue	40	64	5	109	(109)	–
Interest income	932	2,085	3,413	6,430	67	6,497
Other investment return	8,063	16,448	11,171	35,682	10	35,692
Total revenue, net of reinsurance	24,374	34,078	27,899	86,351	39	86,390

Notes

(i) Outward reinsurance premiums of £(12,961) million includes the £(12,130) million paid during the period in respect of the reinsurance of the UK annuity portfolio. See note D1 for further details.

(ii) Included within other income is revenue from the Group's asset management business of £764 million (half year 2017: £643 million; full year 2017: £1,371 million). The remaining other income includes revenue from external customers for policy fees, advisory fees and commission income. The half year 2017 and full year 2017 comparative also included amounts for broker-dealer fees generated by the US broker-dealer network, which was disposed of in August 2017, amounting to £305 million and £542 million respectively.

(iii) Following the adoption of IFRS 15, the half year 2017 and full year 2017 comparative results have been re-presented as described in note A2.

(iv) Total external revenue shown in the tables above is all from external customers except for £166 million within the half year 2018 amount for UK and Europe of £5,153 million. The £166 million represents the insurance recoveries recognised in respect of costs associated with the review of past annuity sales as described further in note B3.

B2 Acquisition costs and other expenditure

	2018 £m	2017 £m	
	Half year	Half year	Full year
Acquisition costs incurred for insurance policies	(1,648)	(1,920)	(3,712)
Acquisition costs deferred less amortisation of acquisition costs	(61)	399	911
Administration costs and other expenditure*	(2,705)	(2,970)	(6,208)
Movements in amounts attributable to external unit holders of consolidated investment funds	(121)	(754)	(984)
Total acquisition costs and other expenditure	(4,535)	(5,245)	(9,993)

* Following the adoption of IFRS 15 the half year 2017 and full year 2017 comparative results have been re-presented as described in note A2.

Included in total acquisition costs and other expenditure is depreciation of property, plant and equipment of £(54) million (half year 2017: £(60) million; full year 2017: £(116) million).

B3 Effect of changes and other accounting matters on insurance assets and liabilities

The following matters are relevant to the determination of the half year 2018 results:

(a) Asia insurance operations

In half year 2018, the IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £69 million (half year 2017: £54 million; full year 2017: £75 million) representing a small number of items that are not expected to reoccur, including the impact of a refinement to the run-off of the allowance for prudence within technical provisions.

(b) UK and Europe insurance operations

Annuity business

Allowance for credit risk

For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowances made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest used for discounting projected future annuity payments to policyholders that would have otherwise applied. The credit risk allowance comprises an amount for long-term best estimate defaults and additional provisions for credit risk premium, the cost of downgrades and short-term defaults.

The IFRS credit risk allowance made for the UK shareholder-backed fixed and linked annuity business equated to 44 basis points at 30 June 2018 (30 June 2017: 43 basis points; 31 December 2017: 42 basis points). The allowance represented 26 per cent of the bond spread over swap rates (30 June 2017: 28 per cent; 31 December 2017: 28 per cent).

The reserves for credit risk allowance at 30 June 2018 for the UK shareholder-backed business were £1.1 billion (30 June 2017: £1.7 billion; 31 December 2017: £1.6 billion). The 30 June 2018 credit risk allowance information is after reflecting the impact of the reinsurance of £12.0 billion of the UK shareholder-backed annuity portfolio to Rothesay Life entered into in March 2018. See note D1 for further details.

Longevity reinsurance and other management actions

Aside from the aforementioned reinsurance agreement with Rothesay Life, no new longevity reinsurance transactions were undertaken in the first half of 2018 (half year 2017: longevity reinsurance transactions covering £0.6 billion of IFRS annuity liabilities contributed £31 million to profit). Other management actions generated profits of £63 million (half year 2017: £157 million; full year 2017: £245 million).

Review of past annuity sales

Prudential has agreed with the Financial Conduct Authority (FCA) to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. The review is examining whether customers were given sufficient information about their potential eligibility to purchase an enhanced annuity, either from Prudential or another pension provider. A gross provision of £400 million, before costs incurred, had been established at 31 December 2017 to cover the costs of undertaking the review and any related redress. Following a reassessment of the provision held, no further amount has been provided in the first half of 2018. The ultimate amount that will be expended by the Group on the review, which is currently expected to be completed in 2019, remains uncertain. In the first half of 2018, the Group agreed with its professional indemnity insurers that they will meet £166 million of the Group's claims costs, which will be paid as the Group incurs costs/redress. This has been recognised on the Group's balance sheet within 'Other debtors' at 30 June 2018.

B4 Tax charge

(a) Total tax charge by nature of expense

The total tax charge in the income statement is as follows:

	2018 £m			2017 £m	
	Current tax	Deferred tax	Half year Total	Half year Total	Full year Total
Attributable to shareholders:					
Asia operations	(90)	(49)	(139)	(144)	(253)
US operations	–	(216)	(216)	(46)	(508)
UK and Europe	(43)	17	(26)	(150)	(267)
Other operations	43	(6)	37	31	122
Tax charge attributable to shareholders' returns	(90)	(254)	(344)	(309)	(906)
Attributable to policyholders:					
Asia operations	(47)	4	(43)	(131)	(249)
UK and Europe	(64)	74	10	(262)	(425)
Tax (charge) credit attributable to policyholders' returns	(111)	78	(33)	(393)	(674)
Total tax charge	(201)	(176)	(377)	(702)	(1,580)

The principal reason for the increase in the tax charge attributable to shareholders' returns is an increase in the proportion of profits arising in US operations, offset by decreases in the proportion of profits arising in UK and Europe. The principal reason for the decrease in the tax charge attributable to policyholders' returns is a decrease in the deferred tax liabilities on unrealised gains on investments in the with-profits funds of the UK and Europe compared to the first half of 2017 and an increase in deferred tax liabilities on policyholder reserves reflecting growth in Asia.

The current tax charge of £201 million (half year 2017: £427 million; full year 2017: £696 million) includes £28 million (half year 2017: £37 million; full year 2017: £59 million) in respect of the tax charge for the Hong Kong operation. The Hong Kong current tax charge is calculated as 16.5 per cent for all periods on either (i) 5 per cent of the net insurance premium or (ii) the estimated assessable profits, depending on the nature of the business written.

(b) Reconciliation of shareholder effective tax rate

In the reconciliation below, the expected tax rates reflect the corporation tax rates that are expected to apply to the taxable profit of the relevant business. Where there are profits of more than one jurisdiction the expected tax rates reflect the corporation tax rates weighted by reference to the amount of profit contributing to the aggregate business result.

	Half year 2018 £m					
	Asia operations	**US operations**	**UK and Europe operations**	**Other operations***	**Total attributable to shareholders**	**Percentage impact on ETR**
Operating profit (loss) based on longer-term investment returns	1,016	1,002	778	(391)	2,405	
Non-operating (loss) profit	(338)	184	(635)	84	(705)	
Profit (loss) before tax	678	1,186	143	(307)	1,700	
Expected tax rate	22%	21%	19%	19%	22%	
Tax at the expected rate	149	249	27	(58)	367	21.6%
Effects of recurring tax reconciliation items:						
Income not taxable or taxable at concessionary rates	(11)	(5)	(1)	(3)	(20)	(1.2%)
Deductions not allowable for tax purposes	23	1	1	1	26	1.5%
Items related to taxation of life insurance businesses note (i)	(2)	(34)	1	–	(35)	(2.1%)
Deferred tax adjustments	(9)	–	–	(8)	(17)	(1.0%)
Effect of results of joint ventures and associates note (ii)	(20)	–	(2)	–	(22)	(1.3%)
Irrecoverable withholding taxes note (iii)	–	–	–	26	26	1.5%
Other	–	2	1	2	5	0.4%
Total	(19)	(36)	–	18	(37)	(2.2%)
Effects of non-recurring tax reconciliation items:						
Adjustments to tax charge in relation to prior years	1	3	(1)	3	6	0.4%
Movements in provisions for open tax matters note (iv)	8	–	–	–	8	0.4%
Total	9	3	(1)	3	14	0.8%
Total actual tax charge (credit)	139	216	26	(37)	344	20.2%
Analysed into:						
Tax on operating profit (loss) based on longer-term investment returns	151	177	150	(49)	429	
Tax on non-operating (loss) profit	(12)	39	(124)	12	(85)	
Actual tax rate:						
Operating profit based on longer-term investment returns:						
Including non-recurring tax reconciling items	15%	18%	19%	13%	18%	
Excluding non-recurring tax reconciling items	14%	17%	19%	13%	17%	
Total profit	21%	18%	18%	12%	20%	

* Other operations include restructuring costs.

B4 Tax charge continued

Notes

(i) *Items related to taxation of life insurance businesses*
The £34 million (half year 2017: £85 million) reconciling item in US operations reflects the impact of the dividend received deduction on the taxation of profits from variable annuity business. The reduction from half year 2017 is a result of the US tax reform changes, which took effect from 1 January 2018. The principal reason for the reduction in the Asia operations reconciling items from £43 million at half year 2017 to £2 million at half year 2018 reflects non-operating investment losses in Hong Kong which do not attract tax relief due to the taxable profit being computed as 5 per cent of net insurance premiums.

(ii) *Effects of results of joint ventures and associates*
Profit before tax includes Prudential's share of profits after tax from the joint ventures and associates. Therefore, the actual tax charge does not include tax arising from profit or loss of joint ventures and associates and is reflected as a reconciling item in the table above.

(iii) *Irrecoverable withholding taxes*
The £26 million (half year 2017: £29 million) adverse reconciling items reflects local withholding taxes on dividends paid by certain non-UK subsidiaries, principally Indonesia, to the UK. The dividends are exempt from UK tax and consequently the withholding tax cannot be offset against UK tax payments.

(iv) *Movements in provisions for open tax matters*
The complexity of the tax laws and regulations that relate to our businesses means that from time to time we may disagree with tax authorities on the technical interpretation of a particular area of tax law. This uncertainty means that in the normal course of business the Group will have matters whereupon ultimate resolution of the uncertainty, the amount of profit subject to tax may be greater than the amounts reflected in the Group's submitted tax returns. The statement of financial position contains the following provisions in relation to open tax matters:

	£m
At 31 December 2017	**(139)**
Movements in the current period included in:	
Tax charge attributable to shareholders	**(8)**
Other movements*	**(2)**
At 30 June 2018	**(149)**

* Other movements include interest arising on open tax matters and amounts included in the Group's share of profits from joint ventures and associates, net of related tax.

	Half year 2017* £m					
	Asia operations	**US operations**	**UK and Europe operations**	**Other operations†**	**Total attributable to shareholders**	**Percentage impact on ETR**
Operating profit (loss) based on longer-term investment returns	953	1,073	745	(413)	2,358	
Non-operating profit (loss)	98	(782)	42	98	(544)	
Profit (loss) before tax	1,051	291	787	(315)	1,814	
Expected tax rate	20%	35%	19%	19%	22%	
Tax at the expected rate	210	102	150	(60)	402	22.2%
Effects of recurring tax reconciliation items:						
Income not taxable or taxable at concessionary rates	(19)	(10)	–	(2)	(31)	(1.7)%
Deductions not allowable for tax purposes	9	–	6	3	18	1.0%
Items related to taxation of life insurance businesses	(43)	(85)	(2)	–	(130)	(7.2)%
Deferred tax adjustments	4	–	(1)	–	3	0.2%
Effect of results of joint ventures and associates	(19)	–	(1)	–	(20)	(1.1)%
Irrecoverable withholding taxes	–	–	–	29	29	1.6%
Other	3	4	4	(1)	10	0.5%
Total	(65)	(91)	6	29	(121)	(6.7)%
Effects of non-recurring tax reconciliation items:						
Adjustments to tax charge in relation to prior years	–	10	(6)	–	4	0.2%
Movements in provisions for open tax matters	7	25	–	–	32	1.7%
Cumulative exchange gains on the sold Korea life business recycled from other comprehensive income	(8)	–	–	–	(8)	(0.4)%
Total	(1)	35	(6)	–	28	1.5%
Total actual tax charge (credit)	144	46	150	(31)	309	17.0%
Analysed into:						
Tax on operating profit (loss) based on longer-term investment returns	152	321	140	(50)	563	
Tax on non-operating profit (loss)	(8)	(275)	10	19	(254)	
Actual tax rate:						
Operating profit based on longer-term investment returns						
Including non-recurring tax reconciling items	16%	30%	19%	12%	24%	
Excluding non-recurring tax reconciling items	15%	27%	20%	12%	22%	
Total profit	14%	16%	19%	10%	17%	

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.
† Other operations include restructuring costs.

B4 Tax charge continued

	Full year 2017 £m					
	Asia operations	US operations	UK and Europe operations	Other operations*	Total attributable to shareholders	Percentage impact on ETR
Operating profit (loss) based on longer-term investment returns	1,975	2,224	1,378	(878)	4,699	
Non-operating profit (loss)	53	(1,462)	(14)	20	(1,403)	
Profit (loss) before tax	2,028	762	1,364	(858)	3,296	
Expected tax rate	21%	35%	19%	19%	24%	
Tax at the expected rate	426	267	259	(163)	789	23.9%
Effects of recurring tax reconciliation items:						
Income not taxable or taxable at concessionary rates	(64)	(11)	(2)	(14)	(91)	(2.8%)
Deductions not allowable for tax purposes	26	6	13	10	55	1.7%
Items related to taxation of life insurance businesses	(92)	(238)	(2)	–	(332)	(10.1%)
Deferred tax adjustments	11	17	(1)	(5)	22	0.7%
Effect of results of joint ventures and associates	(52)	–	(3)	–	(55)	(1.7%)
Irrecoverable withholding taxes	–	–	–	54	54	1.6%
Other	(10)	–	6	(1)	(5)	(0.1%)
Total	(181)	(226)	11	44	(352)	(10.7%)
Effects of non-recurring tax reconciliation items:						
Adjustments to tax charge in relation to prior years	(3)	(15)	(3)	(3)	(24)	(0.7%)
Movements in provisions for open tax matters	19	25	–	–	44	1.3%
Impact of US tax reform	–	445	–	–	445	13.5%
Adjustments in relation to business disposals	(8)	12	–	–	4	0.1%
Total	8	467	(3)	(3)	469	14.2%
Total actual tax charge (credit)	253	508	267	(122)	906	27.4%
Analysed into:						
Tax on operating profit (loss) based on longer-term investment returns	276	548	268	(121)	971	
Tax on non-operating profit (loss)	(23)	(40)	(1)	(1)	(65)	
Actual tax rate:						
Operating profit based on longer-term investment returns:						
Including non-recurring tax reconciling items	14%	25%	19%	14%	21%	
Excluding non-recurring tax reconciling items	13%	24%	20%	13%	20%	
Total profit	12%	67%	20%	14%	27%	

* Other operations include restructuring costs.

B5 Earnings per share

	Note	Before tax note B1.1 £m	Tax note B4 £m	Non-controlling interests £m	Net of tax and non-controlling interests £m	Basic earnings per share pence	Diluted earnings per share pence
		Half year 2018					
Based on operating profit based on longer-term investment returns		2,405	(429)	(1)	1,975	76.8p	76.7p
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	(113)	(24)	–	(137)	(5.3)p	(5.3)p
Amortisation of acquisition accounting adjustments		(22)	4	–	(18)	(0.7)p	(0.7)p
(Loss) attaching to disposal of businesses and corporate transactions		(570)	105	–	(465)	(18.1)p	(18.1)p
Based on profit for the period		1,700	(344)	(1)	1,355	52.7p	52.6p

	Note	Before tax note B1.1 £m	Tax note B4 £m	Non-controlling interests £m	Net of tax and non-controlling interests £m	Basic earnings per share pence	Diluted earnings per share pence
		Half year 2017					
Based on operating profit based on longer-term investment returns		2,358	(563)	–	1,795	70.0p	69.9p
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	(573)	248	–	(325)	(12.7)p	(12.7)p
Amortisation of acquisition accounting adjustments		(32)	6	–	(26)	(1.0)p	(1.0)p
Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income		61	–	–	61	2.4p	2.4p
Based on profit for the period		1,814	(309)	–	1,505	58.7p	58.6p

	Note	Before tax note B1.1 £m	Tax note B4 £m	Non-controlling interests £m	Net of tax and non-controlling interests £m	Basic earnings per share pence	Diluted earnings per share pence
		Full year 2017					
Based on operating profit based on longer-term investment returns		4,699	(971)	(1)	3,727	145.2p	145.1p
Short-term fluctuations in investment returns on shareholder-backed business	B1.2	(1,563)	572	–	(991)	(38.6)p	(38.6)p
Amortisation of acquisition accounting adjustments		(63)	20	–	(43)	(1.7)p	(1.7)p
Cumulative exchange gain on the sold Korea life business recycled from other comprehensive income		61	–	–	61	2.4p	2.4p
Profit attaching to the disposal of businesses		162	(82)	–	80	3.1p	3.1p
Impact of US tax reform		–	(445)	–	(445)	(17.3)p	(17.3)p
Based on profit for the year		3,296	(906)	(1)	2,389	93.1p	93.0p

B5 Earnings per share continued

Earnings per share are calculated based on earnings attributable to ordinary shareholders, after related tax and non-controlling interests.

The weighted average number of shares for calculating earnings per share, which excludes those held in employee share trusts and consolidated unit trusts and OEICs, is set out as below:

	Half year 2018 (millions)	**Half year 2017** (millions)	**Full year 2017** (millions)
Weighted average number of shares for calculation of:			
Basic earnings per share	**2,573**	2,565	2,567
Diluted earnings per share	**2,574**	2,567	2,568

B6 Dividends

	Half year 2018		**Half year 2017**		**Full year 2017**	
	Pence per share	£m	Pence per share	£m	Pence per share	£m
Dividends relating to reporting period:						
First interim ordinary dividend	**15.67p**	**406**	14.50p	375	14.50p	375
Second interim ordinary dividend	**–**	**–**	–	–	32.50p	841
Total	**15.67p**	**406**	14.50p	375	47.00p	1,216
Dividends paid in reporting period:						
Current year first interim ordinary dividend	**–**	**–**	–	–	14.50p	373
Second interim ordinary dividend for prior year	**32.50p**	**840**	30.57p	786	30.57p	786
Total	**32.50p**	**840**	30.57p	786	45.07p	1,159

Dividend per share

The 2018 first interim dividend of 15.67 pence per ordinary share will be paid on 27 September 2018 in sterling to shareholders on the UK register and the Irish branch register on 24 August 2018 (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). 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 7 August 2018. Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 4 October 2018. The exchange rate at which the dividend payable to the US Shareholders will be translated into US dollars will be determined by the depositary agent. The first interim dividend will be paid on or about 4 October 2018 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 exchange rate at which the dividend payable to the SG Shareholders will be translated from Hong Kong dollars into Singapore dollars, will be determined by CDP.

Shareholders on the UK register and Irish branch register are eligible to participate in a Dividend Reinvestment Plan.

C Balance sheet notes

C1 Analysis of Group statement of financial position by segment

To explain the assets, liabilities and capital of the Group's businesses more comprehensively, it is appropriate to provide analyses of the Group's statement of financial position by operating segment and type of business.

		30 Jun 2018 £m						30 Jun 2017 £m	31 Dec 2017 £m
By operating segment	Note	**Asia** C2.1	**US** C2.2	**UK and Europe** C2.3	**Unallocated to a segment (central operations)** note (v)	**Elimination of intra-group debtors and creditors**	**Group Total**	**Group Total**	**Group Total**
Assets									
Goodwill	C5(a)	306	–	1,314	–	–	1,620	1,501	1,482
Deferred acquisition costs and other intangible assets	C5(b)	2,614	8,503	199	43	–	11,359	10,757	11,011
Property, plant and equipment note (i)		123	237	588	3	–	951	727	789
Reinsurers' share of insurance contract liabilities note (ii)		2,258	6,436	2,104	3	(1,181)	9,620	9,709	9,673
Deferred tax assets	C7	112	2,144	130	49	–	2,435	4,105	2,627
Current tax recoverable		23	298	255	115	(65)	626	700	613
Accrued investment income		611	460	1,471	32	–	2,574	2,887	2,676
Other debtors note (iii)		2,429	242	3,580	1,722	(4,454)	3,519	3,417	2,963
Investment properties		5	5	17,595	–	–	17,605	15,218	16,497
Investment in joint ventures and associates accounted for using the equity method		867	–	687	–	–	1,554	1,293	1,416
Loans	C3.3	1,337	9,815	5,664	106	–	16,922	16,952	17,042
Equity securities and portfolio holdings in unit trusts		30,926	135,837	62,832	112	–	229,707	210,437	223,391
Debt securities	C3.2	42,256	36,115	79,744	2,190	–	160,305	170,793	171,374
Derivative assets		191	816	2,305	116	–	3,428	3,789	4,801
Other investments		–	901	5,158	–	–	6,059	5,566	5,622
Deposits		1,203	17	11,020	172	–	12,412	13,353	11,236
Assets held for sale*		–	–	12,024	–	–	12,024	33	38
Cash and cash equivalents		2,177	1,174	3,420	1,679	–	8,450	9,893	10,690
Total assets		87,438	203,000	210,090	6,342	(5,700)	501,170	481,130	493,941

C1 Analysis of Group statement of financial position by segment continued

By operating segment	Note	Asia C2.1	US C2.2	UK and Europe C2.3	Unallocated to a segment (central operations) note (v)	Elimination of intra-group debtors and creditors	Group Total	Group Total 30 Jun 2017 £m	Group Total 31 Dec 2017 £m
		30 Jun 2018 £m							
Total equity		5,741	5,100	8,046	(2,997)	–	15,890	15,450	16,094
Liabilities									
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(a)	66,821	185,150	154,655	37	(1,181)	405,482	398,980	411,243
Unallocated surplus of with-profits funds	C4.1(a)	3,766	–	13,517	–	–	17,283	15,090	16,951
Core structural borrowings of shareholder-financed operations	C6.1	–	189	–	6,178	–	6,367	6,614	6,280
Operational borrowings attributable to shareholder-financed operations	C6.2(a)	17	262	130	1,209	–	1,618	2,096	1,791
Borrowings attributable to with-profits operations	C6.2(b)	32	–	3,557	–	–	3,589	3,336	3,716
Obligations under funding, securities lending and sale and repurchase agreements		–	5,612	1,516	–	–	7,128	6,408	5,662
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		3,550	–	5,781	27	–	9,358	8,577	8,889
Deferred tax liabilities	C7	1,174	1,653	1,602	14	–	4,443	5,683	4,715
Current tax liabilities		155	22	194	109	(65)	415	743	537
Accruals, deferred income and other liabilities note (iv)		5,920	4,914	6,349	822	(4,454)	13,551	14,524	14,185
Provisions		175	19	684	42	–	920	759	1,123
Derivative liabilities		87	79	2,082	901	–	3,149	2,870	2,755
Liabilities held for sale		–	–	11,977	–	–	11,977	–	–
Total liabilities		81,697	197,900	202,044	9,339	(5,700)	485,280	465,680	477,847
Total equity and liabilities		87,438	203,000	210,090	6,342	(5,700)	501,170	481,130	493,941

* Assets held for sale of £12,024 million includes £11,977 million in respect of the reinsured UK annuity business (see note D1).

Notes

(i) £605 million (30 June 2017: £409 million; 31 December 2017: £492 million) of the property, plant and equipment of £951 million (30 June 2017: £727 million; 31 December 2017: £789 million) was held by the Group's with-profits operations, primarily by the consolidated subsidiaries for venture funds and other investment purposes of the PAC with-profits fund. The Group made additions to property, plant and equipment of £167 million during the period (30 June 2017: £120 million; 31 December 2017: £134 million).

(ii) Reinsurers' share of contract liabilities relate primarily to the reinsurance ceded in respect of the acquired REALIC business by the Group's US insurance operations and the reinsurance of part of the UK Shareholder-backed annuity portfolio as described in note D1.

(iii) Within other debtors are premiums receivable of £595 million (30 June 2017: £432 million; 31 December 2017: £547 million) of which 89 per cent are due within one year. The remaining 11 per cent is due after one year.

(iv) Within 'Accruals, deferred income and other liabilities' of £13,551 million (30 June 2017: £14,524 million; 31 December 2017: £14,185 million) is an amount of £8,435 million (30 June 2017: £8,575 million; 31 December 2017: £9,305 million) that is due within one year.

(v) Unallocated to a segment includes central operations, Prudential Capital and Africa operations as per note B1.3.

C2 Analysis of segment statement of financial position by business type

To show the statement of financial position by reference to the differing degrees of policyholder and shareholder economic interest of the different types of business, the analysis below is structured to show the assets and liabilities of each segment by business type.

C2.1 Asia

		2018 £m							2017 £m	
	Note	With-profits business	Unit-linked assets and liabilities	Other business	Total	Asset manage-ment	Elimin-ations	30 Jun Total	30 Jun* Total	31 Dec Total
Assets										
Goodwill		–	–	245	245	61	–	306	306	305
Deferred acquisition costs and other intangible assets		48	–	2,561	2,609	5	–	2,614	2,344	2,540
Property, plant and equipment		86	–	34	120	3	–	123	122	125
Reinsurers' share of insurance contract liabilities		79	–	2,179	2,258	–	–	2,258	1,680	1,960
Deferred tax assets		–	–	105	105	7	–	112	93	112
Current tax recoverable		–	4	19	23	–	–	23	30	58
Accrued investment income		266	57	256	579	32	–	611	597	595
Other debtors		1,599	232	551	2,382	76	(29)	2,429	2,640	2,675
Investment properties		–	–	5	5	–	–	5	5	5
Investment in joint ventures and associates accounted for using the equity method		–	–	723	723	144	–	867	849	912
Loans	C3.3	757	–	580	1,337	–	–	1,337	1,307	1,317
Equity securities and portfolio holdings in unit trusts		16,673	12,592	1,622	30,887	39	–	30,926	26,772	29,976
Debt securities	C3.2	24,923	3,771	13,522	42,216	40	–	42,256	39,061	40,982
Derivative assets		136	3	52	191	–	–	191	102	113
Deposits		271	369	530	1,170	33	–	1,203	1,287	1,291
Cash and cash equivalents		722	524	820	2,066	111	–	2,177	1,942	1,934
Total assets		45,560	17,552	23,804	86,916	551	(29)	87,438	79,137	84,900
Total equity		–	–	5,327	5,327	414	–	5,741	5,563	5,926
Liabilities										
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(b)	36,282	16,094	14,445	66,821	–	–	66,821	59,619	64,133
Unallocated surplus of with-profits funds	C4.1(b)	3,766	–	–	3,766	–	–	3,766	3,003	3,474
Operational borrowings attributable to shareholder-financed operations		–	10	7	17	–	–	17	20	50
Borrowings attributable to with-profits operations		32	–	–	32	–	–	32	20	10
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		2,042	1,273	235	3,550	–	–	3,550	3,541	3,631
Deferred tax liabilities		782	30	362	1,174	–	–	1,174	1,022	1,152
Current tax liabilities		54	–	89	143	12	–	155	175	122
Accruals, deferred income and other liabilities		2,526	137	3,211	5,874	75	(29)	5,920	5,859	6,069
Provisions		26	–	99	125	50	–	175	191	254
Derivative liabilities		50	8	29	87	–	–	87	124	79
Total liabilities		45,560	17,552	18,477	81,589	137	(29)	81,697	73,574	78,974
Total equity and liabilities		45,560	17,552	23,804	86,916	551	(29)	87,438	79,137	84,900

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

Note
The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore operations. Assets and liabilities of other participating businesses are included in the column for 'Other business'.

C2 Analysis of segment statement of financial position by business type continued

C2.2 US

		2018 £m						2017 £m	
	Note	Variable annuity separate account assets and liabilities	Fixed annuity, GIC and other business	Total	Asset manage-ment	Elimin-ations	30 Jun Total	30 Jun* Total	31 Dec Total
Assets									
Goodwill		–	–	–	–	–	–	16	–
Deferred acquisition costs and other intangible assets		–	8,503	8,503	–	–	8,503	8,192	8,219
Property, plant and equipment		–	234	234	3	–	237	232	214
Reinsurers' share of insurance contract liabilities		–	6,436	6,436	–	–	6,436	6,740	6,424
Deferred tax assets		–	2,056	2,056	88	–	2,144	3,808	2,300
Current tax recoverable		–	292	292	6	–	298	354	298
Accrued investment income		–	438	438	22	–	460	569	492
Other debtors		–	236	236	76	(70)	242	266	248
Investment properties		–	5	5	–	–	5	6	5
Loans	C3.3	–	9,815	9,815	–	–	9,815	9,497	9,630
Equity securities and portfolio holdings in unit trusts		135,546	289	135,835	2	–	135,837	125,059	130,630
Debt securities	C3.2	–	36,115	36,115	–	–	36,115	38,029	35,378
Derivative assets		–	816	816	–	–	816	906	1,611
Other investments		–	898	898	3	–	901	936	848
Deposits		–	–	–	17	–	17	18	43
Cash and cash equivalents		–	836	836	338	–	1,174	1,470	1,658
Total assets		135,546	66,969	202,515	555	(70)	203,000	196,098	197,998
Total equity		–	4,896	4,896	204	–	5,100	5,213	5,248
Liabilities									
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(c)	135,546	49,604	185,150	–	–	185,150	177,779	180,724
Core structural borrowings of shareholder-financed operations		–	189	189	–	–	189	192	184
Operational borrowings attributable to shareholder-financed operations		–	262	262	–	–	262	453	508
Obligations under funding, securities lending and sale and repurchase agreements		–	5,612	5,612	–	–	5,612	4,518	4,304
Deferred tax liabilities		–	1,652	1,652	1	–	1,653	2,983	1,845
Current tax liabilities		–	21	21	1	–	22	60	47
Accruals, deferred income and other liabilities		–	4,642	4,642	342	(70)	4,914	4,856	5,109
Provisions		–	12	12	7	–	19	1	24
Derivative liabilities		–	79	79	–	–	79	43	5
Total liabilities		135,546	62,073	197,619	351	(70)	197,900	190,885	192,750
Total equity and liabilities		135,546	66,969	202,515	555	(70)	203,000	196,098	197,998

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.

C2.3 UK and Europe

By operating segment	Note	2018 £m							2017 £m	
			Other funds and subsidiaries							
		With-profits sub-funds†	Unit-linked assets and liabilities	Annuity and other long-term business	Total	Asset management	Eliminations	30 Jun Total	30 Jun* Total	31 Dec Total
Assets										
Goodwill		161	–	–	161	1,153	–	1,314	1,179	1,177
Deferred acquisition costs and other intangible assets		101	–	92	193	6	–	199	189	210
Property, plant and equipment		519	–	33	552	36	–	588	370	447
Reinsurers' share of insurance contract liabilities		1,213	126	765	2,104	–	–	2,104	2,560	2,521
Deferred tax assets		65	–	44	109	21	–	130	152	157
Current tax recoverable		58	–	197	255	–	–	255	311	244
Accrued investment income		993	96	374	1,463	8	–	1,471	1,680	1,558
Other debtors		1,725	399	656	2,780	909	(109)	3,580	3,729	3,118
Investment properties		15,293	647	1,655	17,595	–	–	17,595	15,207	16,487
Investment in joint ventures and associates accounted for using the equity method		649	–	–	649	38	–	687	444	504
Loans	C3.3	3,943	–	1,721	5,664	–	–	5,664	5,784	5,986
Equity securities and portfolio holdings in unit trusts		47,590	15,072	15	62,677	155	–	62,832	58,509	62,670
Debt securities	C3.2	51,064	6,536	22,144	79,744	–	–	79,744	91,302	92,707
Derivative assets		1,844	1	460	2,305	–	–	2,305	2,676	2,954
Other investments		5,147	10	1	5,158	–	–	5,158	4,630	4,774
Deposits		8,853	1,330	837	11,020	–	–	11,020	11,843	9,540
Assets held for sale		47	–	11,977	12,024	–	–	12,024	33	38
Cash and cash equivalents		2,280	138	593	3,011	409	–	3,420	4,915	5,808
Total assets		141,545	24,355	41,564	207,464	2,735	(109)	210,090	205,513	210,900

C2 Analysis of segment statement of financial position by business type continued

C2.3 UK and Europe continued

		2018 £m							2017 £m	
			Other funds and subsidiaries							
By operating segment	Note	With-profits sub-funds†	Unit-linked assets and liabilities	Annuity and other long-term business	Total	Asset management	Eliminations	30 Jun Total	30 Jun* Total	31 Dec Total
Total equity		–	–	6,032	6,032	2,014	–	8,046	8,108	8,245
Liabilities										
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)	C4.1(d)	112,339	22,198	20,118	154,655	–	–	154,655	162,853	167,589
Unallocated surplus of with-profits funds	C4.1(d)	13,517	–	–	13,517	–	–	13,517	12,087	13,477
Operational borrowings attributable to shareholder-financed operations		–	4	126	130	–	–	130	199	148
Borrowings attributable to with-profits operations		3,557	–	–	3,557	–	–	3,557	3,316	3,706
Obligations under funding, securities lending and sale and repurchase agreements		1,193	–	323	1,516	–	–	1,516	1,890	1,358
Net asset value attributable to unit holders of consolidated unit trusts and similar funds		3,998	1,697	86	5,781	–	–	5,781	5,036	5,243
Deferred tax liabilities		1,353	–	225	1,578	24	–	1,602	1,667	1,703
Current tax liabilities		21	48	80	149	45	–	194	490	377
Accruals, deferred income and other liabilities		4,549	403	1,047	5,999	459	(109)	6,349	7,565	6,609
Provisions		25	–	466	491	193	–	684	531	784
Derivative liabilities		993	5	1,084	2,082	–	–	2,082	1,771	1,661
Liabilities held for sale		–	–	11,977	11,977	–	–	11,977	–	–
Total liabilities		141,545	24,355	35,532	201,432	721	(109)	202,044	197,405	202,655
Total equity and liabilities		141,545	24,355	41,564	207,464	2,735	(109)	210,090	205,513	210,900

* The half year 2017 comparative results have been re-presented from those previously published to reflect the Group's current operating segments.
† Includes the Scottish Amicable Insurance Fund which, at 30 June 2018, has total assets and liabilities of £5,310 million (30 June 2017: £5,943 million; 31 December 2017: £5,768 million). The PAC with-profits sub-fund (WPSF) mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The PAC with-profits fund includes £10.2 billion (30 June 2017: £10.9 billion; 31 December 2017: £10.6 billion) of non-profits annuities liabilities.

C3 Assets and liabilities

C3.1 Group assets and liabilities – measurement

(a) Determination of fair value

The fair values of the financial instruments for which fair valuation is required under IFRS are determined by the use of current market bid prices for exchange-quoted investments, or by using quotations from independent third parties, such as brokers and pricing services or by using appropriate valuation techniques.

The estimated fair value of derivative financial instruments reflects the estimated amount the Group would receive or pay in an arm's-length transaction. This amount is determined using quoted prices if exchange listed, quotations from independent third parties or valued internally using standard market practices.

Other than the loans which have been designated at fair value through profit or loss, the loans and receivables have been shown net of provisions for impairment. The fair value of loans has been estimated from discounted cash flows expected to be received. The discount rate used is updated for the market rate of interest where applicable.

The fair value of investment properties is based on market values as assessed by professionally qualified external valuers or by the Group's qualified surveyors.

The fair value of the subordinated and senior debt issued by the parent company is determined using quoted prices from independent third parties.

The fair value of financial liabilities (other than derivative financial instruments) is determined using discounted cash flows of the amounts expected to be paid.

(b) Fair value measurement hierarchy of Group assets and liabilities

Assets and liabilities carried at fair value on the statement of financial position

The table below shows the assets and liabilities carried at fair value analysed by level of the IFRS 13 'Fair Value Measurement' defined fair value hierarchy. This hierarchy is based on the inputs to the fair value measurement and reflects the lowest level input that is significant to that measurement.

C3 Assets and liabilities continued

C3.1 Group assets and liabilities – measurement continued

Financial instruments at fair value

	30 Jun 2018 £m			
	Level 1	Level 2	Level 3	Total
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	–	–	1,848	1,848
Equity securities and portfolio holdings in unit trusts	59,025	4,748	490	64,263
Debt securities	29,680	45,952	355	75,987
Other investments (including derivative assets)	76	3,185	3,866	7,127
Derivative liabilities	(40)	(1,003)	–	(1,043)
Total financial investments, net of derivative liabilities	88,741	52,882	6,559	148,182
Percentage of total	60%	36%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	162,698	494	18	163,210
Debt securities	5,162	5,145	–	10,307
Other investments (including derivative assets)	3	4	7	14
Derivative liabilities	(9)	(4)	–	(13)
Total financial investments, net of derivative liabilities	167,854	5,639	25	173,518
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	–	–	2,935	2,935
Equity securities and portfolio holdings in unit trusts	2,215	9	10	2,234
Debt securities	17,918	55,795	298	74,011
Other investments (including derivative assets)	34	1,403	909	2,346
Derivative liabilities	(1)	(1,692)	(400)	(2,093)
Total financial investments, net of derivative liabilities	20,166	55,515	3,752	79,433
Percentage of total	25%	70%	5%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	–	4,783	4,783
Equity securities and portfolio holdings in unit trusts	223,938	5,251	518	229,707
Debt securities	52,760	106,892	653	160,305
Other investments (including derivative assets)	113	4,592	4,782	9,487
Derivative liabilities	(50)	(2,699)	(400)	(3,149)
Total financial investments, net of derivative liabilities	276,761	114,036	10,336	401,133
Investment contract liabilities without discretionary participation features held at fair value	–	(16,713)	–	(16,713)
Borrowings attributable to with-profits operations	–	–	(1,746)	(1,746)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(5,184)	(3,407)	(767)	(9,358)
Other financial liabilities held at fair value	–	–	(3,159)	(3,159)
Total financial instruments at fair value	271,577	93,916	4,664	370,157
Percentage of total	74%	25%	1%	100%

	30 Jun 2017 £m			
	Level 1	Level 2	Level 3	Total
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	–	–	1,906	1,906
Equity securities and portfolio holdings in unit trusts	51,136	4,282	426	55,844
Debt securities	28,122	44,145	296	72,563
Other investments (including derivative assets)	73	3,310	3,464	6,847
Derivative liabilities	(79)	(752)	–	(831)
Total financial investments, net of derivative liabilities	79,252	50,985	6,092	136,329
Percentage of total	58%	38%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	152,050	399	23	152,472
Debt securities	5,243	4,943	–	10,186
Other investments (including derivative assets)	4	3	4	11
Derivative liabilities	(2)	–	–	(2)
Total financial investments, net of derivative liabilities	157,295	5,345	27	162,667
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	–	309	2,594	2,903
Equity securities and portfolio holdings in unit trusts	2,104	7	10	2,121
Debt securities	21,525	66,233	286	88,044
Other investments (including derivative assets)	–	1,501	996	2,497
Derivative liabilities	(26)	(1,551)	(460)	(2,037)
Total financial investments, net of derivative liabilities	23,603	66,499	3,426	93,528
Percentage of total	25%	71%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	309	4,500	4,809
Equity securities and portfolio holdings in unit trusts	205,290	4,688	459	210,437
Debt securities	54,890	115,321	582	170,793
Other investments (including derivative assets)	77	4,814	4,464	9,355
Derivative liabilities	(107)	(2,303)	(460)	(2,870)
Total financial investments, net of derivative liabilities	260,150	122,829	9,545	392,524
Investment contract liabilities without discretionary participation features held at fair value	–	(17,166)	–	(17,166)
Borrowings attributable to with-profits operations	–	–	(1,816)	(1,816)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(5,719)	(2,421)	(437)	(8,577)
Other financial liabilities held at fair value	–	(394)	(2,766)	(3,160)
Total financial instruments at fair value	254,431	102,848	4,526	361,805
Percentage of total	70%	29%	1%	100%

C3 Assets and liabilities continued

C3.1 Group assets and liabilities – measurement continued

	31 Dec 2017 £m			
	Level 1	Level 2	Level 3	Total
	Quoted prices (unadjusted) in active markets	Valuation based on significant observable market inputs	Valuation based on significant unobservable market inputs	
Analysis of financial investments, net of derivative liabilities by business type				
With-profits				
Loans	–	–	2,023	2,023
Equity securities and portfolio holdings in unit trusts	57,347	4,470	351	62,168
Debt securities	29,143	45,602	348	75,093
Other investments (including derivative assets)	68	3,638	3,540	7,246
Derivative liabilities	(68)	(615)	–	(683)
Total financial investments, net of derivative liabilities	86,490	53,095	6,262	145,847
Percentage of total	60%	36%	4%	100%
Unit-linked and variable annuity separate account				
Equity securities and portfolio holdings in unit trusts	158,631	457	10	159,098
Debt securities	4,993	5,226	–	10,219
Other investments (including derivative assets)	12	4	8	24
Derivative liabilities	–	(1)	–	(1)
Total financial investments, net of derivative liabilities	163,636	5,686	18	169,340
Percentage of total	97%	3%	0%	100%
Non-linked shareholder-backed				
Loans	–	–	2,814	2,814
Equity securities and portfolio holdings in unit trusts	2,105	10	10	2,125
Debt securities	21,443	64,313	306	86,062
Other investments (including derivative assets)	7	2,270	876	3,153
Derivative liabilities	–	(1,559)	(512)	(2,071)
Total financial investments, net of derivative liabilities	23,555	65,034	3,494	92,083
Percentage of total	25%	71%	4%	100%
Group total analysis, including other financial liabilities held at fair value				
Group total				
Loans	–	–	4,837	4,837
Equity securities and portfolio holdings in unit trusts	218,083	4,937	371	223,391
Debt securities	55,579	115,141	654	171,374
Other investments (including derivative assets)	87	5,912	4,424	10,423
Derivative liabilities	(68)	(2,175)	(512)	(2,755)
Total financial investments, net of derivative liabilities	273,681	123,815	9,774	407,270
Investment contract liabilities without discretionary participation features held at fair value	–	(17,397)	–	(17,397)
Borrowings attributable to with-profits operations	–	–	(1,887)	(1,887)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(4,836)	(3,640)	(413)	(8,889)
Other financial liabilities held at fair value	–	–	(3,031)	(3,031)
Total financial instruments at fair value	268,845	102,778	4,443	376,066
Percentage of total	72%	27%	1%	100%

All assets and liabilities held at fair value are classified as fair value through profit or loss, except for £35,860 million (30 June 2017: £37,936 million; 31 December 2017: £35,293 million) of debt securities classified as available-for-sale.

Assets and liabilities at amortised cost and their fair value

The table below shows the assets and liabilities carried at amortised cost on the statement of financial position and their fair value. The assets and liabilities that are carried at amortised cost but where the carrying value approximates the fair value, are excluded from the analysis below.

	30 Jun 2018 £m	
	Total carrying value	Total fair value
Assets		
Loans	12,139	12,710
Liabilities		
Investment contract liabilities without discretionary participation features	(3,001)	(3,003)
Core structural borrowings of shareholder-financed operations	(6,367)	(6,518)
Operational borrowings attributable to shareholder-financed operations	(1,618)	(1,618)
Borrowings attributable to the with-profits funds	(1,843)	(1,768)
Obligations under funding, securities lending and sale and repurchase agreements	(7,128)	(7,126)

	30 Jun 2017 £m	
	Total carrying value	Total fair value
Assets		
Loans	12,142	13,017
Liabilities		
Investment contract liabilities without discretionary participation features	(3,145)	(3,164)
Core structural borrowings of shareholder-financed operations	(6,614)	(7,292)
Operational borrowings attributable to shareholder-financed operations	(2,096)	(2,096)
Borrowings attributable to the with-profits funds	(1,520)	(1,528)
Obligations under funding, securities lending and sale and repurchase agreements	(6,408)	(6,464)

	31 Dec 2017 £m	
	Total carrying value	Total fair value
Assets		
Loans	12,205	12,939
Liabilities		
Investment contract liabilities without discretionary participation features	(2,997)	(3,032)
Core structural borrowings of shareholder-financed operations	(6,280)	(7,032)
Operational borrowings attributable to shareholder-financed operations	(1,791)	(1,791)
Borrowings attributable to the with-profits funds	(1,829)	(1,832)
Obligations under funding, securities lending and sale and repurchase agreements	(5,662)	(5,828)

(c) Valuation approach for level 2 fair valued assets and liabilities

A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades. For further detail on the valuation approach for level 2 fair valued assets and liabilities please refer to note C3.1 of the Group's consolidated financial statements for the year ended 31 December 2017.

Of the total level 2 debt securities of £106,892 million at 30 June 2018 (30 June 2017: £115,321 million; 31 December 2017: £115,141 million), £13,871 million are valued internally (30 June 2017: £13,596 million; 31 December 2017: £13,910 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

C3 Assets and liabilities continued

C3.1 Group assets and liabilities – measurement continued

(d) Fair value measurements for level 3 fair valued assets and liabilities

Reconciliation of movements in level 3 assets and liabilities measured at fair value

The following table reconciles the value of level 3 fair valued assets and liabilities at 1 January 2018 to that presented at 30 June 2018.

Total investment return recorded in the income statement represents interest and dividend income, realised gains and losses, unrealised gains and losses on the assets classified at fair value through profit and loss and foreign exchange movements on an individual entity's overseas investments.

Total gains and losses recorded in other comprehensive income includes unrealised gains and losses on debt securities held as available-for-sale within Jackson and foreign exchange movements arising from the retranslation of the Group's overseas subsidiaries and branches.

	Half year 2018 £m									
	At 1 Jan 2018	Total gains (losses) in income statement	Total gains (losses) recorded in other comprehensive income	Purchases	Sales	Settled	Issued	Transfers into level 3	Transfers out of level 3	At 30 Jun 2018
Loans	4,837	59	65	2	–	(223)	43	–	–	4,783
Equity securities and portfolio holdings in unit trusts	371	43	(7)	112	(1)	–	–	–	–	518
Debt securities	654	(10)	–	55	(46)	–	–	–	–	653
Other investments (including derivative assets)	4,424	188	46	550	(426)	–	–	–	–	4,782
Derivative liabilities	(512)	57	–	–	–	–	–	–	55	(400)
Total financial investments, net of derivative liabilities	9,774	337	104	719	(473)	(223)	43	–	55	10,336
Borrowings attributable to with-profits operations	(1,887)	(2)	–	–	–	143	–	–	–	(1,746)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(413)	38	–	–	–	22*	(414)	–	–	(767)
Other financial liabilities	(3,031)	(84)	(68)	–	–	103	(79)	–	–	(3,159)
Total financial instruments at fair value	4,443	289	36	719	(473)	45	(450)	–	55	4,664

	Half year 2017 £m									
	At 1 Jan 2017	Total gains (losses) in income statement	Total gains (losses) recorded in other comprehensive income	Purchases	Sales	Settled	Issued	Transfers into level 3	Transfers out of level 3	At 30 Jun 2017
Loans	2,699	96	(132)	1,879	–	(70)	28	–	–	4,500
Equity securities and portfolio holdings in unit trusts	722	(17)	(2)	175	(418)	–	–	–	(1)	459
Debt securities	942	2	(11)	142	(471)	–	–	–	(22)	582
Other investments (including derivative assets)	4,480	84	(64)	191	(227)	–	–	–	–	4,464
Derivative liabilities	(516)	56	–	–	–	–	–	–	–	(460)
Total financial investments, net of derivative liabilities	8,327	221	(209)	2,387	(1,116)	(70)	28	–	(23)	9,545
Borrowings attributable to with-profits operations	–	2	–	–	–	–	(1,818)	–	–	(1,816)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(883)	(357)	–	–	(167)	1,017*	(47)	–	–	(437)
Other financial liabilities	(2,851)	(96)	141	–	(1)	73	(32)	–	–	(2,766)
Total financial instruments at fair value	4,593	(230)	(68)	2,387	(1,284)	1,020	(1,869)	–	(23)	4,526

	Full year 2017 £m									
	At 1 Jan 2017	Total gains (losses) in income statement	Total gains (losses) recorded in other compre-hensive income	Purchases	Sales	Settled	Issued	Transfers into level 3	Transfers out of level 3	At 31 Dec 2017
Loans	2,699	17	(235)	2,129	–	(311)	236	302	–	4,837
Equity securities and portfolio holdings in unit trusts	722	11	(5)	186	(468)	(6)	–	1	(70)	371
Debt securities	942	51	(11)	216	(522)	–	–	–	(22)	654
Other investments (including derivative assets)	4,480	73	(133)	727	(725)	–	–	2	–	4,424
Derivative liabilities	(516)	4	–	–	–	–	–	–	–	(512)
Total financial investments, net of derivative liabilities	8,327	156	(384)	3,258	(1,715)	(317)	236	305	(92)	9,774
Borrowings attributable to with-profits operations	–	(13)	–	–	–	115	(1,989)	–	–	(1,887)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(883)	(559)	–	(13)	–	1,276*	(234)	–	–	(413)
Other financial liabilities	(2,851)	14	250	–	–	252	(311)	(385)	–	(3,031)
Total financial instruments at fair value	4,593	(402)	(134)	3,245	(1,715)	1,326	(2,298)	(80)	(92)	4,443

* Includes distributions to third-party investors by subsidiaries held by the UK with-profits funds for investment purposes. These distributions vary period-to-period depending on the maturity of the subsidiaries and the gains realised by those entities in the period.

Of the total net gains and losses in the income statement of £289 million (30 June 2017: £(230) million; 31 December 2017: £(402) million), £210 million (30 June 2017: £(234) million; 31 December 2017: £(139) million) relates to net unrealised gains and losses of financial instruments still held at the end of the period, which can be analysed as follows:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Loans	(23)	–	20
Equity securities	43	21	(12)
Debt securities	(10)	2	(5)
Other investments	109	42	(22)
Derivative liabilities	57	56	4
Borrowings attributable to with-profit operations	(2)	–	(13)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	38	2	(123)
Other financial liabilities	(2)	(357)	12
Total	210	(234)	(139)

C3 Assets and liabilities continued

C3.1 Group assets and liabilities – measurement continued

Valuation approach for level 3 fair valued assets and liabilities

Investments valued using valuation techniques include financial investments which by their nature do not have an externally quoted price based on regular trades, and financial investments for which markets are no longer active as a result of market conditions, eg market illiquidity. The valuation techniques used include comparison to recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option-adjusted spread models and, if applicable, enterprise valuation. For further detail on the valuation approach for level 3 fair valued assets and liabilities, please refer to note C3.1 of the Group's consolidated financial statements for the year ended 31 December 2017.

At 30 June 2018, the Group held £4,664 million (30 June 2017: £4,526 million; 31 December 2017: £4,443 million) of net financial instruments at fair value within level 3. This represents 1 per cent (30 June 2017: 1 per cent; 31 December 2017: 1 per cent) of the total fair valued financial assets net of fair valued financial liabilities.

The net financial instruments at fair value within level 3 at 30 June 2018 include £1,808 million of loans and a corresponding £1,746 million of borrowings held by a subsidiary of the Group's UK with-profits fund, attaching to the acquisition of a portfolio of buy-to-let mortgages and other loans financed largely by external third-party (non-recourse) borrowings (see note C3.3(c) for further details). The Group's exposure is limited to the investment held by the UK with-profits fund rather than to the individual loans and borrowings themselves. The fair value movements of these loans and borrowings have no effect on shareholders' profit and equity. The most significant non-observable inputs to the mortgage fair value are the level of future defaults and prepayments by the mortgage holders.

Included within these amounts are loans of £2,638 million at 30 June 2018 (30 June 2017: £2,594 million; 31 December 2017: £2,512 million), measured as the loan outstanding balance, plus accrued investment income, attached to REALIC and held to back the liabilities for funds withheld under reinsurance arrangements. The funds withheld liability of £2,793 million at 30 June 2018 (30 June 2017: £2,766 million; 31 December 2017: £2,664 million) is also classified within level 3, accounted for on a fair value basis being equivalent to the carrying value of the underlying assets.

Excluding the loans and funds withheld liability under REALIC's reinsurance arrangements as described above, which amounted to a net liability of £(155) million (30 June 2017: £(172) million; 31 December 2017: £(152) million), the level 3 fair valued financial assets net of financial liabilities were £4,819 million (30 June 2017: £4,698 million; 31 December 2017: £4,595 million). Of this amount, a net liability of £(312) million (30 June 2017: net liability of £(218) million; 31 December 2017: net asset of £117 million) is internally valued, representing less than 0.1 per cent of the total fair valued financial assets net of financial liabilities (30 June 2017: 0.1 per cent; 31 December 2017: less than 0.1 per cent). Internal valuations are inherently more subjective than external valuations. Included within these internally valued net assets (liabilities) are:

(a) Debt securities of £494 million (30 June 2017: £446 million; 31 December 2017: £500 million), which were either valued on a discounted cash flow method with an internally developed discount rate or on external prices adjusted to reflect the specific known conditions relating to these securities (eg distressed securities or securities which were being restructured).

(b) Private equity and venture investments in both debt and equity securities of £255 million (30 June 2017: £176 million; 31 December 2017: £217 million) which are valued internally using discounted cash flows based on management information available for these investments. The significant unobservable inputs include the determination of expected future cash flows on the investments being valued, determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The valuation is performed in accordance with International Private Equity and Venture Capital Association Valuation Guidelines. These investments were principally held by consolidated investment funds that are managed on behalf of third parties.

(c) Equity release mortgage loan investments of £297 million (30 June 2017: £309 million classified as level 2; 31 December 2017: £302 million) which are valued internally using the discounted cash flow models. The inputs that are significant to the valuation of these investments are primarily the economic assumptions, being the discount rate (risk-free rate plus a liquidity premium) and property values.

(d) Liabilities of £(735) million (30 June 2017: £(437) million; 31 December 2017: £(403) million) for the net asset value attributable to external unit holders in respect of the consolidated investment funds, which are non-recourse to the Group. These liabilities are valued by reference to the underlying assets.

(e) Derivative liabilities of £(400) million (30 June 2017: £(460) million; 31 December 2017: £(512) million) which are valued internally using the discounted cash flow method in line with standard market practices but are subject to independent assessment against external counterparties' valuations.

(f) Other sundry individual financial investments of £74 million (30 June 2017: £57 million; 31 December 2017: £81 million).

Of the internally valued net liability referred to above of £(312) million (30 June 2017: net liability of £(218) million; 31 December 2017: net asset of £117 million):

(a) A net liability of £(214) million (30 June 2017: net liability of £(97) million; 31 December 2017: net asset of £67 million) was held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments.

(b) A net liability of £(98) million (30 June 2017: net liability of £(121) million; 31 December 2017: net liability of £(184) million) was held to support non-linked shareholder-backed business. If the value of all the level 3 instruments held to support non-linked shareholder-backed business valued internally decreased by 10 per cent, the change in valuation would be £10 million (30 June 2017: £12 million; 31 December 2017: £18 million), which would increase shareholders' equity by this amount before tax. All this amount passes through the income statement substantially as part of short-term fluctuations in investment returns outside of operating profit.

(e) Transfers into and transfers out of levels

The Group's policy is to recognise transfers into and transfers out of levels as of the end of each half year reporting period except for material transfers which are recognised as of the date of the event or change in circumstances that caused the transfer. Transfers are deemed to have occurred when there is a material change in the observed valuation inputs or a change in the level of trading activities of the securities.

During half year 2018, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to level 2 of £621 million and transfers from level 2 to level 1 of £312 million. These transfers which relate to equity securities and debt securities arose to reflect the change in the observed valuation inputs and in certain cases, the change in the level of trading activities of the securities.

In addition, the transfers out of level 3 in half year 2018 were £55 million. These transfers were primarily between levels 3 and 2 for derivative liabilities. There were no transfers into level 3 in the period.

(f) Valuation processes applied by the Group

The Group's valuation policies, procedures and analyses for instruments categorised as level 3 are overseen by business unit committees as part of the Group's wider financial reporting governance processes. The procedures undertaken include approval of valuation methodologies, verification processes, and resolution of significant or complex valuation issues. In undertaking these activities the Group makes use of the extensive expertise of its asset management functions. In addition, the Group has minimum standards for independent price verification to ensure valuation accuracy is regularly independently verified. Adherence to this policy is monitored across the business units.

C3.2 Debt securities

This note provides analysis of the Group's debt securities, including asset-backed securities and sovereign debt securities.

With the exception of certain debt securities for US insurance operations classified as 'available-for-sale' under IAS 39 as disclosed in notes C3.2 (b) to (d) below, the Group's debt securities are carried at fair value through profit or loss.

(a) Credit rating

Debt securities are analysed below according to external credit ratings issued, with equivalent ratings issued by different ratings agencies grouped together. Standard & Poor's ratings have been used where available, if this isn't the case Moody's and then Fitch have been used as alternatives. For the US NAIC ratings have also been used where relevant. In the table below, AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB- ratings. Financial assets which fall outside this range are classified as below BBB-. Debt securities with no external credit rating are classified as 'other'.

	30 Jun 2018 £m						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	2,496	11,425	3,983	3,351	1,768	1,900	24,923
Unit-linked	726	147	489	1,326	441	642	3,771
Non-linked shareholder-backed	948	3,138	3,234	3,063	2,040	1,099	13,522
Asset Management	12	–	28	–	–	–	40
US							
Non-linked shareholder-backed	442	6,338	9,439	13,148	1,035	5,713	36,115
UK and Europe							
With-profits	7,091	8,723	11,606	13,544	2,847	7,253	51,064
Unit-linked	358	2,099	1,694	1,448	718	219	6,536
Non-linked shareholder-backed	3,273	6,296	5,138	1,496	223	5,718	22,144
Other operations	673	1,237	177	39	45	19	2,190
Total debt securities	16,019	39,403	35,788	37,415	9,117	22,563	160,305

C3 Assets and liabilities continued

C3.2 Debt securities continued

	30 Jun 2017 £m						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	3,168	9,722	3,540	3,201	1,789	1,978	23,398
Unit-linked	501	129	526	1,502	323	461	3,442
Non-linked shareholder-backed	1,138	2,758	3,035	2,699	1,645	946	12,221
US							
Non-linked shareholder-backed	455	6,739	10,318	13,526	1,046	5,945	38,029
UK and Europe							
With-profits	5,965	9,872	10,827	12,577	3,481	6,443	49,165
Unit-linked	597	2,871	1,131	1,856	176	112	6,743
Non-linked shareholder-backed	4,481	10,313	10,396	4,036	388	5,780	35,394
Other operations	819	1,275	192	95	14	6	2,401
Total debt securities	17,124	43,679	39,965	39,492	8,862	21,671	170,793

	31 Dec 2017 £m						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below BBB-	Other	Total
Asia							
With-profits	2,504	10,641	3,846	3,234	1,810	2,397	24,432
Unit-linked	528	103	510	1,429	372	565	3,507
Non-linked shareholder-backed	990	2,925	3,226	2,970	1,879	1,053	13,043
US							
Non-linked shareholder-backed	368	6,352	9,578	12,311	1,000	5,769	35,378
UK and Europe							
With-profits	6,492	9,378	11,666	12,856	2,877	7,392	50,661
Unit-linked	670	2,732	1,308	1,793	91	117	6,711
Non-linked shareholder-backed	5,118	11,005	9,625	3,267	258	6,062	35,335
Other operations	742	1,264	182	67	36	16	2,307
Total debt securities	17,412	44,400	39,941	37,927	8,323	23,371	171,374

The credit ratings, information or data contained in this report which are attributed and specifically provided by Standard & Poor's, Moody's and Fitch Solutions and their respective affiliates and suppliers ('Content Providers') is referred to here as the 'Content'. Reproduction of any Content in any form is prohibited except with the prior written permission of the relevant party. The Content Providers do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. The Content Providers expressly disclaim liability for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold any such investment or security, nor does it address the suitability an investment or security and should not be relied on as investment advice.

Securities with credit ratings classified as 'Other' can be further analysed as follows:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Asia – Non-linked shareholder-backed			
Internally rated			
Government bonds	23	40	25
Corporate bonds – rated as investment grade by local external ratings agencies	1,006	821	959
Other	70	85	69
Total Asia non-linked shareholder-backed	1,099	946	1,053

	2018 £m			2017 £m	
	Mortgage -backed securities	Other securities	30 Jun Total	30 Jun Total	31 Dec Total
US					
Implicit ratings of other US debt securities based on NAIC* valuations (see below)					
NAIC 1	1,802	2,101	3,903	3,944	3,918
NAIC 2	14	1,767	1,781	1,903	1,794
NAIC 3-6	3	26	29	98	57
Total US†	1,819	3,894	5,713	5,945	5,769

* The Securities Valuation Office of the NAIC classifies debt securities into six quality categories ranging from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5 and securities in or near default are designated Class 6.

† Mortgage-backed securities totalling £1,545 million at 30 June 2018 have credit ratings issued by Standard & Poor's of BBB- or above and hence are designated as investment grade. Other securities totalling £3,868 million at 30 June 2018 with NAIC ratings 1 or 2 are also designated as investment grade.

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
UK and Europe			
Internal ratings or unrated			
AAA to A-	7,828	7,494	7,994
BBB to B-	2,866	3,180	3,141
Below B- or unrated	2,496	1,661	2,436
Total UK and Europe	13,190	12,335	13,571

(b) Additional analysis of US insurance operations debt securities

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Corporate and government security and commercial loans:			
Government	4,737	4,884	4,835
Publicly traded and SEC Rule 144A securities*	23,346	24,971	22,849
Non-SEC Rule 144A securities	4,659	4,543	4,468
Asset backed securities note (e)	3,373	3,631	3,226
Total US debt securities†	36,115	38,029	35,378

* A 1990 SEC rule that facilitates the resale of privately placed securities under Rule 144A that are without SEC registration to qualified institutional investors. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

† Debt securities for US operations included in the statement of financial position comprise:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Available-for-sale	35,860	37,936	35,293
Fair value through profit and loss	255	93	85
Total	36,115	38,029	35,378

Realised gains and losses, including impairments, recorded in the income statement are as shown in note B1.2 of this report.

C3 Assets and liabilities continued

C3.2 Debt securities continued

(c) Movements in unrealised gains and losses on Jackson available-for-sale securities

The movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £1,205 million to a net unrealised loss of £247 million as analysed in the table below.

	30 Jun 2018	Foreign exchange translation†	Changes in unrealised appreciation	31 Dec 2017
		Reflected as part of movement in other comprehensive income		
	£m	£m	£m	£m
Assets fair valued at below book value				
Book value*	23,159			6,325
Unrealised (loss)	(762)	(30)	(626)	(106)
Fair value (as included in statement of financial position)	22,397			6,219
Assets fair valued at or above book value				
Book value*	12,948			27,763
Unrealised gain	515	(1)	(795)	1,311
Fair value (as included in statement of financial position)	13,463			29,074
Total				
Book value*	36,107			34,088
Net unrealised (loss) gain	(247)	(31)	(1,421)	1,205
Fair value (as included in the footnote above in the overview table and the statement of financial position)	35,860			35,293

* Book value represents cost/amortised cost of the debt securities.
† Translated at the average rate of US$1.38: £1.00.

(d) US debt securities classified as available-for-sale in an unrealised loss position

(i) Fair value of securities as a percentage of book value

The following table shows the fair value of the debt securities in a gross unrealised loss position for various percentages of book value:

	30 Jun 2018 £m		30 Jun 2017 £m		31 Dec 2017 £m	
	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
Between 90% and 100%	22,187	(729)	7,962	(236)	6,170	(95)
Between 80% and 90%	195	(29)	482	(64)	36	(6)
Below 80%:						
Other than mortgage-backed securities	–	–	10	(6)	10	(4)
Corporate bonds	15	(4)	–	–	3	(1)
	15	(4)	10	(6)	13	(5)
Total	22,397	(762)	8,454	(306)	6,219	(106)

(ii) Unrealised losses by maturity of security

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
1 year to 5 years	(65)	(5)	(7)
5 years to 10 years	(348)	(48)	(41)
More than 10 years	(297)	(231)	(39)
Mortgage-backed and other debt securities	(52)	(22)	(19)
Total	(762)	(306)	(106)

(iii) Age analysis of unrealised losses for the periods indicated

The following table shows the age analysis of all the unrealised losses in the portfolio by reference to the length of time the securities have been in an unrealised loss position:

	30 Jun 2018 £m			30 Jun 2017 £m			31 Dec 2017 £m		
Age analysis	**Non-investment grade**	**Investment grade**	**Total**	**Non-investment grade**	**Investment grade**	**Total**	**Non-investment grade**	**Investment grade**	**Total**
Less than 6 months	(14)	(418)	(432)	(1)	(15)	(16)	(4)	(31)	(35)
6 months to 1 year	(7)	(148)	(155)	–	(251)	(251)	(1)	(4)	(5)
1 year to 2 years	(1)	(148)	(149)	(2)	(1)	(3)	–	(49)	(49)
2 years to 3 years	–	(1)	(1)	(3)	(12)	(15)	(1)	(6)	(7)
More than 3 years	(1)	(24)	(25)	(1)	(20)	(21)	–	(10)	(10)
Total	(23)	(739)	(762)	(7)	(299)	(306)	(6)	(100)	(106)

Further, the following table shows the age analysis as at 30 June 2018 of the securities whose fair values were below 80 per cent of the book value:

	30 Jun 2018 £m		30 Jun 2017 £m		31 Dec 2017 £m	
Age analysis	**Fair value**	**Unrealised loss**	**Fair value**	**Unrealised loss**	**Fair value**	**Unrealised loss**
Less than 3 months	13	(3)	–	–	2	–
3 months to 6 months	–	–	–	–	1	(1)
More than 6 months	2	(1)	10	(6)	10	(4)
Total	15	(4)	10	(6)	13	(5)

(e) Asset-backed securities

The Group's holdings in asset-backed securities (ABS), which comprise residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDO) funds and other asset-backed securities, at 30 June 2018 are as follows:

	2018 £m	2017 £m	
	30 Jun	**30 Jun**	**31 Dec**
Shareholder-backed operations:			
Asia operations note (i)	97	104	118
US operations note (ii)	3,373	3,631	3,226
UK and Europe operations (2018: 33% AAA, 15% AA) note (iii)	960	1,045	1,070
Other operations note (iv)	507	665	589
	4,937	5,445	5,003
With-profits operations:			
Asia operations note (i)	192	233	233
UK and Europe operations (2018: 65% AAA, 10% AA) note (iii)	5,414	5,091	5,658
	5,606	5,324	5,891
Total	10,543	10,769	10,894

C3 Assets and liabilities continued

C3.2 Debt securities continued

Notes

(i) Asia operations
The Asia operations' exposure to asset-backed securities is primarily held by the with-profits operations. Of the £192 million, 100 per cent (30 June 2017: 99 per cent; 31 December 2017: 98 per cent) are investment grade.

(ii) US operations
US operations' exposure to asset-backed securities at 30 June 2018 comprises:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
RMBS			
Sub-prime (2018: 2% AAA, 6% AA, 3% A)	105	150	112
Alt-A (2018: 3% AAA, 2% A)	117	151	126
Prime including agency (2018: 5% AAA, 67% AA, 8% A)	425	515	440
CMBS (2018: 83% AAA, 16% AA, 1% A)	1,638	1,768	1,579
CDO funds (2018: 13% AA, 87% A), including £nil exposure to sub-prime	11	33	28
Other ABS (2018: 16% AAA, 16% AA, 53% A), including £93 million exposure to sub-prime	1,077	1,014	941
Total	3,373	3,631	3,226

(iii) UK and Europe operations
The majority of holdings of the shareholder-backed business are UK securities and relate to PAC's annuity business. Of the holdings of the with-profits operations, £1,833 million (30 June 2017: £1,473 million; 31 December 2017: £1,913 million) relates to exposure to the US markets with the remaining exposure being primarily to the UK market.

(iv) Other operations
Other operations' exposure to asset-backed securities is held by Prudential Capital with no sub-prime exposure. Of the £507 million, 99 per cent (30 June 2017: 96 per cent; 31 December 2017: 96 per cent) are graded AAA.

(f) Group sovereign debt and bank debt exposure

The Group exposures held by the shareholder-backed business and with-profits funds in sovereign debts and bank debt securities at 30 June 2018 are analysed as follows:

Exposure to sovereign debts

	30 Jun 2018 £m		30 Jun 2017 £m		31 Dec 2017 £m	
	Shareholder-backed business	With-profits funds	Shareholder-backed business	With-profits funds	Shareholder-backed business	With-profits funds
Italy	–	60	57	62	58	63
Spain	36	18	33	18	34	18
France	23	6	23	23	23	38
Germany*	663	315	649	317	693	301
Other Eurozone	77	30	82	32	82	31
Total Eurozone	799	429	844	452	890	451
United Kingdom	3,482	3,130	4,904	3,049	5,918	3,287
United States†	5,243	10,519	4,959	9,913	5,078	10,156
Other, including Asia	4,923	2,314	4,174	2,221	4,638	2,143
Total	14,447	16,392	14,881	15,635	16,524	16,037

* Including bonds guaranteed by the federal government.
† The exposure to the United States sovereign debt comprises holdings of the US, UK and Europe and Asia insurance operations.

Exposure to bank debt securities

Shareholder-backed business	2018 £m Senior debt Covered	Senior	Total senior debt	Subordinated debt Tier 1	Tier 2	Total subordinated debt	30 Jun Total	2017 £m 30 Jun Total	31 Dec Total
Italy	–	–	–	–	–	–	–	32	–
Spain	42	36	78	–	–	–	78	59	68
France	27	37	64	13	4	17	81	163	86
Germany	30	–	30	–	89	89	119	167	117
Netherlands	–	45	45	–	6	6	51	73	71
Other Eurozone	15	–	15	–	–	–	15	23	15
Total Eurozone	114	118	232	13	99	112	344	517	357
United Kingdom	575	545	1,120	5	164	169	1,289	1,401	1,382
United States	–	2,399	2,399	1	95	96	2,495	2,757	2,619
Other, including Asia	16	699	715	105	391	496	1,211	1,138	1,163
Total	705	3,761	4,466	124	749	873	5,339	5,813	5,521
With-profits funds									
Italy	–	38	38	–	–	–	38	65	31
Spain	–	21	21	–	–	–	21	85	16
France	8	245	253	2	63	65	318	273	286
Germany	141	31	172	–	35	35	207	167	180
Netherlands	–	216	216	5	6	11	227	204	199
Other Eurozone	–	27	27	–	–	–	27	30	27
Total Eurozone	149	578	727	7	104	111	838	824	739
United Kingdom	865	797	1,662	2	368	370	2,032	1,792	1,938
United States	–	2,188	2,188	47	298	345	2,533	2,334	2,518
Other, including Asia	580	1,451	2,031	327	430	757	2,788	2,133	2,531
Total	1,594	5,014	6,608	383	1,200	1,583	8,191	7,083	7,726

The tables above exclude assets held to cover linked liabilities and those of the consolidated unit trusts and similar funds. In addition, the tables above exclude the proportionate share of sovereign debt holdings of the Group's joint venture operations.

C3 Assets and liabilities continued

C3.3 Loans portfolio

(a) Overview of loans portfolio

Loans are principally accounted for at amortised cost, net of impairment except for:

— Certain mortgage loans which have been designated at fair value through profit or loss of the UK and Europe insurance operations as this loan portfolio is managed and evaluated on a fair value basis; and
— Certain policy loans of the US insurance operations that are held to back liabilities for funds withheld under reinsurance arrangements and are also accounted on a fair value basis.

The amounts included in the statement of financial position are analysed as follows:

	30 Jun 2018 £m				30 Jun 2017 £m				31 Dec 2017 £m			
	Mortgage loans*	Policy loans†	Other loans‡	Total	Mortgage loans*	Policy loans†	Other loans‡	Total	Mortgage loans*	Policy loans†	Other loans‡	Total
Asia												
With-profits	–	652	105	757	–	589	113	702	–	613	112	725
Non-linked shareholder-backed	170	217	193	580	188	219	198	605	177	216	199	592
US												
Non-linked shareholder-backed	6,292	3,523	–	9,815	5,964	3,533	–	9,497	6,236	3,394	–	9,630
UK and Europe												
With-profits	2,267	4	1,672	3,943	2,576	5	1,455	4,036	2,441	4	1,823	4,268
Non-linked shareholder-backed	1,686	–	35	1,721	1,711	–	37	1,748	1,681	–	37	1,718
Other operations	–	–	106	106	–	–	364	364	–	–	109	109
Total loans securities	10,415	4,396	2,111	16,922	10,439	4,346	2,167	16,952	10,535	4,227	2,280	17,042

* All mortgage loans are secured by properties.
† In the US £2,638 million (30 June 2017: £2,594 million; 31 December 2017: £2,512 million) policy loans are backing liabilities for funds withheld under reinsurance arrangements and are accounted for at fair value through profit or loss. All other policy loans are accounted for at amortised cost, less any impairment.
‡ Other loans held in UK with-profits funds are commercial loans and comprise mainly syndicated loans. The majority of other loans in shareholder-backed business in Asia are commercial loans held by the Malaysia operation and which are all investment graded by two local rating agencies.

(b) Additional information on US mortgage loans

In the US, mortgage loans are all commercial mortgage loans that are secured by the following property types: industrial, multi-family residential, suburban office, retail or hotel. The average loan size is £13.3 million (30 June 2017: £12.5 million; 31 December 2017: £12.6 million). The portfolio has a current estimated average loan to value of 55 per cent (30 June 2017: 59 per cent; 31 December 2017: 55 per cent).

At 30 June 2018, Jackson had no mortgage loans where the contractual terms of the agreements had been restructured (30 June 2017 and 31 December 2017: none).

(c) Additional information on UK mortgage loans

The UK with-profits fund invests in an entity established to acquire a portfolio of buy-to-let mortgage loans. The vehicle financed the acquisition through the issue of debt instruments, largely to external parties, securitised upon the loans acquired. These third-party borrowings have no recourse to any other assets of the Group and the Group's exposure is limited to the amount invested by the UK with-profits fund.

By carrying value, 99.99 per cent of the £1,686 million (30 June 2017: 100 per cent of £1,711 million; 31 December 2017: 99.98 per cent of £1,681 million) mortgage loans held by the UK shareholder-backed business relates to lifetime (equity release) mortgage business which has an average loan to property value of 32 per cent (30 June 2017: 30 per cent; 31 December 2017: 31 per cent).

C4 Policyholder liabilities and unallocated surplus

The note provides information of policyholder liabilities and unallocated surplus of with-profits funds held on the Group's statement of financial position:

C4.1 Movement and duration of liabilities

C4.1(a) Group overview

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

	Insurance operations £m			
Half year 2018 movements	**Asia** note C4.1(b)	**US** note C4.1(c)	**UK and Europe** note C4.1(d)	**Total**
At 1 January 2018	73,839	180,724	181,066	435,629
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position (excludes £32 million classified as unallocated to a segment)*	62,898	180,724	167,589	411,211
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,474	–	13,477	16,951
– Group's share of policyholder liabilities of joint ventures and associate†	7,467	–	–	7,467
Reclassification of reinsured UK annuity contracts as held for sale‡	–	–	(12,002)	(12,002)
Net flows:				
Premiums	6,247	7,111	6,964	20,322
Surrenders	(1,547)	(5,953)	(3,446)	(10,946)
Maturities/deaths	(838)	(1,076)	(3,499)	(5,413)
Net flows	3,862	82	19	3,963
Shareholders' transfers post tax	(27)	–	(127)	(154)
Investment-related items and other movements	(1,349)	(103)	(801)	(2,253)
Foreign exchange translation differences	690	4,447	17	5,154
At 30 June 2018	77,015	185,150	168,172	430,337
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position (excludes £37 million classified as unallocated to a segment)*	65,640	185,150	154,655	405,445
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,766	–	13,517	17,283
– Group's share of policyholder liabilities of joint ventures and associate†	7,609	–	–	7,609
Half year 2017 movements				
At 1 January 2017	62,784	177,626	169,304	409,714
Comprising:				
*– Policyholder liabilities on the consolidated statement of financial position**	53,716	177,626	157,654	388,996
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,667	–	11,650	14,317
– Group's share of policyholder liabilities of joint ventures and associate†	6,401	–	–	6,401
Net flows:				
Premiums	5,699	8,148	7,756	21,603
Surrenders	(1,508)	(5,071)	(3,816)	(10,395)
Maturities/deaths	(880)	(1,119)	(3,533)	(5,532)
Net flows	3,311	1,958	407	5,676
Shareholders' transfers post tax	(27)	–	(115)	(142)
Investment-related items and other movements	4,288	7,124	5,214	16,626
Foreign exchange translation differences	(2,035)	(8,929)	130	(10,834)
At 30 June 2017	68,321	177,779	174,940	421,040
Comprising:				
*– Policyholder liabilities on the consolidated statement of financial position**	58,348	177,779	162,853	398,980
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,003	–	12,087	15,090
– Group's share of policyholder liabilities of joint ventures and associate†	6,970	–	–	6,970
Average policyholder liability balances§				
Half year 2018	71,807	182,937	161,122	415,866
Half year 2017	62,718	177,702	160,254	400,674

C4 Policyholder liabilities and unallocated surplus continued

C4.1 Movement and duration of liabilities continued

* The policyholder liabilities of the Asia insurance operations of £65,640 million (30 June 2017: £58,348 million; 31 December 2017: £62,898 million), shown in the table above, are after deducting the intra-group reinsurance liabilities ceded by the UK and Europe insurance operations of £1,181 million (30 June 2017: £1,271 million; 31 December 2017: £1,235 million) to the Hong Kong with-profits business. Including this amount, total Asia policyholder liabilities were £66,821 million (30 June 2017: £59,619 million; 31 December 2017: £64,133 million).

† The Group's investments in joint ventures and associate are accounted for on an equity method basis in the Group's statement of financial position. The Group's share of the policyholder liabilities as shown above relates to life businesses in China, India and of the Takaful business in Malaysia.

‡ The reclassification of the reinsured UK annuity business as held for sale reflects the value of policyholder liabilities held at 1 January 2018. Movements in items covered by the reinsurance contract prior to the 14 March inception date are included within net flows of the UK and Europe business.

§ Averages have been based on opening and closing balances and exclude unallocated surplus of with-profits funds.

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed. The policyholder liabilities shown include investment contracts without discretionary participation features (as defined in IFRS 4) and their full movement in the period but exclude liabilities that have not been allocated to a reporting segment. The items above are shown gross of external reinsurance.

The analysis includes the impact of premiums, claims and investment movements on policyholders' liabilities. The impact does not represent premiums, claims and investment movements as reported in the income statement. For example, the premiums shown above will exclude any deductions for fees/charges. Claims (surrenders, maturities and deaths) represent the policyholder liabilities provision released rather than the claim amount paid to the policyholder.

(ii) Analysis of movements in policyholder liabilities for shareholder-backed business

	Half year 2018 £m			
	Asia	**US**	**UK and Europe**	**Total** note (b)
At 1 January 2018	37,402	180,724	56,367	274,493
Reclassification of reinsured UK annuity contracts as held for sale*	–	–	(12,002)	(12,002)
Net flows:				
Premiums	3,266	7,111	681	11,058
Surrenders	(1,383)	(5,953)	(1,200)	(8,536)
Maturities/deaths	(420)	(1,076)	(1,294)	(2,790)
Net flows note	1,463	82	(1,813)	(268)
Investment-related items and other movements	(718)	(103)	(236)	(1,057)
Foreign exchange translation differences	1	4,447	–	4,448
At 30 June 2018	38,148	185,150	42,316	265,614
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position (excludes £37 million classified as unallocated to a segment)	30,539	185,150	42,316	258,005
– Group's share of policyholder liabilities relating to joint ventures and associate	7,609	–	–	7,609

	Half year 2017 £m			
	Asia	**US**	**UK and Europe**	**Total**
At 1 January 2017	32,851	177,626	56,158	266,635
Net flows:				
Premiums	2,801	8,148	1,658	12,607
Surrenders	(1,335)	(5,071)	(1,500)	(7,906)
Maturities/deaths	(450)	(1,119)	(1,325)	(2,894)
Net flows note	1,016	1,958	(1,167)	1,807
Investment-related items and other movements	1,912	7,124	1,500	10,536
Foreign exchange translation differences	(739)	(8,929)	–	(9,668)
At 30 June 2017	35,040	177,779	56,491	269,310
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	28,070	177,779	56,491	262,340
– Group's share of policyholder liabilities relating to joint ventures and associate	6,970	–	–	6,970

* The reclassification of the reinsured UK annuity business as held for sale reflects the value of policyholder liabilities held at 1 January 2018. Movements in items covered by the reinsurance contract prior to the 14 March inception date are included within net flows of the UK and Europe business.

Note
Including net flows of the Group's insurance joint ventures and associate.

C4.1(b) Asia insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of Asia insurance operations from the beginning of the period to 30 June is as follows:

Half year 2018 movements	**With-profits business*** £m	**Unit-linked liabilities** £m	**Other business** £m	**Total** £m
At 1 January 2018	36,437	20,027	17,375	73,839
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	32,963	16,263	13,672	62,898
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,474	–	–	3,474
– Group's share of policyholder liabilities relating to joint ventures and associate†	–	3,764	3,703	7,467
Premiums:				
New business	432	870	435	1,737
In-force	2,549	841	1,120	4,510
	2,981	1,711	1,555	6,247
Surrenders note (c)	(164)	(1,071)	(312)	(1,547)
Maturities/deaths	(418)	(93)	(327)	(838)
Net flows note (b)	2,399	547	916	3,862
Shareholders' transfers post tax	(27)	–	–	(27)
Investment-related items and other movements note (d)	(631)	(652)	(66)	(1,349)
Foreign exchange translation differences note (a)	689	(142)	143	690
At 30 June 2018	38,867	19,780	18,368	77,015
Comprising:				
*– Policyholder liabilities on the consolidated statement of financial position**	35,101	16,094	14,445	65,640
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,766	–	–	3,766
– Group's share of policyholder liabilities relating to joint ventures and associate†	–	3,686	3,923	7,609

C4 Policyholder liabilities and unallocated surplus continued

C4.1 Movement and duration of liabilities continued

Half year 2017 movements	With-profits business* £m	Unit-linked liabilities £m	Other business £m	Total £m
At 1 January 2017	29,933	17,507	15,344	62,784
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	27,266	14,289	12,161	53,716
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	2,667	–	–	2,667
– Group's share of policyholder liabilities relating to joint ventures and associate†	–	3,218	3,183	6,401
Premiums:				
New business	676	527	528	1,731
In-force	2,222	805	941	3,968
	2,898	1,332	1,469	5,699
Surrenders note (c)	(173)	(1,102)	(233)	(1,508)
Maturities/deaths	(430)	(82)	(368)	(880)
Net flows note (b)	2,295	148	868	3,311
Shareholders' transfers post tax	(27)	–	–	(27)
Investment-related items and other movements note (d)	2,376	1,551	361	4,288
Foreign exchange translation differences note (a)	(1,296)	(373)	(366)	(2,035)
At 30 June 2017	33,281	18,833	16,207	68,321
Comprising:				
– Policyholder liabilities on the consolidated statement of financial position	30,278	15,326	12,744	58,348
– Unallocated surplus of with-profits funds on the consolidated statement of financial position	3,003	–	–	3,003
– Group's share of policyholder liabilities relating to joint ventures and associate†	–	3,507	3,463	6,970
Average policyholder liability balances‡				
Half year 2018	**34,032**	**19,903**	**17,872**	**71,807**
Half year 2017	28,772	18,170	15,776	62,718

* The policyholder liabilities of the with-profits business of £35,101 million, shown in the table above, is after deducting the intra-group reinsurance liabilities ceded by the UK and Europe insurance operations of £1,181 million to the Hong Kong with-profits business (30 June 2017: £1,271 million; 31 December 2017: £1,235 million). Including this amount the Asia with-profits policyholder liabilities are £36,282 million (30 June 2017: £31,549 million; 31 December 2017: £34,198 million).

† The Group's investment in joint ventures and associate are accounted for on an equity method and the Group's share of the policyholder liabilities as shown above relate to the life business in China, India and of the Takaful business in Malaysia.

‡ Averages have been based on opening and closing balances and adjusted for any acquisitions, disposals and corporate transactions arising in the period and exclude unallocated surplus of with-profits funds.

Notes

(a) Movements in the period have been translated at the average exchange rates for the period ended 30 June 2018. The closing balance has been translated at the closing spot rates as at 30 June 2018. Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows increased by 17 per cent from £3,311 million in half year 2017 to £3,862 million in half year 2018 predominantly reflecting continued growth of the in-force book.

(c) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 3.7 per cent in the first half of 2018 (half year 2017: 4.1 per cent).

(d) Investment-related items and other movements in the first half of 2018 primarily represent unrealised investments losses following unfavourable equity markets in the period and rising interest rates.

C4.1(c) US insurance operations

(i) Analysis of movements in policyholder liabilities

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the period to 30 June is as follows:

US insurance operations

Half year 2018 movements	Variable annuity separate account liabilities £m	Fixed annuity, GIC and other business £m	Total £m
At 1 January 2018	130,528	50,196	180,724
Premiums	5,528	1,583	7,111
Surrenders	(4,225)	(1,728)	(5,953)
Maturities/deaths	(540)	(536)	(1,076)
Net flows note (b)	763	(681)	82
Transfers from general to separate account	387	(387)	–
Investment-related items and other movements note (c)	582	(685)	(103)
Foreign exchange translation differences note (a)	3,286	1,161	4,447
At 30 June 2018	135,546	49,604	185,150
Half year 2017 movements			
At 1 January 2017	120,411	57,215	177,626
Premiums	5,981	2,167	8,148
Surrenders	(3,409)	(1,662)	(5,071)
Maturities/deaths	(541)	(578)	(1,119)
Net flows note (b)	2,031	(73)	1,958
Transfers from general to separate account	1,240	(1,240)	–
Investment-related items and other movements	7,236	(112)	7,124
Foreign exchange translation differences note (a)	(6,183)	(2,746)	(8,929)
At 30 June 2017	124,735	53,044	177,779
Average policyholder liability balances*			
Half year 2018	133,037	49,900	182,937
Half year 2017	122,573	55,129	177,702

* Averages have been based on opening and closing balances.

Notes

(a) Movements in the period have been translated at an average rate of US$1.38: £1.00 (30 June 2017: US$1.26: £1.00; 31 December 2017: US$1.29: £1.00). The closing balance has been translated at closing rate of US$1.32:£1.00 (30 June 2017: US$1.30:£1.00; 31 December 2017: US$1.30:£1.00). Differences upon retranslation are included in foreign exchange translation differences.

(b) Net flows in the first half of 2018 were £82 million (first half of 2017: £1,958 million) as we continue to grow the business with gross inflows of £7,111 million, principally into variable annuities, more than exceeding surrenders and maturities in the period which are expected to grow in line with the business.

(c) Positive investment-related items and other movements in variable annuity separate account liabilities of £582 million for the first six months in 2018 represents positive separate account return mainly following the increase in the US equity market in the period. For fixed annuity, GIC and other business, investment-related items and other movements mainly represent accounting value movements on the guaranteed liabilities driven by increase in interest rates.

C4 Policyholder liabilities and unallocated surplus continued

C4.1 Movement and duration of liabilities continued

C4.1(d) UK and Europe insurance operations

(i) Analysis of movements in policyholder liabilities and unallocated surplus of with-profits funds

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK and Europe insurance operations from the beginning of the period to 30 June is as follows:

		Shareholder-backed funds and subsidiaries		
Half year 2018 movements	**With-profits sub-funds*** £m	**Unit-linked liabilities** £m	**Annuity and other long-term business** £m	**Total** £m
At 1 January 2018	**124,699**	**23,145**	**33,222**	**181,066**
Comprising:				
– Policyholder liabilities	111,222	23,145	33,222	167,589
– Unallocated surplus of with-profits funds	13,477	–	–	13,477
Reclassification of reinsured UK annuity contracts as held for sale†	–	–	(12,002)	(12,002)
Premiums	6,283	516	165	6,964
Surrenders	(2,246)	(1,163)	(37)	(3,446)
Maturities/deaths	(2,205)	(313)	(981)	(3,499)
Net flows note (a)	1,832	(960)	(853)	19
Shareholders' transfers post tax	(127)	–	–	(127)
Switches	(89)	89	–	–
Investment-related items and other movements note (b)	(476)	(76)	(249)	(801)
Foreign exchange translation differences	17	–	–	17
At 30 June 2018	**125,856**	**22,198**	**20,118**	**168,172**
Comprising:				
– Policyholder liabilities	112,339	22,198	20,118	154,655
– Unallocated surplus of with-profits funds	13,517	–	–	13,517
Half year 2017 movements				
At 1 January 2017	113,146	22,119	34,039	169,304
Comprising:				
– Policyholder liabilities	101,496	22,119	34,039	157,654
– Unallocated surplus of with-profits funds	11,650	–	–	11,650
Premiums	6,098	1,484	174	7,756
Surrenders	(2,316)	(1,472)	(28)	(3,816)
Maturities/deaths	(2,208)	(323)	(1,002)	(3,533)
Net flows note (a)	1,574	(311)	(856)	407
Shareholders' transfers post tax	(115)	–	–	(115)
Switches	(91)	91	–	–
Investment-related items and other movements note (b)	3,805	1,018	391	5,214
Foreign exchange translation differences	130	–	–	130
At 30 June 2017	118,449	22,917	33,574	174,940
Comprising:				
– Policyholder liabilities	106,362	22,917	33,574	162,853
– Unallocated surplus of with-profits funds	12,087	–	–	12,087
Average policyholder liability balances‡				
Half year 2018	**111,781**	**22,671**	**26,670**	**161,122**
Half year 2017	103,929	22,518	33,807	160,254

* Includes the Scottish Amicable Insurance Fund.

† The reclassification of the reinsured UK annuity business as held for sale reflects the value of policyholder liabilities held at 1 January 2018. Movements in items covered by the reinsurance contract prior to the 14 March inception date are included within net flows.

‡ Averages have been based on opening and closing balances and adjusted for any acquisitions, disposals and corporate transactions arising in the period and exclude unallocated surplus of with-profits funds.

Notes

(a) Net flows have declined from net inflows of £407 million in the first half of 2017 to net inflows of £19 million in the same period of 2018 due primarily to lower premium flows into unit-linked business. The levels of inflows/outflows for unit-linked business is driven by corporate pension schemes with transfers in or out from only a small number of schemes influencing the level of flows in the period.

(b) Investment-related items and other movements for with-profits business principally comprise investment return attributable to policyholders earned in the period reflecting unfavourable equity market movements. For shareholder-backed annuity and other long-term business, investment-related items and other movements include the effects of movement in interest rates and credit spreads.

C5 Intangible assets

(a) Goodwill

	Attributable to:				
	Shareholders	With-profits	2018 £m	2017 £m	
			30 Jun	30 Jun	31 Dec
Cost					
At beginning of period	1,458	24	1,482	1,628	1,628
Disposals/reclassifications to held for sale	–	(10)	(10)	(127)	(155)
Additions in the period	–	149	149	–	9
Exchange differences	1	(2)	(1)	–	–
Net book amount at end of period	1,459	161	1,620	1,501	1,482

Goodwill comprises:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
M&G	1,153	1,153	1,153
Other – attributable to shareholders	306	322	305
Goodwill – attributable to shareholders	1,459	1,475	1,458
Venture fund investments – attributable to with-profits funds	161	26	24
	1,620	1,501	1,482

Other goodwill attributable to shareholders represents amounts allocated to entities in Asia. These goodwill amounts are not individually material.

During the first half of 2018, the PAC with-profits fund, via its venture fund holdings managed by M&G Prudential asset management, made a small number of acquisitions that are consolidated by the Group resulting in an addition to goodwill of £149 million. As these transactions are within the with-profits fund, they have no impact on shareholders' profit or equity for the period ended 30 June 2018. The impact on the Group's consolidated revenue, including investment returns, is not material. Had the acquisitions been effected at 1 January 2018, the revenue and profit of the Group for half year 2018 would not have been materially different.

(b) Deferred acquisition costs and other intangible assets

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Deferred acquisition costs and other intangible assets attributable to shareholders	11,210	10,643	10,866
Deferred acquisition costs and other intangible assets attributable to with-profits funds	149	114	145
Total of deferred acquisition costs and other intangible assets	11,359	10,757	11,011

The deferred acquisition costs and other intangible assets attributable to shareholders comprise:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Deferred acquisition costs related to insurance contracts as classified under IFRS 4	9,596	9,022	9,170
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4	61	60	63
	9,657	9,082	9,233
Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF)	35	39	36
Distribution rights and other intangibles	1,518	1,522	1,597
	1,553	1,561	1,633
Total of deferred acquisition costs and other intangible assets	11,210	10,643	10,866

C5 Intangible assets continued

(b) Deferred acquisition costs and other intangible assets continued

	2018 £m						2017 £m	
	Deferred acquisition costs							
	Asia insurance	US insurance	UK and Europe insurance	All asset management	PVIF and other intangibles* note	30 Jun Total	30 Jun Total	31 Dec Total
Balance at beginning of period:	946	8,197	84	6	1,633	10,866	10,755	10,755
Additions	199	290	7	1	14	511	541	1,240
Amortisation to the income statement:†								
Operating profit	(70)	(280)	(6)	(3)	(88)	(447)	(375)	(709)
Non-operating profit		(199)				(199)	227	455
	(70)	(479)	(6)	(3)	(88)	(646)	(148)	(254)
Disposals and transfers	–	–	–	–	(11)	(11)	–	–
Exchange differences and other movements	6	206	–	1	5	218	(436)	(799)
Amortisation of DAC related to net unrealised valuation movements on the US insurance operation's available-for-sale securities recognised within other comprehensive income†	–	272	–	–	–	272	(69)	(76)
Balance at end of period	1,081	8,486	85	5	1,553	11,210	10,643	10,866

* PVIF and other intangibles includes amounts in relation to software rights with additions of £10 million, amortisation of £18 million, disposals of £10 million and a balance at 30 June 2018 of £49 million.

† Under the Group's application of IFRS 4, US GAAP is used for measuring the insurance assets and liabilities of its US and certain Asia operations. Under US GAAP, most of the US insurance operation's products are accounted for under Accounting Standard no. 97 of the Financial Accounting Standards Board (FAS 97) whereby deferred acquisition costs are amortised in line with the emergence of actual and expected gross profits which are determined using an assumption for long-term investment returns for the separate account of 7.4 per cent (half year and full year 2017: 7.4 per cent) (gross of asset management fees and other charges to policyholders, but net of external fund management fees). The amounts included in the income statement and other comprehensive income affect the pattern of profit emergence and thus the DAC amortisation attaching. DAC amortisation is allocated to the operating and non-operating components of the Group's supplementary analysis of profit and other comprehensive income by reference to the underlying items.

Note

PVIF and other intangibles comprise PVIF, distribution rights and other intangibles such as software rights. Distribution rights relate to amounts that have been paid or have become unconditionally due for payment as a result of past events in respect of bancassurance partnership arrangements in Asia. These agreements allow for bank distribution of Prudential's insurance products for a fixed period of time.

US insurance operations

The DAC amount in respect of US insurance operations comprises amounts in respect of:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Variable annuity business	8,258	8,133	8,208
Other business	241	330	278
Cumulative shadow DAC (for unrealised gains/losses booked in other comprehensive income)*	(13)	(292)	(289)
Total DAC for US operations	8,486	8,171	8,197

* Consequent upon the negative unrealised valuation movement for half year 2018 of £(1,421) million (30 June 2017: positive unrealised valuation movement of £565 million; 31 December 2017: positive unrealised valuation movement of £617 million), there is a gain of £272 million (30 June 2017: a loss of £(69) million; 31 December 2017: a loss of £(76) million) for altered 'shadow' DAC amortisation booked within other comprehensive income. These adjustments reflect the movement from period to period, in the changes to the pattern of reported gross profits that would have happened if the assets reflected in the statement of financial position had been sold, crystallising the unrealised gains and losses, and the proceeds reinvested at the yields currently available in the market. At 30 June 2018, the cumulative shadow DAC balance as shown in the table above was negative £13 million (30 June 2017: negative £292 million; 31 December 2017: negative £289 million).

Sensitivity of amortisation charge

The amortisation charge to the income statement is reflected in both operating profit and short-term fluctuations in investment returns. The amortisation charge to the operating profit in a reporting period comprises:

(i) A core amount that reflects a relatively stable proportion of underlying premiums or profit; and
(ii) An element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique (which is used for moderating the effect of short-term volatility in investment returns) are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

Furthermore, in those periods where the cap or floor is relevant, the mean reversion technique provides no further dampening and additional volatility may result.

In the first half of 2018, the DAC amortisation charge for operating profit was determined after including a charge for accelerated amortisation of £(42) million (half year 2017 credit for deceleration: £36 million; full year 2017 credit for deceleration: £86 million). The acceleration arising in the first half of 2018 reflects a mechanical reduction in the projected separate account return for the next five years under the mean-reversion technique. Under this technique the projected level of return for each of the next five years is adjusted so that in combination with the actual rates of return for the preceding three years (including the current period) the assumed long-term annual separate account return of 7.4 per cent is realised on average over the entire eight-year period. The acceleration in DAC amortisation in the first half of 2018, is driven, in part, by the lower than expected return in 2015 falling out of the eight-year period and primarily represents the reversal of the benefit received in 2015 under the mean reversion formula.

The application of the mean reversion formula has the effect of dampening the impact of equity market movements on DAC amortisation while the mean reversion assumption lies within the corridor. At 1 July 2018, it would take approximate movements in separate account values of more than either negative 33.1 per cent or positive 34.6 per cent for mean reversion assumption to move outside the corridor.

C6 Borrowings

C6.1 Core structural borrowings of shareholder-financed operations

	2018 £m	**2017** £m	
	30 Jun	**30 Jun**	**31 Dec**
Holding company operations: note (i)			
Perpetual Subordinated Capital Securities (Tier 1) note (iv)	833	847	814
Perpetual Subordinated Capital Securities (Tier 2)	2,388	2,620	2,326
Subordinated notes (Tier 2)	2,133	2,131	2,132
Subordinated debt total	5,354	5,598	5,272
Senior debt: note (ii)			
£300m 6.875% Bonds 2023	300	300	300
£250m 5.875% Bonds 2029	249	249	249
Holding company total	5,903	6,147	5,821
Prudential Capital bank loan note (iii)	275	275	275
Jackson US$250m 8.15% Surplus Notes 2027 note (v)	189	192	184
Total (per condensed consolidated statement of financial position) note (vi)	6,367	6,614	6,280

Notes

(i) These debt tier classifications are consistent with the treatment of capital for regulatory purposes under the Solvency II regime.
The Group has designated US$4,275 million (30 June 2017: US$4,525 million; 31 December 2017: US$4,275 million) of its US dollar denominated subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.
(ii) The senior debt ranks above subordinated debt in the event of liquidation.
(iii) The Prudential Capital bank loan of £275 million is drawn at a cost of 12 month GBP LIBOR plus 0.33 per cent. The loan was renewed in December 2017 maturing on 20 December 2022 with an option to repay annually.
(iv) These borrowings can be converted, in whole or part, at the Company's option and subject to certain conditions, on any interest payment date, into one or more series of Prudential preference shares.
(v) Jackson's borrowings are unsecured and subordinated to all present and future indebtedness, policy claims and other creditor claims of Jackson.
(vi) The maturity profile, currency and interest rates applicable to all other core structural borrowings of shareholder-financed operations of the Group are as detailed in note C6.1 of the Group's consolidated financial statements for the year ended 31 December 2017.

C6 Borrowings continued

C6.1 Core structural borrowings of shareholder-financed operations continued

Prudential plc has debt ratings from Standard & Poor's, Moody's and Fitch. Prudential plc's long-term senior debt is rated A2 by Moody's, A by Standard & Poor's and A- by Fitch.

Prudential plc's short-term debt is rated as P-1 by Moody's, A-1 by Standard & Poor's and F1 by Fitch.

Prudential plc's ratings have a stable outlook.

The financial strength of The Prudential Assurance Company Limited is rated A+ by Standard & Poor's, Aa3 by Moody's and AA- by Fitch. These ratings have a stable outlook.

Jackson National Life Insurance Company's financial strength is rated AA- by Standard & Poor's and Fitch and A1 by Moody's and these ratings have a stable outlook. Jackson's financial strength also has an A+ rating with the outlook on Under Review with Developing Implications by A.M. Best.

Prudential Assurance Co. Singapore (Pte) Ltd.'s (Prudential Singapore) financial strength is rated AA- by Standard & Poor's and has a stable outlook.

C6.2 Other borrowings

(a) Operational borrowings attributable to shareholder-financed operations

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Borrowings in respect of short-term fixed income securities programmes:			
Commercial paper	909	825	485
Medium Term Notes 2018	300	599	600
	1,209	1,424	1,085
Other borrowings[note]	409	672	706
Total	1,618	2,096	1,791

Note

Other borrowings mainly include senior debt issued through the Federal Home Loan Bank of Indianapolis (FHLB), secured by collateral posted with the FHLB by Jackson. In addition, other borrowings include amounts whose repayment to the lender is contingent upon future surplus emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(b) Borrowings attributable to with-profits operations

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
Non-recourse borrowings of consolidated investment funds*	3,521	3,178	3,570
£100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc†	–	100	100
Other borrowings (predominantly obligations under finance leases)	68	58	46
Total	3,589	3,336	3,716

* In all instances the holders of the debt instruments issued by these subsidiaries and funds do not have recourse beyond the assets of those subsidiaries and funds.

† The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinated to the entitlements of the policyholders of that fund. These bonds were redeemed in full on 30 June 2018.

C7 Deferred tax

The statement of financial position contains the following deferred tax assets and liabilities in relation to:

	2018 £m				
	At 1 Jan	Movement in income statement	Movement through other comprehensive income and equity	Other movements including foreign currency movements	At 30 Jun
Deferred tax assets					
Unrealised losses or gains on investments	14	(1)	55	(1)	67
Balances relating to investment and insurance contracts	1	–	–	–	1
Short-term temporary differences	2,498	(343)	(12)	44	2,187
Capital allowances	14	1	–	1	16
Unused tax losses	100	63	1	–	164
Total	2,627	(280)	44	44	2,435
Deferred tax liabilities					
Unrealised losses or gains on investments	(1,748)	126	186	32	(1,404)
Balances relating to investment and insurance contracts	(872)	(49)	–	(4)	(925)
Short-term temporary differences	(2,041)	27	(11)	(36)	(2,061)
Capital allowances	(54)	–	–	1	(53)
Total	(4,715)	104	175	(7)	(4,443)

Under IAS 12, 'Income Taxes', deferred tax is measured at the tax rates that are expected to apply to the period when the asset is realised or the liability settled, based on the tax rates (and laws) that have been enacted or are substantively enacted at the end of the reporting period.

Deferred tax assets are recognised to the extent that they are regarded as recoverable, that is to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences can be deducted.

The principal reasons for the decrease in deferred tax assets are a reduction in the deferred tax asset in the US insurance business relating to a narrowing of the difference between the accounting basis and tax basis for insurance reserves following changes in US interest rates, combined with a reduction in the deferred tax asset for losses on derivatives, which for US tax purposes are spread across three years, reflecting a lower level of losses in the first half of 2018 (and therefore a lower amount deferred to subsequent periods) compared to the first half of 2017.

The taxation regimes applicable across the Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the recognition of deferred tax assets. For the 2018 half year results and financial position at 30 June 2018 the following tax benefits have not been recognised:

	2018		2017			
	30 Jun		30 Jun		31 Dec	
	Tax benefit £m	Losses £bn	Tax benefit £m	Losses £bn	Tax benefit £m	Losses £bn
Capital losses	70	0.4	90	0.4	79	0.4
Trading losses	42	0.2	48	0.2	74	0.3

Of the unrecognised trading losses, losses giving rise to a tax benefit of £38 million will expire within the next seven years, the rest have no expiry date.

C8 Defined benefit pension schemes

(a) IAS 19 financial positions

The Group's businesses operate a number of pension schemes. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). The Group also operates two smaller UK defined benefit schemes in respect of Scottish Amicable (SASPS) and M&G (M&GGPS). In addition, there are two small defined benefit schemes in Taiwan which have negligible deficits.

The Group asset/liability in respect of defined benefit pension schemes is as follows:

	2018 £m					2017 £m									
	30 Jun					30 Jun					31 Dec				
	PSPS	SASPS	M&GGPS	Other schemes	Total	PSPS	SASPS	M&GGPS	Other schemes	Total	PSPS	SASPS	M&GGPS	Other schemes	Total
Underlying economic surplus (deficit)	891	(62)	143	(1)	971	753	(154)	85	(1)	683	721	(137)	109	(1)	692
Less: unrecognised surplus	(657)	–	–	–	(657)	(598)	–	–	–	(598)	(485)	–	–	–	(485)
Economic surplus (deficit) (including investment in Prudential insurance policies)	234	(62)	143	(1)	314	155	(154)	85	(1)	85	236	(137)	109	(1)	207
Attributable to:															
PAC with-profits fund	164	(25)	–	–	139	109	(62)	–	–	47	165	(55)	–	–	110
Shareholder-backed operations	70	(37)	143	(1)	175	46	(92)	85	(1)	38	71	(82)	109	(1)	97
Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies	–	–	(214)	–	(214)	–	–	(145)	–	(145)	–	–	(151)	–	(151)
IAS 19 pension asset (liability) on the Group statement of financial position*	234	(62)	(71)	(1)	100	155	(154)	(60)	(1)	(60)	236	(137)	(42)	(1)	56

* At 30 June 2018, the PSPS pension asset of £234 million (30 June 2017: £155 million; 31 December 2017: £236 million) and the other schemes' pension liabilities of £134 million (30 June 2017: £215 million; 31 December 2017: £180 million) are included within 'Other debtors' and 'Provisions' respectively in the consolidated statement of financial position.

Triennial actuarial valuations

Defined benefit pension schemes in the UK are generally required to be subject to full actuarial valuations every three years in order to assess the appropriate level of funding for schemes in relation to their commitments. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. The actuarial valuation differs from the IAS 19 accounting basis valuation in a number of respects, including the discount rate assumption where IAS 19 prescribes a rate based on high quality corporate bonds while a more 'prudent' assumption is used for the actuarial valuation.

The triennial valuation for the PSPS as at 5 April 2017 was completed in the first half of 2018 demonstrating the scheme to be 105 per cent funded. There is no change to the ongoing contributions which are kept at the minimum level required under the scheme rules.

For SASPS, the current funding arrangement agreed with the trustees based on the last completed triennial valuation as at 31 March 2017 is described in note C9 of the Group's consolidated financial statements for the year ended 31 December 2017.

The triennial valuation for the M&GGPS as at 31 December 2017 is currently in progress.

(b) Estimated pension scheme surpluses and deficits

The underlying pension position on an economic basis reflects the assets (including investments in Prudential policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. The IAS 19 basis excludes the investments in Prudential policies. At 30 June 2018, M&GGPS held investments in Prudential insurance policies of £214 million (30 June 2017: £145 million; 31 December 2017: £151 million).

Movements on the pension scheme deficit determined on the economic basis are as follows, with the effect of the application of IFRIC 14 being shown separately:

	Half year 2018 £m				
	Surplus (deficit) in schemes at 1 Jan 2018	(Charge) credit to income statement	Actuarial gains and losses in other comprehensive income	Contributions paid	Surplus (deficit) in schemes at 30 Jun 2018
All schemes					
Underlying position (without the effect of IFRIC 14)					
Surplus (deficit)	692	(15)	267	27	971
Less: amount attributable to PAC with-profits fund	(473)	4	(144)	(10)	(623)
Shareholders' share:					
Gross of tax surplus (deficit)	219	(11)	123	17	348
Related tax	(42)	2	(24)	(3)	(67)
Net of shareholders' tax	177	(9)	99	14	281
Application of IFRIC 14 for the derecognition of PSPS surplus					
Derecognition of surplus	(485)	(6)	(166)	–	(657)
Less: amount attributable to PAC with-profits fund	363	4	117	–	484
Shareholders' share:					
Gross of tax	(122)	(2)	(49)	–	(173)
Related tax	23	–	10	–	33
Net of shareholders' tax	(99)	(2)	(39)	–	(140)
With the effect of IFRIC 14					
Surplus (deficit)	207	(21)	101	27	314
Less: amount attributable to PAC with-profits fund	(110)	8	(27)	(10)	(139)
Shareholders' share:					
Gross of tax surplus (deficit)	97	(13)	74	17	175
Related tax	(19)	2	(14)	(3)	(34)
Net of shareholders' tax	78	(11)	60	14	141

C9 Share capital, share premium and own shares

Issued shares of 5p each fully paid:	30 Jun 2018 Number of ordinary shares	Share capital £m	Share premium £m	30 Jun 2017 Number of ordinary shares	Share capital £m	Share premium £m	31 Dec 2017 Number of ordinary shares	Share capital £m	Share premium £m
At 1 January	2,587,175,445	129	1,948	2,581,061,573	129	1,927	2,581,061,573	129	1,927
Shares issued under share-based schemes	4,697,422	–	6	4,791,845	–	10	6,113,872	–	21
At end of period	2,591,872,867	129	1,954	2,585,853,418	129	1,937	2,587,175,445	129	1,948

Amounts recorded in share capital represent the nominal value of the shares issued. The difference between the proceeds received on issue of shares, net of issue costs, and the nominal value of shares issued is credited to the share premium account.

At 30 June 2018, there were options outstanding under Save As You Earn schemes to subscribe for shares as follows:

	Number of shares to subscribe for	Share price range from	to	Exercisable by year
30 June 2018	5,851,810	629p	1,455p	2023
30 June 2017	6,280,110	466p	1,155p	2022
31 December 2017	6,448,853	629p	1,455p	2023

Transactions by Prudential plc and its subsidiaries in Prudential plc shares

The Group buys and sells Prudential plc shares ('own shares') either in relation to its employee share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. The cost of own shares of £197 million at 30 June 2018 (30 June 2017: £257 million; 31 December 2017: £250 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans. At 30 June 2018, 9.7 million (30 June 2017: 11.5 million; 31 December 2017: 11.4 million) Prudential plc shares with a market value of £168 million (30 June 2017: £204 million; 31 December 2017: £218 million) were held in such trusts, all of which are for employee incentive plans. The maximum number of shares held during the period was 14.9 million which was in March 2018.

The Company purchased the following number of shares in respect of employee incentive plans:

	Number of shares purchased (in millions)	Cost £m
Half year 2018	1.8	32.2
Half year 2017	3.3	56.0
Full year 2017	3.9	66.1

The Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 30 June 2018 was 4.8 million (30 June 2017: 6.7 million; 31 December 2017: 6.4 million) and the cost of acquiring these shares of £46 million (30 June 2017: £75 million; 31 December 2017: £71 million) is included in the cost of own shares. The market value of these shares as at 30 June 2018 was £84 million (30 June 2017: £120 million; 31 December 2017: £121 million). During 2018, these funds made disposals of 1,556,423 Prudential shares (30 June 2017: additions of 678,131; 31 December 2017: additions of 372,029) for a net decrease of £24.4 million to book cost (30 June 2017: net increase of £13.8 million; 31 December 2017: net increase of £9.4 million).

All share transactions were made on an exchange other than the Stock Exchange of Hong Kong.

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during half year 2018 or 2017.

D Other notes

D1 Held for sale and corporate transactions

'(Loss) gain on disposal of businesses and corporate transactions' comprises the following:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Loss arising on reinsurance of part of UK shareholder-backed annuity portfolio note (i)	(513)	–	–
Other transactions note (ii)	(57)	61	223
(Loss) gain on disposal of businesses and corporate transactions	(570)	61	223

Notes

(i) Loss arising on reinsurance of part of UK shareholder-backed annuity portfolio
In March 2018, M&G Prudential announced the sale of £12.0 billion (as at 31 December 2017) of its shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential has reinsured the liabilities to Rothesay Life, which is expected to be followed by a court-sanctioned legal transfer, under Part VII of the Financial Services and Markets Act 2000 (Part VII), of the policies underlying the liabilities to Rothesay Life by the end of 2019.
The reinsurance agreement became effective on 14 March 2018. A reinsurance premium of £12,130 million has been recognised within 'Outward reinsurance premiums' in the income statement and settled via the transfer of financial investments and other assets to Rothesay Life. After allowing for the recognition of a reinsurance asset and associated changes to policyholder liabilities, a loss of £(513) million was recognised in the first half of 2018 in relation to the transaction.
The reinsured annuity business that will be transferred once the Part VII process is complete has been classified as held for sale in these consolidated financial statements in accordance with IFRS 5, 'Non-current assets held for sale and discontinued operations'. Following the reinsurance transaction the carrying value, and fair value less costs to sell, of the business to be transferred is £nil.
The assets and liabilities of the M&G Prudential annuity business classified as held for sale on the statement of financial position as at 30 June 2018 are as follows:

	2018 £m
	Half year
Assets	
Reinsurers' share of insurance contract liabilities	11,928
Other debtors	49
Assets held for sale	11,977
Liabilities	
Policyholder liabilities	11,928
Accruals, deferred income and other liabilities	49
Liabilities held for sale	11,977

(ii) Other transactions
In the first half of 2017, the Group completed the disposal of its Korea life business, realising a gain of £61 million in half year 2017 principally as a result of recycling from other comprehensive income cumulative exchange gains of this business.
On 15 August 2017, the Group, through its subsidiary National Planning Holdings, Inc. ('NPH') sold its US independent broker-dealer network to LPL Financial LLC which realised a gain of £162 million in the second half of 2017. Including the £61 million for Korea referred to above, this gave a total gain on disposal of other businesses and corporate transactions in full year 2017 of £223 million.
Other transaction costs of £57 million incurred by the Group in the first half of 2018 primarily relate to additional costs incurred in exiting from the NPH broker-dealer business and costs related to preparation for the previously announced intention to demerge M&G Prudential from Prudential plc, resulting in two separately listed entities.

D2 Contingencies and related obligations

In addition to the matters set out in note B3(b) in relation to the Financial Conduct Authority review of past annuity sales, the Group is involved in various litigation and regulatory issues. These may from time to time include class actions involving Jackson. While the outcome of such litigation and regulatory issues cannot be predicted with certainty, Prudential believes that the ultimate outcome will not have a material adverse effect on the Group's financial condition, results of operations or cash flows.

There have been no material changes to the Group's contingencies and related obligations in the six-month period ended 30 June 2018.

D3 Post balance sheet events

First interim ordinary dividend

The 2018 first interim ordinary dividend approved by the Board of Directors after 30 June 2018 is as described in note B6.

On 25 July 2018 the Group announced that Eastspring had reached an agreement to initially acquire 65 per cent of TMB Asset Management Co., Ltd., an asset management company in Thailand, from TMB Bank Public Company Limited ('TMB'). Eastspring has an option to increase its ownership to 100 per cent in the future. As part of this acquisition, Eastspring has also entered into a distribution agreement with TMB to provide investment solutions to their customers. The completion of the transaction is subject to local regulatory approval.

In August 2018 the Group announced the extension of the geographical scope of its bancassurance partnership with Standard Chartered Bank to include Ghana. Under the partnership, a range of Prudential Ghana's life insurance products will be made available to clients through Standard Chartered's branch network.

In August 2018 the Group announced that it had entered into an agreement with the UK-based healthcare technology and services company Babylon Health to provide customers in Asia access to a suite of health services that utilise artificial intelligence technology.

D4 Related party transactions

There were no transactions with related parties during the six months ended 30 June 2018 which have had a material effect on the results or financial position of the Group.

The nature of the related party transactions of the Group has not changed from those described in the Group's consolidated financial statements for the year ended 31 December 2017.

Statement of Directors' responsibilities

The Directors (who are listed below) are responsible for preparing the Half Year Financial Report in accordance with applicable law and regulations.

Accordingly, the Directors confirm that to the best of their knowledge:

— the condensed consolidated financial statements have been prepared in accordance with IAS 34, 'Interim Financial Reporting', as adopted by the European Union;
— the Half Year Financial Report includes a fair review of information required by:

(a) DTR 4.2.7R of the Disclosure Guidance and Transparency Rules, being an indication of important events that have occurred during the six months ended 30 June 2018, and their impact on the condensed consolidated financial statements, and a description of the principal risks and uncertainties for the remaining six months of the year; and

(b) DTR 4.2.8R of the Disclosure Guidance and Transparency Rules, being related party transactions that have taken place during the six months ended 30 June 2018 and that have materially affected the financial position or the performance of the Group during the period and changes in the related party transactions described in the Group's consolidated financial statements for the year ended 31 December 2017.

Prudential plc Board of Directors

Chairman
Paul Manduca

Executive Directors
Michael Wells
Mark FitzPatrick CA
James Turner FCA
John Foley
Nicolaos Nicandrou ACA
Anne Richards
Barry Stowe

Independent Non-executive Directors
The Hon. Philip Remnant CBE FCA
Sir Howard Davies
David Law ACA
Kaikhushru Nargolwala FCA
Anthony Nightingale CMG SBS JP
Alice Schroeder
Lord Turner FRS
Thomas Watjen

7 August 2018

Independent review report to Prudential plc

Conclusion

We have been engaged by the Company to review the International Financial Reporting Standards (IFRS) basis financial information in the Half Year Financial Report for the six months ended 30 June 2018 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Statement of Changes in Equity, the Condensed Consolidated Statement of Financial Position, the Condensed Consolidated Statement of Cash Flows and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the IFRS basis financial information in the Half Year Financial Report for the six months ended 30 June 2018 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted by the European Union ('EU') and the Disclosure Guidance and Transparency Rules ('the DTR') of the UK's Financial Conduct Authority ('the UK FCA').

We have also been engaged by the Company to review the European Embedded Value (EEV) basis supplementary financial information for the six months ended 30 June 2018 which comprises the Post-tax Operating Profit Based on Longer-Term Investment Returns, the Post-tax Summarised Consolidated Income Statement, the Movement in Shareholders' Equity, the Summary Statement of Financial Position and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the EEV basis supplementary financial information for the six months ended 30 June 2018 is not prepared, in all material respects, in accordance with the European Embedded Value Principles dated April 2016 by the European Insurance CFO Forum ('the EEV Principles'), using the methodology and assumptions set out in the Notes to the EEV basis supplementary financial information.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. We read the other information contained in the Half Year Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the IFRS basis financial information or the EEV basis supplementary financial information.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Directors' responsibilities

The Half Year Financial Report, including the IFRS basis financial information contained therein, is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Half Year Financial Report in accordance with the DTR of the UK FCA. The Directors have accepted responsibility for preparing the EEV basis supplementary financial information in accordance with the EEV Principles and for determining the methodology and assumptions used in the application of those principles.

The annual IFRS basis financial statements of the Group are prepared in accordance with IFRSs as adopted by the EU. The Directors are responsible for preparing the IFRS basis financial information included in the Half Year Financial Report in accordance with IAS 34 as adopted by the EU.

The EEV basis supplementary financial information has been prepared in accordance with the EEV Principles using the methodology and assumptions set out in the Notes to the EEV basis supplementary financial information. The EEV basis supplementary financial information should be read in conjunction with the IFRS basis financial information.

Our responsibility

Our responsibility is to express to the Company a conclusion on the IFRS basis financial information in the Half Year Financial Report and the EEV basis supplementary financial information based on our reviews.

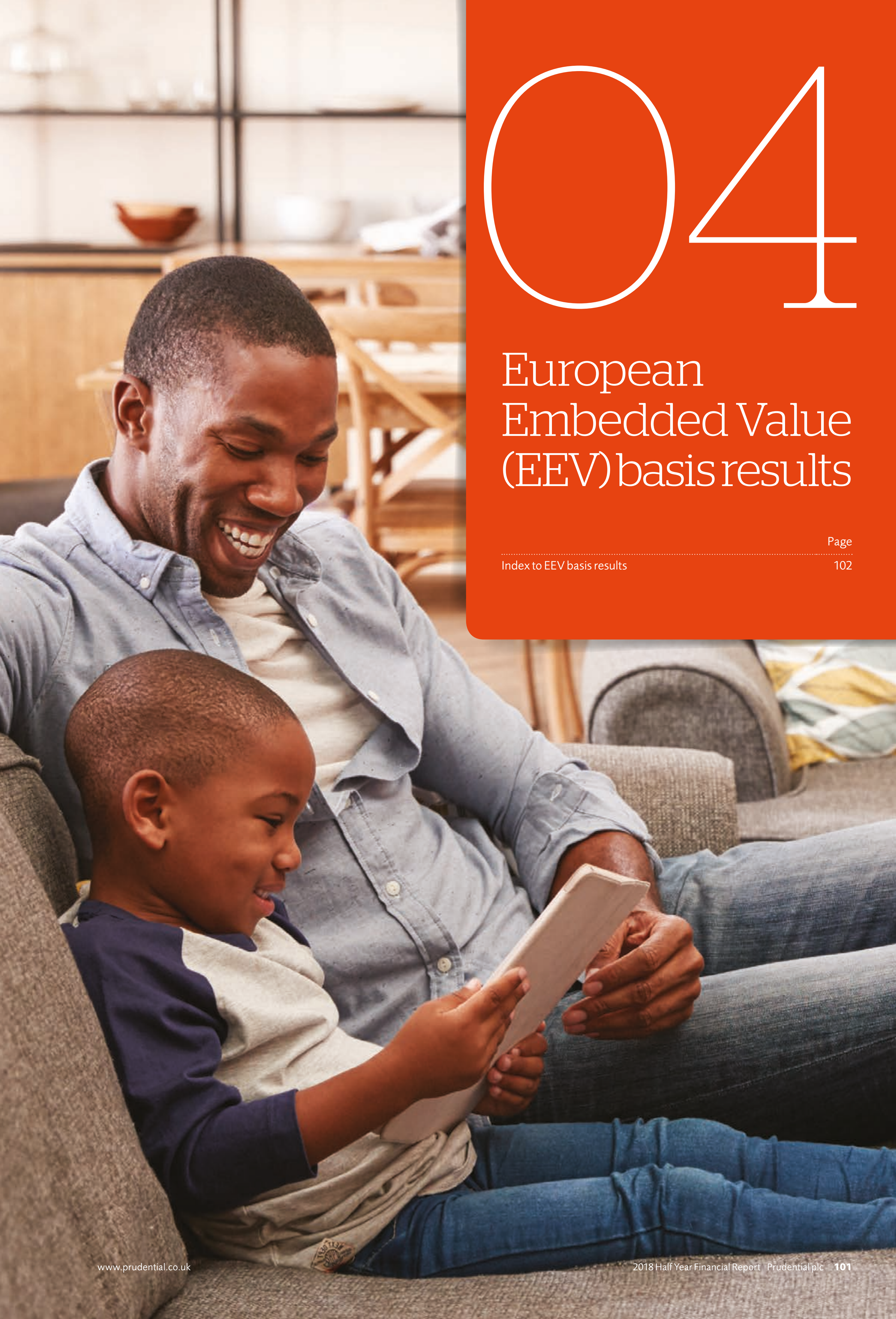
The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the DTR of the UK FCA and also to provide a review conclusion to the Company on the EEV basis supplementary financial information. Our review of the IFRS basis financial information has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. Our review of the EEV basis supplementary financial information has been undertaken so that we might state to the Company those matters we have been engaged to state in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Philip Smart

Philip Smart
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
London
E14 5GL

7 August 2018



04

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Description of EEV basis reporting

In broad terms, IFRS profit for long-term business reflects the aggregate of results on a traditional accounting basis. By contrast, EEV is a way of reporting the value of the life insurance business.

The EEV basis results have been prepared in accordance with the EEV Principles dated April 2016, issued by the European Insurance CFO Forum. The EEV Principles provide consistent definitions, a framework for setting actuarial assumptions, and an approach to the underlying methodology and disclosures.

Results prepared under the EEV Principles capture the discounted value of future profits expected to arise from the current book of long-term business. The results are prepared by projecting cash flows, by product, using best estimate assumptions for all relevant factors. Furthermore, in determining these expected profits, full allowance is made for the risks attached to their emergence and the associated cost of capital, taking into account recent experience in assessing likely future persistency, mortality, morbidity and expenses. Further details are explained in notes 12 and 13.

European Embedded Value (EEV) basis results

Post-tax operating profit based on longer-term investment returns

	Note	2018 £m Half year	2017 £m Half year notes (iii)(iv)	2017 £m Full year note (iii)
Asia operations				
New business	3	1,122	1,092	2,368
Business in force	4	631	549	1,337
Long-term business		1,753	1,641	3,705
Asset management		77	73	155
Total		1,830	1,714	3,860
US operations				
New business	3	466	436	906
Business in force	4	539	452	1,237
Long-term business		1,005	888	2,143
Asset management		(2)	(4)	7
Total		1,003	884	2,150
UK and Europe operations				
New business	3	179	161	342
Business in force	4	592	304	673
Long-term business		771	465	1,015
General insurance commission		15	14	13
Total insurance operations		786	479	1,028
Asset management		221	201	403
Total		1,007	680	1,431
Other income and expenditure note (i)		(340)	(381)	(746)
Restructuring costs note (ii)		(57)	(27)	(97)
Operating profit based on longer-term investment returns		3,443	2,870	6,598
Analysed as profit (loss) from:				
New business	3	1,767	1,689	3,616
Business in force	4	1,762	1,305	3,247
Long-term business		3,529	2,994	6,863
Asset management and general insurance commission		311	284	578
Other results		(397)	(408)	(843)
		3,443	2,870	6,598

Notes

(i) EEV basis other income and expenditure represents the post-tax IFRS basis results for other operations (including Group and Asia Regional Head Office, holding company borrowings, Africa operations and Prudential Capital) less the unwind of expected margins on the internal management of the assets of the covered business (as explained in note 12(a)(vii)).

(ii) Restructuring costs comprise the post-tax charge recognised on an IFRS basis and the additional amount recognised on an EEV basis for the shareholders' share incurred by the PAC with-profits fund. The costs are primarily incurred in the UK, Europe and Asia and represent the cost of business transformation and integration.

(iii) The comparative results have been prepared using previously reported average exchange rates for the period.

(iv) The half year 2017 comparative results have been re-presented from those previously published following the reassessment of the Group's operating segments as described in note B1.3 of the IFRS financial statements. This approach has been adopted consistently throughout this supplementary information.

Post-tax summarised consolidated income statement

		2018 £m	2017 £m	
	Note	Half year	Half year	Full year
Asia operations		1,830	1,714	3,860
US operations		1,003	884	2,150
UK and Europe operations		1,007	680	1,431
Other income and expenditure		(340)	(381)	(746)
Restructuring costs		(57)	(27)	(97)
Operating profit based on longer-term investment returns		3,443	2,870	6,598
Short-term fluctuations in investment returns	5	(1,234)	739	2,111
Effect of changes in economic assumptions	6	592	(50)	(102)
Mark to market value movements on core structural borrowings		579	(262)	(326)
Impact of US tax reform	16	–	–	390
(Loss) profit attaching to corporate transactions	15	(412)	–	80
Total non-operating (loss) profit		(475)	427	2,153
Profit for the period		2,968	3,297	8,751
Attributable to:				
Equity holders of the Company		2,967	3,297	8,750
Non-controlling interests		1	–	1
		2,968	3,297	8,751

Basic earnings per share

	2018	2017	
	Half year	Half year	Full year
Based on post-tax operating profit including longer-term investment returns after non-controlling interests (in pence)	133.8p	111.9p	257.0p
Based on post-tax profit attributable to equity holders of the Company (in pence)	115.3p	128.5p	340.9p
Weighted average number of shares (millions)	2,573	2,565	2,567

Movement in shareholders' equity

	Note	2018 £m Half year	2017 £m Half year	2017 £m Full year
Profit for the period attributable to equity holders of the Company		**2,967**	3,297	8,750
Items taken directly to equity:				
Exchange movements on foreign operations and net investment hedges		**523**	(1,045)	(2,045)
External dividends		**(840)**	(786)	(1,159)
Mark to market value movements on Jackson assets backing surplus and required capital		**(32)**	31	40
Other reserve movements		**127**	55	144
Net increase in shareholders' equity	8	**2,745**	1,552	5,730
Shareholders' equity at beginning of period		**44,698**	38,968	38,968
Shareholders' equity at end of period	8	**47,443**	40,520	44,698

	30 Jun 2018 £m			30 Jun 2017 £m			31 Dec 2017 £m		
Comprising:	Long-term business operations	Asset management and other operations	Group total	Long-term business operations	Asset management and other operations	Group total	Long-term business operations	Asset management and other operations	Group total
Asia operations	**22,194**	**414**	**22,608**	19,851	382	20,233	21,191	401	21,592
US operations	**14,096**	**204**	**14,300**	11,370	202	11,572	13,257	235	13,492
UK and Europe operations	**11,614**	**2,029**	**13,643**	10,878	1,882	12,760	11,713	1,914	13,627
Other operations	**–**	**(3,108)**	**(3,108)**	–	(4,045)	(4,045)	–	(4,013)	(4,013)
Shareholders' equity at end of period	**47,904**	**(461)**	**47,443**	42,099	(1,579)	40,520	46,161	(1,463)	44,698
Representing:									
Net assets attributable to equity holders of the Company excluding acquired goodwill, holding company net borrowings and non-controlling interests	**47,659**	**2,122**	**49,781**	41,854	1,292	43,146	45,917	1,562	47,479
Acquired goodwill	**245**	**1,214**	**1,459**	245	1,230	1,475	244	1,214	1,458
Holding company net borrowings at market value [note 7]	**–**	**(3,797)**	**(3,797)**	–	(4,101)	(4,101)	–	(4,239)	(4,239)
	47,904	**(461)**	**47,443**	42,099	(1,579)	40,520	46,161	(1,463)	44,698

Summary statement of financial position

	Note	2018 £m 30 Jun	2017 £m 30 Jun	2017 £m 31 Dec
Total assets less liabilities, before deduction of insurance funds		**429,035**	419,811	434,615
Less insurance funds:*				
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds		**(413,145)**	(404,361)	(418,521)
Less shareholders' accrued interest in the long-term business	8	**31,561**	25,071	28,611
		(381,584)	(379,290)	(389,910)
Less non-controlling interests		**(8)**	(1)	(7)
Total net assets attributable to equity holders of the Company	8	**47,443**	40,520	44,698
Share capital		**129**	129	129
Share premium		**1,954**	1,937	1,948
IFRS basis shareholders' reserves		**13,799**	13,383	14,010
Total IFRS basis shareholders' equity	8	**15,882**	15,449	16,087
Additional EEV basis retained profit	8	**31,561**	25,071	28,611
Total EEV basis shareholders' equity	8	**47,443**	40,520	44,698

* Including liabilities in respect of insurance products classified as investment contracts under IFRS 4.

Net asset value per share

	2018 30 Jun	2017 30 Jun	2017 31 Dec
Based on EEV basis shareholders' equity of £47,443 million (30 Jun 2017: £40,520 million, 31 Dec 2017: £44,698 million) (in pence)	**1,830p**	1,567p	1,728p
Number of issued shares at period end (millions)	**2,592**	2,586	2,587
Annualised return on embedded value*	**15%**	15%	17%

* Annualised return on embedded value is based on EEV post-tax operating profit after non-controlling interests, as a percentage of opening EEV basis shareholders' equity. Half year profits are annualised by multiplying by two.

Notes on the EEV basis results

1 Basis of preparation

The EEV basis results have been prepared in accordance with the EEV Principles dated April 2016, issued by the European Insurance CFO Forum. Where appropriate, the EEV basis results include the effects of adoption of EU-endorsed IFRS.

The Directors are responsible for the preparation of the supplementary information in accordance with the EEV Principles. The EEV basis results for half year 2018 and half year 2017 are unaudited. The full year 2017 results have been derived from the EEV basis results supplement to the Company's statutory accounts for 2017. The supplement included an unqualified audit report from the auditors.

A detailed description of the EEV methodology and accounting presentation is provided in note 12.

2 Results analysis by business area

The half year 2017 comparative results are shown below on both actual exchange rates (AER) and constant exchange rates (CER) bases. The half year 2017 CER comparative results are translated at half year 2018 average exchange rates.

Annual premium equivalents (APE) note 14

		Half year 2018 £m	Half year 2017 £m		% change	
	Note		AER	CER	AER	CER
Asia		1,736	1,943	1,811	(11)%	(4)%
US		816	960	879	(15)%	(7)%
UK and Europe		770	721	721	7%	7%
Group total	3	3,322	3,624	3,411	(8)%	(3)%

Post-tax operating profit

		Half year 2018 £m	Half year 2017 £m		% change	
	Note		AER	CER	AER	CER
Asia operations						
New business	3	1,122	1,092	1,009	3%	11%
Business in force	4	631	549	510	15%	24%
Long-term business		1,753	1,641	1,519	7%	15%
Asset management		77	73	68	5%	13%
Total		1,830	1,714	1,587	7%	15%
US operations						
New business	3	466	436	399	7%	17%
Business in force	4	539	452	413	19%	31%
Long-term business		1,005	888	812	13%	24%
Asset management		(2)	(4)	(4)	50%	50%
Total		1,003	884	808	13%	24%
UK and Europe operations						
New business	3	179	161	161	11%	11%
Business in force	4	592	304	304	95%	95%
Long-term business		771	465	465	66%	66%
General insurance commission		15	14	14	7%	7%
Total insurance operations		786	479	479	64%	64%
Asset management		221	201	201	10%	10%
Total		1,007	680	680	48%	48%
Other income and expenditure		(340)	(381)	(375)	11%	9%
Restructuring costs		(57)	(27)	(27)	(111)%	(111)%
Operating profit based on longer-term investment returns		3,443	2,870	2,673	20%	29%

2 Results analysis by business area continued

Post-tax operating profit continued

	Note	Half year 2018 £m	Half year 2017 £m		% change	
			AER	CER	AER	CER
Analysed as profit (loss) from:						
New business	3	1,767	1,689	1,569	5%	13%
Business in force	4	1,762	1,305	1,227	35%	44%
Total long-term business		3,529	2,994	2,796	18%	26%
Asset management and general insurance commission		311	284	279	10%	11%
Other results		(397)	(408)	(402)	3%	1%
		3,443	2,870	2,673	20%	29%

Post-tax profit

	Note	Half year 2018 £m	Half year 2017 £m		% change	
			AER	CER	AER	CER
Operating profit based on longer-term investment returns		3,443	2,870	2,673	20%	29%
Short-term fluctuations in investment returns	5	(1,234)	739	707		
Effect of changes in economic assumptions	6	592	(50)	(38)		
Mark to market value movements on core structural borrowings		579	(262)	(262)		
Loss attaching to corporate transactions	15	(412)	–	–		
Total non-operating (loss) profit		(475)	427	407	(211)%	(217)%
Profit for the period		2,968	3,297	3,080	(10)%	(4)%

Basic earnings per share

	Half year 2018	Half year 2017		% change	
		AER	CER	AER	CER
Based on post-tax operating profit including longer-term investment returns after non-controlling interests (in pence)	133.8p	111.9p	104.2p	20%	28%
Based on post-tax profit attributable to equity holders of the Company (in pence)	115.3p	128.5p	120.1p	(10)%	(4)%

3 Analysis of new business contribution

(i) Group summary for long-term business operations

	Half year 2018				
	Annual premium equivalents (APE) £m note 14	Present value of new business premiums (PVNBP) £m note 14	New business contribution £m note	New business margin APE %	New business margin PVNBP %
Asia note (ii)	1,736	9,132	1,122	65	12.3
US	816	8,163	466	57	5.7
UK and Europe	770	7,088	179	23	2.5
Total	3,322	24,383	1,767	53	7.2

	Half year 2017				
	Annual premium equivalents (APE) £m note 14	Present value of new business premiums (PVNBP) £m note 14	New business contribution £m	New business margin APE %	New business margin PVNBP %
Asia note (ii)	1,943	10,095	1,092	56	10.8
US	960	9,602	436	45	4.5
UK and Europe	721	6,616	161	22	2.4
Total	3,624	26,313	1,689	47	6.4

	Full year 2017				
	Annual premium equivalents (APE) £m note 14	Present value of new business premiums (PVNBP) £m note 14	New business contribution £m	New business margin APE %	New business margin PVNBP %
Asia note (ii)	3,805	20,405	2,368	62	11.6
US	1,662	16,622	906	55	5.5
UK and Europe	1,491	13,784	342	23	2.5
Total	6,958	50,811	3,616	52	7.1

Note
After allowing for foreign exchange effects of £(120) million, the new business contribution increased by £198 million on a CER basis. This increase is driven by the beneficial effect of pricing, product mix and other actions of £186 million and the positive effect of changes in long-term interest rates and other economic assumptions (£53 million), partially offset by lower sales volumes (a negative impact of £(41) million). The £186 million impact of pricing, product mix and other actions reflects the beneficial impact of our strategic emphasis on increasing sales from health and protection business in Asia, together with a positive £46 million effect in the US for the impact of US tax reform that arose in the second half of 2017 (see note 16).

(ii) Asia new business contribution by business unit

	2018 £m	2017 £m		
	Half year	AER Half year	CER Half year	AER Full year
China	76	67	66	133
Hong Kong	731	706	641	1,535
Indonesia	59	88	78	174
Taiwan	21	27	26	57
Other	235	204	198	469
Total Asia	1,122	1,092	1,009	2,368

4 Operating profit from business in force

(i) Group summary for long-term business operations

	Half year 2018 £m			
	Asia operations note (ii)	US operations note (iii)	UK and Europe operations note (iv)	Total note
Unwind of discount and other expected returns	601	433	234	1,268
Effect of changes in operating assumptions	–	–	–	–
Experience variances and other items	30	106	358	494
Group total	631	539	592	1,762

	Half year 2017 £m			
	Asia operations note (ii)	US operations note (iii)	UK and Europe operations note (iv)	Total
Unwind of discount and other expected returns	499	312	232	1,043
Effect of changes in operating assumptions	6	–	–	6
Experience variances and other items	44	140	72	256
Group total	549	452	304	1,305

	Full year 2017 £m			
	Asia operations note (ii)	US operations note (iii)	UK and Europe operations note (iv)	Total
Unwind of discount and other expected returns	1,007	694	465	2,166
Effect of changes in operating assumptions	241	196	195	632
Experience variances and other items	89	347	13	449
Group total	1,337	1,237	673	3,247

Note

The movement in operating profit from business in force of £457 million from £1,305 million for half year 2017 to £1,762 million for half year 2018 comprises:

	£m
Movement in unwind of discount and other expected returns:	
Effects of changes in:	
Growth in opening value	207
Interest rates and other economic assumptions	77
Foreign exchange	(59)
	225
Movement in effect of changes in operating assumptions, experience variances and other items	232
Net movement in operating profit from business in force	457

(ii) Asia

	2018 £m	2017 £m	
	Half year	Half year	Full year
Unwind of discount and other expected returns note (a)	601	499	1,007
Effect of changes in operating assumptions	–	6	241
Experience variances and other items note (b)	30	44	89
Total	631	549	1,337

Notes

(a) The £102 million increase in unwind of discount and other expected returns from £499 million in half year 2017 to £601 million for half year 2018 is primarily driven by growth in the in-force book and a positive £40 million impact from increases in interest rates and other economic assumption changes offset by the effect of foreign exchange movements (£(33) million).

(b) The £30 million effect of experience variances and other items in half year 2018 is driven by positive mortality and morbidity experiences in a number of business units, together with positive persistency variances from participating and health and protection products, partially offset by unfavourable persistency variances on unit-linked products. Experience variances also include expense overruns where these are expected to be short-lived, including businesses that are growing rapidly or are sub-scale.

(iii) US

	2018 £m	2017 £m	
	Half year	Half year	Full year
Unwind of discount and other expected returns[note (a)]	433	312	694
Effect of changes in operating assumptions	–	–	196
Experience variances and other items:			
Spread experience variance	26	42	71
Amortisation of interest-related realised gains and losses	45	47	91
Other[note (b)]	35	51	185
	106	140	347
Total	539	452	1,237

Notes

(a) The £121 million increase in unwind of discount and other expected returns from £312 million in half year 2017 to £433 million for half year 2018 reflects growth in the in-force book (after allowing for the benefit of US tax reform) and a £27 million benefit from a 55 basis point increase in the US 10-year treasury yield since 30 June 2017, offset by a £(26) million adverse effect for foreign exchange movements.

(b) Other experience variances of £35 million in half year 2018 include the effects of positive persistency experience in the period.

(iv) UK and Europe

	2018 £m	2017 £m	
	Half year	Half year	Full year
Unwind of discount and other expected returns[note (a)]	234	232	465
Change in longevity assumption basis	–	–	195
Other items[note (b)]	358	72	13
Total	592	304	673

Notes

(a) Unwind of discount and other expected returns is broadly consistent with half year 2017.

(b) Other items comprise the following:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Longevity reinsurance	–	(6)	(6)
Impact of specific management actions to improve solvency position	141	65	127
Provision for cost of undertaking past non-advised annuity sales review and related redress[note (c)]	–	–	(187)
Insurance recoveries in respect of above costs[note (c)]	138	–	–
Other	79	13	79
	358	72	13

(c) In response to the findings of the FCA's Thematic Review of Annuities Sales Practices, the UK business has agreed to review all internally vesting annuities sold without advice after 1 July 2008. A gross provision before any costs incurred of £(332) million (post-tax) had been established at 31 December 2017, of which £(187) million was charged in full year 2017. Following a reassessment of the provision held, no further amount has been provided in the first half of 2018. The ultimate amount that will be expended remains uncertain. During the first half of 2018, the Group agreed with its professional indemnity insurers that they will meet £166 million of the Group's claims costs, which will be paid as the Group incurs costs/redress. This benefit has been recognised on the Group balance sheet at 30 June 2018 and a post-tax credit of £138 million is recognised in the EEV operating profit.

5 Short-term fluctuations in investment returns

Short-term fluctuations in investment returns included in profit for the period arise as follows:

(i) Group summary

	2018 £m	2017 £m	
	Half year	Half year	Full year
Asia operations[note (ii)]	(515)	544	887
US operations[note (iii)]	(528)	(126)	582
UK and Europe operations[note (iv)]	(269)	242	621
Other operations[note (v)]	78	79	21
Total	(1,234)	739	2,111

(ii) Asia operations

The short-term fluctuations in investment returns for Asia operations comprise:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Hong Kong	(212)	371	531
Singapore	(126)	85	126
Other	(177)	88	230
Total	(515)	544	887

Note

For half year 2018, the charge of £(515) million mainly reflects losses on bonds arising from increases in interest rates, together with lower than assumed returns on equities backing with-profits business in Hong Kong and Singapore and unit-linked businesses in Indonesia, Singapore and Malaysia.

(iii) US operations

The short-term fluctuations in investment returns for US operations comprise:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Investment return related experience on fixed income securities[note (a)]	15	–	(46)
Investment return related impact due to changed expectation of profits on in-force variable annuity business in future periods based on current period separate account return, net of related hedging activity and other items[note (b)]	(543)	(126)	628
Total	(528)	(126)	582

Notes

(a) The net result relating to fixed income securities reflects a number of offsetting items as follows:
- the impact on portfolio yields of changes in the asset portfolio in the period;
- the difference between actual realised gains and losses and the amortisation of interest-related realised gains and losses that is recorded within operating profit; and
- credit experience (versus the longer-term assumption).

(b) This item reflects the net impact of:
- changes in projected future fees and future benefit costs arising from the difference between the actual growth in separate account asset values of 2.2 per cent and that assumed of 3.2 per cent for the period (half year 2017: actual growth of 7.9 per cent compared to assumed growth of 2.9 per cent; full year 2017: actual growth of 17.5 per cent compared to assumed growth of 5.9 per cent); and
- related hedging activity arising from realised and unrealised gains and losses on equity-related hedges and interest rate options, and other items.

(iv) UK and Europe operations

The short-term fluctuations in investment returns for UK and Europe operations comprise:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Insurance operations:			
Shareholder-backed annuity business	(17)	204	387
With-profits and other	(247)	11	229
Asset management	(5)	27	5
Total	(269)	242	621

Note

The £(269) million fluctuation in half year 2018 primarily represents the impact of achieving a 0.1 per cent pre-tax return on the with-profits fund (including unallocated surplus) compared to the assumed rate of return of 2.6 per cent for the period (half year 2017: achieved return of 4.3 per cent compared to assumed rate of 2.6 per cent; full year 2017: achieved return of 9 per cent compared to assumed rate of 5 per cent), partially offset by the effect of a partial hedge of future shareholder transfers expected to emerge from the UK's with-profits sub-fund entered into to protect future shareholder with-profit transfers from movements in the UK equity market.

(v) Other operations

Short-term fluctuations in investment returns of positive £78 million include unrealised value movements on financial instruments held outside of the main life operations.

6 Effect of changes in economic assumptions

The effects of changes in economic assumptions for in-force business included in the profit for the period arise as follows:

(i) Group summary for long-term business operations

	2018 £m	2017 £m	
	Half year	Half year	Full year
Asia note (ii)	243	55	(95)
US note (iii)	367	(159)	(136)
UK and Europe note (iv)	(18)	54	129
Total	592	(50)	(102)

(ii) Asia

The effect of changes in economic assumptions for Asia comprises:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Hong Kong	400	(72)	(321)
Indonesia	(89)	67	81
Malaysia	(41)	(20)	59
Singapore	(32)	59	131
Taiwan	16	(16)	(12)
Other	(11)	37	(33)
Total	243	55	(95)

Note

The positive effect in half year 2018 of £243 million largely arises from movements in long-term interest rates, resulting in higher assumed fund earned rates in Hong Kong and Taiwan, partially offset by the impact of valuing future profits for health and protection business at higher discount rates in Indonesia, Malaysia and Singapore (see note 13(i)).

(iii) US

The effect of changes in economic assumptions for US comprises:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Variable annuity business	497	(194)	(101)
Fixed annuity and other general account business	(130)	35	(35)
Total	367	(159)	(136)

Note

For half year 2018, the credit of £367 million mainly reflects the increase in the assumed separate account return and reinvestment rates, following the 46 basis points increase in the US 10-year treasury yield since 31 December 2017, resulting in higher projected fee income and a decrease in projected benefit costs for variable annuity business. For fixed annuity and other general account business, the impact reflects the effect on the present value of future projected spread income from discounting at a higher risk discount rate as a result of the increase in interest rates. In June 2018, the National Association of Insurance Commissioners (NAIC) formally approved changes to RBC capital factors that reflect the December 2017 US tax reform. Consequently, the effect of changes in economic assumptions for half year 2018 of £367 million also includes a negative £(22) million impact resulting from these changes.

(iv) UK and Europe

The effect of changes in economic assumptions for UK and Europe comprises:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Shareholder-backed annuity business	6	–	28
With-profits and other business	(24)	54	101
Total	(18)	54	129

Note

The charge of £(18) million includes the impact of the movement in expected long-term rates of investment return and risk discount rates as shown in note 13(iii). In addition, the effect of changes in economic assumptions for with-profits and other business of £(24) million includes a £(78) million charge for the effect of lower fund earned rates on equities and property as a result of the change in UK indexation of capital gains rules effective from 1 January 2018.

7 Net core structural borrowings of shareholder-financed operations

	2018 £m			2017 £m					
	30 Jun			30 Jun			31 Dec		
	IFRS basis	Mark to market value adjustment	EEV basis at market value	IFRS basis	Mark to market value adjustment	EEV basis at market value	IFRS basis	Mark to market value adjustment	EEV basis at market value
Holding company (including central finance subsidiaries) cash and short-term investments	(2,210)	–	(2,210)	(2,657)	–	(2,657)	(2,264)	–	(2,264)
Central funds									
Subordinated debt	5,354	(39)	5,315	5,598	443	6,041	5,272	515	5,787
Senior debt	549	143	692	549	168	717	549	167	716
	5,903	104	6,007	6,147	611	6,758	5,821	682	6,503
Holding company net borrowings	3,693	104	3,797	3,490	611	4,101	3,557	682	4,239
Prudential Capital bank loan	275	–	275	275	–	275	275	–	275
Jackson Surplus Notes	189	47	236	192	62	254	184	61	245
Group total	4,157	151	4,308	3,957	673	4,630	4,016	743	4,759

Note
The movement in IFRS basis core structural borrowings from 31 December 2017 to 30 June 2018 includes foreign exchange effects for US dollar denominated core structural borrowings.

8 Reconciliation of movement in shareholders' equity

	Half year 2018 £m				
	Asia operations note (i)	**US operations**	**UK and Europe operations**	**Other operations** note (i)	**Group total** note (iv)
Operating profit (based on longer-term investment returns)					
Long-term business:					
New business note 3	1,122	466	179	–	1,767
Business in force note 4	631	539	592	–	1,762
	1,753	1,005	771	–	3,529
Asset management and general insurance commission	77	(2)	236	–	311
Restructuring costs	(10)	–	(39)	(8)	(57)
Other results	–	–	–	(340)	(340)
Operating profit based on longer-term investment returns	1,820	1,003	968	(348)	3,443
Non-operating items	(282)	(181)	(651)	639	(475)
Non-controlling interests	–	–	–	(1)	(1)
Profit for the period attributable to equity holders of the Company	1,538	822	317	290	2,967
Other items taken directly to equity:					
Exchange movements on foreign operations and net investment hedges	230	354	(5)	(56)	523
Intra-group dividends and investment in operations note (ii)	(748)	(327)	(341)	1,416	–
External dividends	–	–	–	(840)	(840)
Mark to market value movements on Jackson assets backing surplus and required capital	–	(32)	–	–	(32)
Other movements note (iii)	(5)	(9)	45	96	127
Net increase in shareholders' equity	1,015	808	16	906	2,745
Shareholders' equity at beginning of period	21,348	13,492	13,627	(3,769)	44,698
Shareholders' equity at end of period	22,363	14,300	13,643	(2,863)	47,443
Representing:					
IFRS basis shareholders' equity:					
Net assets (liabilities)	5,434	5,100	6,893	(3,004)	14,423
Goodwill	61	–	1,153	245	1,459
Total IFRS basis shareholders' equity	5,495	5,100	8,046	(2,759)	15,882
Additional retained profit (loss) on an EEV basis	16,868	9,200	5,597	(104)	31,561
EEV basis shareholders' equity	22,363	14,300	13,643	(2,863)	47,443
Balance at beginning of period:					
IFRS basis shareholders' equity:					
Net assets (liabilities)	5,620	5,248	7,092	(3,331)	14,629
Goodwill	61	–	1,153	244	1,458
Total IFRS basis shareholders' equity	5,681	5,248	8,245	(3,087)	16,087
Additional retained profit (loss) on an EEV basis	15,667	8,244	5,382	(682)	28,611
EEV basis shareholders' equity	21,348	13,492	13,627	(3,769)	44,698

Notes

(i) Other operations of £(2,863) million represents the shareholders' equity of £(3,108) million as shown in the movement in shareholders' equity and includes goodwill of £245 million (half year 2017: £245 million; full year 2017: £244 million) related to Asia long-term operations.

(ii) Intra-group dividends represent dividends that have been declared in the period and investment in operations reflect increases/decreases in share capital. The amounts included for these items in the analysis of movement in free surplus in note 10 are as per the holding company cash flow at transaction rates. The difference primarily relates to intra-group loans, foreign exchange and other non-cash items.

(iii) Other movements include reserve movements in respect of the shareholders' share of actuarial gains and losses on defined benefit pension schemes, share capital subscribed, share-based payments and treasury shares and intra-group transfers between operations which have no overall effect on the Group's embedded value.

8 Reconciliation of movement in shareholders' equity continued

(iv) Group total EEV basis shareholders' equity can be further analysed as follows:

	30 Jun 2018 £m				31 Dec 2017 £m			
	Total long-term business operations note 9	**Asset management and general insurance commission**	**Other operations**	**Group total**	**Total long-term business operations** note 9	**Asset management and general insurance commission**	**Other operations**	**Group total**
Total IFRS basis shareholders' equity	15,994	2,647	(2,759)	15,882	16,624	2,550	(3,087)	16,087
Additional retained profit (loss) on an EEV basis note (v)	31,665	–	(104)	31,561	29,293	–	(682)	28,611
Total EEV basis shareholders' equity	47,659	2,647	(2,863)	47,443	45,917	2,550	(3,769)	44,698

(v) The additional retained loss on an EEV basis for other operations represents the mark to market value adjustment for holding company net borrowings of a cumulative charge of £(104) million (30 June 2017: £(611) million, 31 December 2017: £(682) million), as shown in note 7.

9 Analysis of movement in net worth and value of in-force for long-term business

	Half year 2018 £m				
	Free surplus	**Required capital**	**Total net worth**	**Value of in-force business** note (i)	**Total embedded value**
Group					
Shareholders' equity at beginning of period	6,242	10,265	16,507	29,410	45,917
New business contribution note 3	(540)	366	(174)	1,941	1,767
Existing business – transfer to net worth	1,698	(349)	1,349	(1,349)	–
Expected return on existing business note 4	88	110	198	1,070	1,268
Changes in operating assumptions and experience variances note 4	350	(76)	274	220	494
Restructuring costs	(15)	–	(15)	(5)	(20)
Operating profit based on longer-term investment returns	1,581	51	1,632	1,877	3,509
Non-operating items	(583)	(291)	(874)	(203)	(1,077)
Profit for the period	998	(240)	758	1,674	2,432
Exchange movements on foreign operations and net investment hedges	37	72	109	471	580
Intra-group dividends and investment in operations	(1,238)	–	(1,238)	–	(1,238)
Other movements	(32)	–	(32)	–	(32)
Shareholders' equity at end of period	6,007	10,097	16,104	31,555	47,659
Asia					
New business contribution note 3	(260)	76	(184)	1,306	1,122
Existing business – transfer to net worth	692	(85)	607	(607)	–
Expected return on existing business note 4	32	29	61	540	601
Changes in operating assumptions and experience variances note 4	49	(32)	17	13	30
Operating profit based on longer-term investment returns	513	(12)	501	1,252	1,753
Non-operating items	(167)	(75)	(242)	(40)	(282)
Profit for the period	346	(87)	259	1,212	1,471

	Half year 2018 £m				
	Free surplus	**Required capital**	**Total net worth**	**Value of in-force business** note (i)	**Total embedded value**
US					
New business contribution note 3	(180)	174	(6)	472	466
Existing business – transfer to net worth	702	(92)	610	(610)	–
Expected return on existing business note 4	26	32	58	375	433
Changes in operating assumptions and experience variances note 4	47	(3)	44	62	106
Operating profit based on longer-term investment returns	595	111	706	299	1,005
Non-operating items note (ii)	(457)	91	(366)	217	(149)
Profit for the period	138	202	340	516	856
UK and Europe					
New business contribution note 3	(100)	116	16	163	179
Existing business – transfer to net worth	304	(172)	132	(132)	–
Expected return on existing business note 4	30	49	79	155	234
Changes in operating assumptions and experience variances note 4	254	(41)	213	145	358
Restructuring costs	(15)	–	(15)	(5)	(20)
Operating profit based on longer-term investment returns	473	(48)	425	326	751
Non-operating items	41	(307)	(266)	(380)	(646)
Profit for the period	514	(355)	159	(54)	105

Notes

(i) The net value of in-force business comprises the value of future margins from current in-force business less the cost of holding required capital for long-term business as shown below:

	30 Jun 2018 £m				31 Dec 2017 £m			
	Asia	**US**	**UK and Europe**	**Total**	**Asia**	**US**	**UK and Europe**	**Total**
Value of in-force business before deduction of cost of capital and time value of guarantees	19,700	11,096	3,481	34,277	17,539	10,486	3,648	31,673
Cost of capital	(535)	(310)	(494)	(1,339)	(588)	(232)	(607)	(1,427)
Cost of time value of guarantees*	(976)	(407)	–	(1,383)	(186)	(650)	–	(836)
Net value of in-force business	18,189	10,379	2,987	31,555	16,765	9,604	3,041	29,410
Total net worth	3,760	3,717	8,627	16,104	4,182	3,653	8,672	16,507
Total embedded value note 8	21,949	14,096	11,614	47,659	20,947	13,257	11,713	45,917

* The cost of time value of guarantees arises from the variability of economic outcomes in the future and is, where appropriate, calculated as the difference between a full stochastic valuation and a single deterministic valuation, as described in note 12(a)(iv). Both valuations reflect the level of policyholder benefits (including guaranteed benefits and discretionary bonuses) and associated charges, and management actions in response to emerging investment and fund solvency conditions. The increase in the cost of time value of guarantees for Asia operations from £(186) million at 31 December 2017 to £(976) million at 30 June 2018 reflects the interaction between these different effects on the full stochastic and single deterministic valuations at the respective level of interest rates and equity markets, as well as the growth in the business over the period.

(ii) In June 2018, the National Association of Insurance Commissioners (NAIC) formally approved changes to RBC capital factors that reflect the December 2017 US tax reform. The half year 2018 EEV results reflect these changes, with a resulting increase in required capital and a corresponding reduction in free surplus of £(160) million.

10 Analysis of movement in free surplus

For EEV covered business, free surplus is the excess of the regulatory basis net assets for EEV reporting purposes (net worth) over the capital required to support the covered business. Where appropriate, adjustments are made to the net worth so that backing assets are included at fair value rather than cost so as to comply with the EEV Principles. In Asia and US operations, assets deemed to be inadmissible on local regulatory basis are included in net worth where considered fully recognisable on an EEV basis. Free surplus for asset management operations and the UK general insurance commission is taken to be IFRS basis post-tax earnings and shareholders' equity, net of goodwill. Free surplus for other operations (including Group and Asia Regional Head Office, holding company borrowings, Africa operations and Prudential Capital) is taken to be EEV basis post-tax earnings and shareholders' equity net of goodwill, with subordinated debt recorded as free surplus to the extent that it is classified as available capital under Solvency II.

Free surplus for insurance and asset management operations and Group total free surplus, including other operations, are shown in the tables below.

(i) Underlying free surplus generated – insurance and asset management operations

The half year 2017 comparative results are shown below on both actual exchange rates (AER) and constant exchange rates (CER) bases. The half year 2017 CER comparative results are translated at half year 2018 average exchange rates.

	Half year 2018 £m	Half year 2017 £m		% change	
		AER	CER	AER	CER
Asia operations					
Underlying free surplus generated from in-force life business	**773**	763	714	1%	8%
Investment in new business note (iii)(a)	**(260)**	(283)	(265)	8%	2%
Long-term business	**513**	480	449	7%	14%
Asset management	**77**	73	68	5%	13%
Total	**590**	553	517	7%	14%
US operations					
Underlying free surplus generated from in-force life business	**775**	801	733	(3)%	6%
Investment in new business note (iii)(a)	**(180)**	(246)	(225)	27%	20%
Long-term business	**595**	555	508	7%	17%
Asset management	**(2)**	(4)	(4)	50%	50%
Total	**593**	551	504	8%	18%
UK and Europe operations					
Underlying free surplus generated from in-force life business	**588**	569	569	3%	3%
Investment in new business note (iii)(a)	**(100)**	(42)	(42)	(138)%	(138)%
Long-term business	**488**	527	527	(7)%	(7)%
General insurance commission	**15**	14	14	7%	7%
Asset management	**221**	201	201	10%	10%
Total	**724**	742	742	(2)%	(2)%
Underlying free surplus generated from insurance and asset management operations before restructuring costs	**1,907**	1,846	1,763	3%	8%
Restructuring costs	**(44)**	(6)	(6)	(633)%	(633)%
Underlying free surplus generated from insurance and asset management operations	**1,863**	1,840	1,757	1%	6%

	Half year 2018 £m	Half year 2017 £m		% change	
		AER	CER	AER	CER
Representing:					
Long-term business:					
Expected in-force cash flows (including expected return on net assets)	1,786	1,785	1,676	0%	7%
Effects of changes in operating assumptions, operating experience variances and other items before restructuring costs	350	348	340	1%	3%
Underlying free surplus generated from in-force life business before restructuring costs	2,136	2,133	2,016	0%	6%
Investment in new business [note (iii)(a)]	(540)	(571)	(532)	5%	(2)%
Total long-term business	1,596	1,562	1,484	2%	8%
Asset management and general insurance commission	311	284	279	10%	11%
Restructuring costs	(44)	(6)	(6)	(633)%	(633)%
	1,863	1,840	1,757	1%	6%

(ii) Underlying free surplus generated – Group total

	Half year 2018 £m	Half year 2017 £m		% change	
		AER	CER	AER	CER
Underlying free surplus generated from insurance and asset management operations [note (i)]	1,863	1,840	1,757	1%	6%
Other income and expenditure	(348)	(402)	(396)	13%	12%
Group total	1,515	1,438	1,361	5%	11%

(iii) Movement in free surplus

	Half year 2018 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Underlying free surplus generated before restructuring costs	590	593	724	1,907	(340)	1,567
Restructuring costs	(10)	–	(34)	(44)	(8)	(52)
Underlying free surplus generated [notes (i)(ii)]	580	593	690	1,863	(348)	1,515
Non-operating items [note (b)]	(167)	(489)	36	(620)	97	(523)
	413	104	726	1,243	(251)	992
Net cash flows to parent company [note (c)]	(391)	(342)	(378)	(1,111)	1,111	–
External dividends	–	–	–	–	(840)	(840)
Exchange rate movements, timing differences and other items [note (d)]	(359)	12	77	(270)	413	143
Net movement in free surplus	(337)	(226)	425	(138)	433	295
Balance at beginning of period	2,470	1,928	3,180	7,578	1,774	9,352
Balance at end of period	2,133	1,702	3,605	7,440	2,207	9,647

10 Analysis of movement in free surplus continued

(iii) Movement in free surplus continued

	Half year 2017 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Underlying free surplus generated before restructuring costs	553	551	742	1,846	(381)	1,465
Restructuring costs	–	–	(6)	(6)	(21)	(27)
Underlying free surplus generated notes (i)(ii)	553	551	736	1,840	(402)	1,438
Non-operating items note (b)	268	(470)	267	65	82	147
	821	81	1,003	1,905	(320)	1,585
Net cash flows to parent company note (c)	(350)	(475)	(405)	(1,230)	1,230	–
External dividends	–	–	–	–	(786)	(786)
Exchange rate movements, timing differences and other items note (d)	(266)	(74)	30	(310)	224	(86)
Net movement in free surplus	205	(468)	628	365	348	713
Balance at beginning of period	2,142	2,418	2,006	6,566	1,648	8,214
Balance at end of period	2,347	1,950	2,634	6,931	1,996	8,927

	Full year 2017 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Underlying free surplus generated before restructuring costs	1,078	1,328	1,311	3,717	(746)	2,971
Restructuring costs	(14)	–	(63)	(77)	(10)	(87)
Underlying free surplus generated	1,064	1,328	1,248	3,640	(756)	2,884
Non-operating items note (b)	330	(1,203)	572	(301)	27	(274)
	1,394	125	1,820	3,339	(729)	2,610
Net cash flows to parent company note (c)	(645)	(475)	(668)	(1,788)	1,788	–
External dividends	–	–	–	–	(1,159)	(1,159)
Exchange rate movements, timing differences and other items note (d)	(421)	(140)	22	(539)	226	(313)
Net movement in free surplus	328	(490)	1,174	1,012	126	1,138
Balance at beginning of year	2,142	2,418	2,006	6,566	1,648	8,214
Balance at end of year	2,470	1,928	3,180	7,578	1,774	9,352

Notes

(a) Free surplus invested in new business primarily represents acquisition costs and amounts set aside for required capital.

(b) Non-operating items include short-term fluctuations in investment returns, the effect of changes in economic assumptions for long-term business operations and the effect of corporate transactions as described in note 15. For half year 2017 and full year 2017, it reflects the release of £76 million of required capital and corresponding recognition of free surplus upon completion of the sale of the Group's life insurance subsidiary in Korea. In addition, for full year 2017 this includes the impact of US tax reform (see note 16) and for half year 2018 this includes the consequent changes to RBC factors approved by the National Association of Insurance Commissioners (NAIC), which were formally approved in June 2018.

(c) Net cash flows to parent company for long-term business operations reflect the flows as included in the holding company cash flow at transaction rates.

(d) Exchange rate movements, timing differences and other items represent:

	Half year 2018 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Exchange rate movements	3	38	(5)	36	9	45
Mark to market value movements on Jackson assets backing surplus and required capital	–	(32)	–	(32)	–	(32)
Other items[note (e)]	(362)	6	82	(274)	404	130
	(359)	12	77	(270)	413	143

	Half year 2017 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Exchange rate movements	(52)	(106)	3	(155)	(17)	(172)
Mark to market value movements on Jackson assets backing surplus and required capital	–	31	–	31	–	31
Other items[note (e)]	(214)	1	27	(186)	241	55
	(266)	(74)	30	(310)	224	(86)

	Full year 2017 £m					
	Asia operations	US operations	UK and Europe operations	Total insurance and asset management operations	Other operations	Group total
Exchange rate movements	(113)	(190)	6	(297)	(13)	(310)
Mark to market value movements on Jackson assets backing surplus and required capital	–	40	–	40	–	40
Other items[note (e)]	(308)	10	16	(282)	239	(43)
	(421)	(140)	22	(539)	226	(313)

(e) Other items include the effect of movements in subordinated debt for other operations, intra-group loans and other intra-group transfers between operations and other non-cash items.

11 Sensitivity of results to alternative assumptions

Sensitivity analysis – economic assumptions

The tables below show the sensitivity of the embedded value as at 30 June 2018 and 31 December 2017 and the new business contribution after the effect of required capital for half year 2018 and full year 2017 for long-term business operations to:

- 1 per cent increase in the discount rates;
- 1 per cent increase in interest rates and risk discount rates, including consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets);
- 0.5 per cent decrease in interest rates and risk discount rates, including consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets);
- 1 per cent rise in equity and property yields;
- 10 per cent fall in market value of equity and property assets (embedded value only);
- The statutory minimum capital level in contrast to EEV basis required capital (for embedded value only); and
- 5 basis points increase in UK long-term expected defaults.

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions.

11 Sensitivity of results to alternative assumptions continued

Sensitivity analysis – economic assumptions continued

New business contribution from long-term business operations

	Half year 2018 £m				Full year 2017 £m			
	Asia	US	UK and Europe	Total	Asia	US	UK and Europe	Total
New business contribution note 3	1,122	466	179	1,767	2,368	906	342	3,616
Discount rates – 1% increase	(223)	(25)	(24)	(272)	(477)	(34)	(48)	(559)
Interest rates – 1% increase	(94)	34	24	(36)	(103)	124	44	65
Interest rates – 0.5% decrease	20	(39)	(13)	(32)	(59)	(85)	(23)	(167)
Equity/property yields – 1% rise	54	52	27	133	130	130	52	312
Long-term expected defaults – 5 bps increase	–	–	–	–	–	–	(1)	(1)

Embedded value of long-term business operations

	30 Jun 2018 £m				31 Dec 2017 £m			
	Asia	US	UK and Europe	Total	Asia	US	UK and Europe	Total
Shareholders' equity note 9	21,949	14,096	11,614	47,659	20,947	13,257	11,713	45,917
Discount rates – 1% increase	(2,813)	(540)	(727)	(4,080)	(2,560)	(440)	(774)	(3,774)
Interest rates – 1% increase	(1,326)	(61)	(666)	(2,053)	(944)	26	(635)	(1,553)
Interest rates – 0.5% decrease	395	(199)	390	586	121	(166)	384	339
Equity/property yields – 1% rise	959	878	429	2,266	873	896	425	2,194
Equity/property market values – 10% fall	(420)	(201)	(451)	(1,072)	(429)	(209)	(479)	(1,117)
Statutory minimum capital	133	214	–	347	169	158	–	327
Long-term expected defaults – 5 bps increase	–	–	(82)	(82)	–	–	(135)	(135)

The sensitivities shown above are for the impact of instantaneous changes on the embedded value of long-term business operations and include the combined effect on the value of in-force business and net assets at the balance sheet dates indicated. If the change in assumptions shown in the sensitivities were to occur, then the effect shown above would be recorded within two components of the profit analysis for the following year, namely the effect of economic assumption changes and short-term fluctuations in investment returns. In addition to the sensitivity effects shown above, the other components of the profit for the following year would be calculated by reference to the altered assumptions, for example new business contribution and unwind of discount, together with the effect of other changes such as altered corporate bond spreads. In addition for changes in interest rates, the effect shown above for Jackson would also be recorded within the fair value movements on assets backing surplus and required capital, which are taken directly to shareholders' equity.

12 Methodology and accounting presentation

(a) Methodology

Overview

The embedded value is the present value of the shareholders' interest in the earnings distributable from assets allocated to covered business after sufficient allowance has been made for the aggregate risks in that business. The shareholders' interest in the Group's long-term business comprises:

- the present value of future shareholder cash flows from in-force covered business (value of in-force business), less deductions for:
  - the cost of locked-in required capital; and
  - the time value of cost of options and guarantees;
- locked-in required capital; and
- the shareholders' net worth in excess of required capital (free surplus).

The value of future new business is excluded from the embedded value.

Notwithstanding the basis of presentation of results as explained in note 12(b)(iii), no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or profit. Separately, the analysis of profit is delineated between operating profit based on longer-term investment returns and other constituent items, as explained in note 12(b)(i).

(i) Covered business

The EEV results for the Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Group's long-term insurance business, including the Group's investments in joint venture and associate insurance operations, for which the value of new and in-force contracts is attributable to shareholders. The post-tax EEV basis results for the Group's covered business are then combined with the post-tax IFRS basis results of the Group's asset management and other operations (including Group and Asia Regional Head Office, holding company borrowings, Africa operations and Prudential Capital). Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management, as described in note 12(a)(vii).

The definition of long-term business operations comprises those contracts falling under the definition for regulatory purposes together with, for US operations, contracts that are in substance the same as guaranteed investment contracts (GICs) but do not fall within the technical definition.

Covered business comprises the Group's long-term business operations, with two exceptions:

- the closed Scottish Amicable Insurance Fund (SAIF) which is excluded from covered business. SAIF is a ring-fenced sub-fund of The Prudential Assurance Company Limited (PAC) long-term fund, established by a Court Approved Scheme of Arrangement in October 1997. SAIF is closed to new business and the assets and liabilities of the fund are wholly attributable to the policyholders of the fund; and
- the presentational treatment of the Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS). The partial recognition of the surplus for PSPS is recognised in 'Other' operations.

A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

(ii) Valuation of in-force and new business

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency, mortality and morbidity, as described in note 13(vii). These assumptions are used to project future cash flows. The present value of the future cash flows is then calculated using a discount rate which reflects both the time value of money and the non-diversifiable risks associated with the cash flows that are not otherwise allowed for.

New business

In determining the EEV basis value of new business, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.

New business premiums reflect those premiums attaching to covered business, including premiums for contracts classified as investment products for IFRS basis reporting. New business premiums for regular premium products are shown on an annualised basis. Internal vesting business is classified as new business where the contracts include an open market option.

The post-tax contribution from new business represents profits determined by applying operating and economic assumptions as at the end of the period. New business profitability is a key metric for the Group's management of the development of the business. In addition, post-tax new business margins are shown by reference to annual premium equivalents (APE) and the present value of new business premiums (PVNBP). These margins are calculated as the percentage of the value of new business profit to APE and PVNBP. APE is calculated as the aggregate of regular premiums and one-tenth of single premiums. PVNBP is calculated as the aggregate of single premiums and the present value of expected future premiums from regular premium new business, allowing for lapses and the other assumptions made in determining the EEV new business contribution. The half year 2018 new business contribution for Hong Kong and Singapore medical reimbursement business allows explicitly for expected future premium inflation and separately for future medical claims inflation. Previously, the new business contribution allowed for such inflation implicitly as a single effect.

12 Methodology and accounting presentation continued

(a) Methodology continued

Valuation movements on investments

With the exception of debt securities held by Jackson, investment gains and losses during the period (to the extent that changes in capital values do not directly match changes in liabilities) are included directly in the profit for the period and shareholders' equity as they arise.

The results for any covered business conceptually reflect the aggregate of the IFRS results and the movements on the additional shareholders' interest recognised on the EEV basis. Thus the start point for the calculation of the EEV results for Jackson, as for other businesses, reflects the market value movements recognised on an IFRS basis.

However, in determining the movements on the additional shareholders' interest, the basis for calculating the EEV result for Jackson acknowledges that, for debt securities backing liabilities, the aggregate EEV results reflect the fact that the value of in-force business instead incorporates the discounted value of future spread earnings. This value is not affected generally by short-term market movements on securities that, broadly speaking, are held for the longer term.

Fixed income securities backing the free surplus and required capital for Jackson are accounted for at fair value. However, consistent with the treatment applied under IFRS for Jackson securities classified as available-for-sale, movements in unrealised appreciation/depreciation on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

(iii) Cost of capital

A charge is deducted from the embedded value for the cost of locked-in required capital supporting the Group's long-term business. The cost is the difference between the nominal value of the capital and the discounted value of the projected releases of this capital, allowing for post-tax investment earnings on the capital.

The annual result is affected by the movement in this cost from year to year, which comprises a charge against new business profit and generally a release in respect of the reduction in capital requirements for business in force as this runs off.

Where required capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its expected release over time and no further adjustment is necessary in respect of required capital.

(iv) Financial options and guarantees

Nature of financial options and guarantees in Prudential's long-term business

Asia

Subject to local market circumstances and regulatory requirements, the guarantee features described below in respect of UK and Europe business broadly apply to similar types of participating contracts in Asia, which are principally written in Hong Kong, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

There are also various non-participating long-term products with guarantees. The principal guarantees are those for whole-of-life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequently with market conditions.

US (Jackson)

The principal financial options and guarantees in Jackson are associated with the fixed annuity (FA) and variable annuity (VA) lines of business.

Fixed annuities provide that, at Jackson's discretion, it may reset the interest rate credited to policyholders' accounts, subject to a guaranteed minimum. The guaranteed minimum return varies from 1.0 per cent to 5.5 per cent for all periods, depending on the particular product, jurisdiction where issued, and date of issue. At 30 June 2018, 88 per cent of the account values on fixed annuities are for policies with guarantees of 3 per cent or less (30 June 2017: 87 per cent; 31 December 2017: 87 per cent), and the average guarantee rate is 2.6 per cent for all periods shown.

Fixed annuities also present a risk that policyholders will exercise their option to surrender their contracts in periods of rapidly rising interest rates, possibly requiring Jackson to liquidate assets at an inopportune time.

Jackson issues variable annuity (VA) contracts for which it contractually guarantees to the contract holder, subject to specific conditions, either: a) return of no less than total deposits made to the contract adjusted for any partial withdrawals; b) total deposits made to the contract adjusted for any partial withdrawals plus a minimum return; or c) the highest contract value on a specified anniversary date adjusted for any withdrawals following the specified contract anniversary. These guarantees include benefits that are payable upon depletion of funds (Guaranteed Minimum Withdrawal Benefit (GMWB)), as death benefits (Guaranteed Minimum Death Benefits (GMDB)) or as income benefits (Guaranteed Minimum Income Benefits (GMIB)). These guarantees generally protect the policyholders' value in the event of poor equity market performance. Jackson hedges the GMWB and GMDB guarantees through the use of equity options and futures contracts, and essentially fully reinsures the GMIB guarantees.

Jackson also issues fixed index annuities (FIA) that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns are of a similar nature to those described above for fixed annuities.

UK and Europe (M&G Prudential)

The only significant financial options and guarantees in M&G Prudential's covered business arise in the with-profits fund.

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses – annual and final. Annual bonuses are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Final bonuses are guaranteed only until the next bonus declaration. The PAC with-profits fund also held a provision of £52 million at 30 June 2018 (30 June 2017: £62 million; 31 December 2017: £53 million) to honour guarantees on a small number of guaranteed annuity option products.

The Group's main exposure to guaranteed annuity options in M&G Prudential is through the non-covered business of SAIF. A provision of £467 million was held in SAIF at 30 June 2018 (30 June 2017: £572 million; 31 December 2017: £503 million) to honour the guarantees. As described in note 12(a)(i), the assets and liabilities are wholly attributable to the policyholders of the fund. Therefore the movement in the provision has no direct impact on shareholders' funds.

Time value

The value of financial options and guarantees comprises two parts:

- The first part arises from a deterministic valuation on best estimate assumptions (the intrinsic value); and
- The second part arises from the variability of economic outcomes in the future (the time value).

Where appropriate, a full stochastic valuation has been undertaken to determine the time value of the financial options and guarantees.

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations. Assumptions specific to the stochastic calculations reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of long-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with an allowance for correlation between the various asset classes. Details of the key characteristics of each model are given in notes 13(iv), (v) and (vi).

In deriving the time value of financial options and guarantees, management actions in response to emerging investment and fund solvency conditions have been modelled. Management actions encompass, but are not confined to, investment allocation decisions, levels of reversionary and terminal bonuses and credited rates. Bonus rates are projected from current levels and varied in accordance with assumed management actions applying in the emerging investment and fund solvency conditions.

In all instances, the modelled actions are in accordance with approved local practice and therefore reflect the options actually available to management. For the PAC with-profits fund, the actions assumed are consistent with those set out in the Principles and Practices of Financial Management which explains how regular and final bonus rates within the discretionary framework are determined, subject to the general legislative requirements applicable.

(v) Level of required capital

In adopting the EEV Principles, Prudential has based required capital on its internal targets, subject to it being at least the local statutory minimum requirements.

For with-profits business written in a segregated life fund, as is the case in Asia and the UK, the capital available in the fund is sufficient to meet the required capital requirements. For M&G Prudential, a portion of future shareholder transfers expected from the with-profits fund is recognised within net worth, together with the associated capital requirements.

For shareholder-backed business, the following capital requirements for long-term business operations apply:

- Asia: the level of required capital has been set to an amount at least equal to the higher of local statutory requirements and the internal target. For China operations, from 31 December 2017, the level of required capital follows the approach for embedded value reporting issued by the China Association of Actuaries (CAA), reflecting the C-ROSS regime;
- US: the level of required capital has been set at 250 per cent of the risk-based capital (RBC) required by the National Association of Insurance Commissioners (NAIC) at the Company Action Level (CAL); and
- UK and Europe: the capital requirements are set at the Solvency II Solvency Capital Requirement (SCR) for shareholder-backed business as a whole. Following the announced demerger, from 1 January 2018 this does not allow for diversification outside the planned perimeter of the business to be demerged.

(vi) With-profits business and the treatment of the estate

The proportion of surplus allocated to shareholders from the PAC with-profits fund has been based on the present level of 10 per cent. The value attributed to the shareholders' interest in the estate is derived by increasing final bonus rates (and related shareholder transfers) so as to exhaust the estate over the lifetime of the in-force with-profits business. In any scenarios where the total assets of the life fund are insufficient to meet policyholder claims in full, the excess cost is fully attributed to shareholders. Similar principles apply, where appropriate, for other with-profits funds of the Group's Asia operations.

12 Methodology and accounting presentation continued

(a) Methodology continued

(vii) Internal asset management

The in-force and new business results from long-term business include the projected value of profits or losses from asset management and service companies that support the Group's covered insurance businesses. The results of the Group's asset management operations include the current period profits from the management of both internal and external funds. EEV basis shareholders' other income and expenditure is adjusted to deduct the unwind of the expected internal asset management profit margin for the period as included in 'Other operations'. The deduction is on a basis consistent with that used for projecting the results for covered insurance business. Group operating profit accordingly includes the variance between actual and expected profit in respect of management of the assets for covered business.

(viii) Allowance for risk and risk discount rates

Overview

Under the EEV Principles, discount rates used to determine the present value of future cash flows are set by reference to risk-free rates plus a risk margin.

For Asia and the US, the risk-free rates are based on 10-year local government bond yields.

For UK and Europe, the EEV risk-free rate is based on the full term structure of interest rates, ie a yield curve, which is used to determine the embedded value at the end of the reporting period.

The risk margin should reflect any non-diversifiable risk associated with the emergence of distributable earnings that is not allowed for elsewhere in the valuation. In order to better reflect differences in relative market risk volatility inherent in each product group, Prudential sets the risk discount rates to reflect the expected volatility associated with the cash flows for each product category in the embedded value model, rather than at a Group level.

Since financial options and guarantees are explicitly valued under the EEV methodology, risk discount rates under EEV are set excluding the effect of these product features.

The risk margin represents the aggregate of the allowance for market risk, additional allowance for credit risk where appropriate, and allowance for non-diversifiable non-market risk. No allowance is required for non-market risks where these are assumed to be fully diversifiable.

Market risk allowance

The allowance for market risk represents the beta multiplied by an equity risk premium. Except for UK shareholder-backed annuity business (as explained below), such an approach has been used for the Group's businesses.

The beta of a portfolio or product measures its relative market risk. The risk discount rates reflect the market risk inherent in each product group and hence the volatility of product cash flows. These are determined by considering how the profits from each product are affected by changes in expected returns on various asset classes. By converting this into a relative rate of return, it is possible to derive a product-specific beta.

Product level betas reflect the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

Additional credit risk allowance

The Group's methodology is to allow appropriately for credit risk. The allowance for total credit risk is to cover:

— expected long-term defaults;
— credit risk premium (to reflect the volatility in downgrade and default levels); and
— short-term downgrades and defaults.

These allowances are initially reflected in determining best estimate returns and through the market risk allowance described above. However, for those businesses largely backed by holdings of debt securities, these allowances in the projected returns and market risk allowances may not be sufficient and an additional allowance may be appropriate.

The practical application of the allowance for credit risk varies depending upon the type of business as described below:

Asia

For Asia, the allowance for credit risk incorporated in the projected rates of return and the market risk allowance are considered to be sufficient. Accordingly, no additional allowance for credit risk is required.

The projected rates of return for holdings of corporate bonds comprise the risk-free rate plus an assessment of long-term spread over the risk-free rate.

US (Jackson)

For Jackson business, the allowance for long-term defaults is reflected in the risk margin reserve (RMR) charge which is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

The risk discount rate incorporates an additional allowance for credit risk premium and short-term downgrades and defaults (0.2 per cent for variable annuity business and 1.0 per cent for non-variable annuity business for all periods), as shown in note 13(ii). In determining this allowance, a number of factors have been considered. These factors, in particular, include:

- How much of the credit spread on debt securities represents an increased short-term credit risk not reflected in the RMR long-term default assumptions, and how much is liquidity premium (which is the premium required by investors to compensate for the risk of longer-term investments which cannot be easily converted into cash at the fair market value). In assessing this effect, consideration has been given to a number of approaches to estimating the liquidity premium by considering recent statistical data; and
- Policyholder benefits for Jackson fixed annuity business are not fixed. It is possible in adverse economic scenarios to pass on a component of credit losses to policyholders (subject to guarantee features) through lower investment returns credited to policyholders. Consequently, it is only necessary to allow for the balance of the credit risk in the risk discount rate.

The level of the additional allowance is assessed at each reporting period to take account of prevailing credit conditions and as the business in force alters over time. The additional allowance for variable annuity business has been set at one-fifth of the non-variable annuity business to reflect the proportion of the allocated holdings of general account debt securities.

The level of allowance differs from that for UK annuity business for investment portfolio differences and to take account of the management actions available in adverse economic scenarios to reduce crediting rates to policyholders, subject to guarantee features of the products.

UK and Europe (M&G Prudential)

(1) Shareholder-backed annuity business

For shareholder-backed annuity business, Prudential has used a market consistent embedded value (MCEV) approach to derive an implied risk discount rate which is then applied to the projected best estimate cash flows.

In the annuity MCEV calculations, as the assets are generally held to maturity to match liabilities, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on the Solvency II allowance for credit risk. The Solvency II allowance is set by the European Insurance and Occupational Pensions Authority (EIOPA) using a prudent assumption that all future downgrades will be replaced annually, and allowing for the credit spread floor.

For the purposes of presentation in the EEV results, the results produced on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for a best estimate credit risk allowance. The remaining elements of prudence within the Solvency II allowance are incorporated into the risk margin included in the discount rate, shown in note 13(iii).

(2) With-profits fund non-profit annuity business

For non-profit annuity business attributable to the PAC with-profits fund, the basis for determining the aggregate allowance for credit risk is consistent with that applied for UK shareholder-backed annuity business (as described above). The allowance for credit risk for this business is taken into account in determining the projected cash flows from the with-profits fund, which are in turn discounted at the risk discount rate applicable to all of the projected cash flows from the fund.

(3) With-profits fund holdings of debt securities

The with-profits fund holds debt securities as part of its investment portfolio backing policyholder liabilities and unallocated surplus. The assumed earned rate for with-profit holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over risk free, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

Allowance for non-diversifiable non-market risks

The majority of non-market and non-credit risks are considered to be diversifiable. An allowance for non-diversifiable non-market risks is estimated as set out below:

A base level allowance of 50 basis points is applied to cover the non-diversifiable non-market risks associated with the Group's businesses. For the Group's Asia operations in China, Indonesia, the Philippines, Taiwan, Thailand and Vietnam, additional allowances are applied for emerging market risk ranging from 100 to 250 basis points. The level of these allowances are reviewed and updated based on an assessment of a range of pre-defined emerging market risk indicators, as well as the Group's exposure and experience in the business units. For the Group's US business and UK and Europe business, no additional allowance is necessary.

12 Methodology and accounting presentation continued

(a) Methodology continued

(ix) Foreign currency translation

Foreign currency profits and losses have been translated at average exchange rates for the period. Foreign currency assets and liabilities have been translated at period-end exchange rates. The principal exchange rates are shown in note A1 of the IFRS financial statements.

(x) Taxation

In determining the post-tax profit for the period for covered business, the overall tax rate includes the impact of tax effects determined on a local regulatory basis. Tax payments and receipts included in the projected cash flows to determine the value of in-force business are calculated using rates that have been announced and substantively enacted by the end of the reporting period.

(xi) Inter-company arrangements

The EEV results for covered business incorporate annuities established in the PAC non-profit sub-fund from vesting pension policies in SAIF (which is not covered business). The EEV results also incorporate the effect of the reinsurance arrangement of non-profit immediate pension annuity liabilities of SAIF to the PAC non-profit sub-fund.

(b) Accounting presentation

(i) Analysis of post-tax profit

To the extent applicable, the presentation of the EEV post-tax profit for the period is consistent in the classification between operating and non-operating results with the basis that the Group applies for the analysis of IFRS basis results. Operating results reflect underlying results including longer-term investment returns (which are determined as described in note 12(b)(ii)) and incorporate the following:

— new business contribution, as defined in note 12(a)(ii);
— unwind of discount on the value of in-force business and other expected returns, as described in note 12(b)(iii);
— the impact of routine changes of estimates relating to operating assumptions, as described in note 12(b)(iv); and
— operating experience variances, as described in note 12(b)(v).

Non-operating results comprise:

— short-term fluctuations in investment returns;
— the mark to market value movements on core structural borrowings;
— the effect of changes in economic assumptions; and
— the impact of corporate transactions undertaken in the period.

In addition, operating results include the effect of changes in tax legislation, unless these changes are one-off and structural in nature, such as the impact of the US tax reform in full year 2017 (see note 16), or primarily affect the level of projected investment returns, in which case they are reflected as a non-operating result.

Total profit attributable to shareholders and basic earnings per share include these items, together with actual investment returns. The Group believes that operating profit, as adjusted for these items, better reflects underlying performance.

(ii) Investment returns included in operating profit

For the investment element of the assets covering the net worth of long-term insurance business, investment returns are recognised in operating results at the expected long-term rate of return. These expected returns are calculated by reference to the asset mix of the portfolio. For the purpose of calculating the longer-term investment return to be included in the operating result of the PAC with-profits fund of M&G Prudential, where assets backing the liabilities and unallocated surplus are subject to market volatility, asset values at the beginning of the reporting period are adjusted to remove the effects of short-term market movements as explained in note 12(b)(iii).

For the purpose of determining the long-term returns for debt securities of US operations for fixed annuity and other general account business, a risk margin reserve charge is included which reflects the expected long-term rate of default based on the credit quality of the portfolio. For Jackson, interest-related realised gains and losses are amortised to the operating results over the maturity period of the sold bonds and for equity-related investments, a long-term rate of return is assumed, which reflects the aggregation of end-of-period risk-free rates and the equity risk premium. For US variable annuity separate account business, operating profit includes the unwind of discount on the opening value of in-force business adjusted to reflect end-of-period projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with related hedging activity.

For UK annuity business, rebalancing of the asset portfolio backing the liabilities to policyholders may, from time to time, take place to align it more closely with the internal benchmark of credit quality that management applies. Such rebalancing will result in a change in the projected yield on the asset portfolio and the allowance for default risk. The net effect of these changes is included in the operating result for the period.

(iii) Unwind of discount and other expected returns

The Group's methodology in determining the unwind of discount and other expected returns is by reference to:

— the value of in-force business at the beginning of the period (adjusted for the effect of current period economic and operating assumption changes); and
— required capital and surplus assets.

In applying this general approach, the unwind of discount included in operating profit for M&G Prudential is described below.

M&G Prudential

The unwind is determined by reference to an implied single risk discount rate. The EEV risk-free rate is based on a yield curve (as set out in note 12(a)(viii)), which is used to derive a single implied discount rate which, if this rate had been used, would reproduce the same embedded value as that calculated by reference to the yield curve. The difference between the operating profit determined using the single implied discount rate and that derived using the yield curve is included within non-operating profit.

For with-profits business, the opening value of in-force is adjusted for the effect of short-term investment volatility due to market movements (ie smoothed). In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed. At 30 June 2018, the shareholders' interest in the smoothed surplus assets used for this purpose only were £14 million higher (30 June 2017: £31 million lower; 31 December 2017: £57 million lower) than the surplus assets carried in the statement of financial position.

(iv) Effect of changes in operating assumptions

Operating profit includes the effect of changes to non-economic assumptions on the value of in-force at the end of the period. For presentational purposes the effect of changes is delineated to show the effect on the opening value of in-force as operating assumption changes, with the experience variances subsequently being determined by reference to the end-of-period assumptions (see note 12(b)(v)).

(v) Operating experience variances

Operating profit includes the effect of experience variances on non-economic assumptions, such as persistency, mortality and morbidity, expenses and other factors, which are calculated with reference to the end-of-period assumptions.

(vi) Effect of changes in economic assumptions

Movements in the value of in-force business at the beginning of the period caused by changes in economic assumptions, net of the related change in the time value of cost of options and guarantees, are recorded in non-operating results. For M&G Prudential, the embedded value incorporates Solvency II transitional measures, which are recalculated using management's estimate of the impact of operating and market conditions at the valuation date. The effect of changes in economic assumptions is after allowing for this recalculation.

13 Assumptions

Principal economic assumptions

The EEV basis results for the Group's operations have been determined using economic assumptions where the long-term expected rates of return on investments and risk discount rates are set by reference to period-end risk-free rates of return (defined below for each of the Group's insurance operations). Expected returns on equity and property asset classes and corporate bonds are derived by adding a risk premium, based on the Group's long-term view, to the risk-free rate.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same over time as that calculated under the IFRS basis. Since the embedded value basis reflects discounted future cash flows, under the EEV methodology the profit emergence is advanced, thus more closely aligning the timing of the recognition of profit with the efforts and risks of current management actions, particularly with regard to business sold during the period.

13 Assumptions continued

Principal economic assumptions continued

(i) Asia notes (b)(c)

The risk-free rates of return for Asia are defined as 10-year government bond yields at the end of the period.

	Risk discount rate %					
	New business			In-force business		
	2018	2017		2018	2017	
	30 Jun	30 Jun	31 Dec	30 Jun	30 Jun	31 Dec
China	9.3	9.3	9.7	9.3	9.3	9.7
Hong Kong notes (b)(d)	4.3	3.6	4.1	4.4	3.7	4.1
Indonesia	12.1	11.2	10.6	12.1	11.2	10.6
Malaysia note (d)	6.8	6.8	6.4	6.8	6.9	6.5
Philippines	14.1	12.2	12.7	14.1	12.2	12.7
Singapore note (d)	3.9	3.8	3.5	4.9	4.7	4.4
Taiwan	4.5	3.8	4.3	4.0	4.1	3.9
Thailand	10.1	10.0	9.8	10.1	10.0	9.8
Vietnam	12.2	13.2	12.6	12.2	13.2	12.6
Total weighted risk discount rate note (a)	5.6	5.1	5.3	6.0	5.8	5.7

	10-year government bond yield %			Expected long-term inflation %		
	2018	2017		2018	2017	
	30 Jun	30 Jun	31 Dec	30 Jun	30 Jun	31 Dec
China	3.5	3.6	3.9	3.0	3.0	3.0
Hong Kong notes (b)(d)	2.9	2.3	2.4	2.5	2.5	2.5
Indonesia	7.9	6.9	6.4	4.5	4.5	4.5
Malaysia note (d)	4.2	3.9	3.9	2.5	2.5	2.5
Philippines	6.6	4.7	5.2	4.0	4.0	4.0
Singapore note (d)	2.6	2.1	2.0	2.0	2.0	2.0
Taiwan	0.9	1.1	0.9	1.5	1.5	1.5
Thailand	2.6	2.5	2.3	3.0	3.0	3.0
Vietnam	4.7	5.7	5.1	5.5	5.5	5.5

Notes

(a) The weighted risk discount rates for Asia operations shown above have been determined by weighting each market's risk discount rates by reference to the post-tax EEV basis new business contribution and the closing value of in-force business. The changes in the risk discount rates for individual Asia business units reflect the movements in 10-year government bond yields, changes in product mix and the effect of changes in the economic basis.

(b) For Hong Kong the assumptions shown are for US dollar denominated business. For other business units, the assumptions are for local currency denominated business.

(c) Equity risk premiums in Asia range from 4.0 per cent to 9.4 per cent for all periods.

(d) The mean equity return assumptions for the most significant equity holdings of the Asia operations are:

	2018 %	2017 %	
	30 Jun	30 Jun	31 Dec
Hong Kong	6.9	6.3	6.4
Malaysia	10.7	10.4	10.4
Singapore	9.1	8.6	8.5

(ii) US

The risk-free rates of return for the US are defined as the 10-year treasury bond yield at the end of the period.

	2018 %	2017 %	
	30 Jun	30 Jun	31 Dec
Assumed new business spread margins:*			
Fixed annuity business:†			
January to June issues	1.75	1.50	1.50
July to December issues	n/a	n/a	1.25
Fixed index annuity business:			
January to June issues	2.00	1.75	1.75
July to December issues	n/a	n/a	1.50
Institutional business	0.50	0.50	0.50
Allowance for long-term defaults included in projected spread note 12(a)(viii)	0.18	0.20	0.19
Risk discount rate:			
Variable annuity:			
Risk discount rate	7.3	6.7	6.8
Additional allowance for credit risk included in risk discount rate note 12(a)(viii)	0.2	0.2	0.2
Non-variable annuity:			
Risk discount rate	4.6	3.9	4.1
Additional allowance for credit risk included in risk discount rate note 12(a)(viii)	1.0	1.0	1.0
Weighted average total:			
New business	7.1	6.5	6.7
In-force business	7.0	6.3	6.5
US 10-year treasury bond yield	2.9	2.3	2.4
Pre-tax expected long-term nominal rate of return for US equities	6.9	6.3	6.4
Expected long-term rate of inflation	3.1	2.9	3.0
Equity risk premium	4.0	4.0	4.0
S&P equity return volatility note (v)	18.0	18.0	18.0

* For fixed annuity and fixed index annuity business, the assumed spread margin grades up linearly by 25 basis points to a long-term assumption over five years.
† Including the proportion of variable annuity business invested in the general account.

13 Assumptions continued

Principal economic assumptions continued

(iii) UK and Europe

The risk-free rate is based on the full term structure of interest rates, ie a yield curve, which is used to determine the embedded value at the end of the reporting period. These yield curves are used to derive pre-tax expected long-term nominal rates of investment return and risk discount rates. For the purpose of determining the unwind of discount in the analysis of operating profit, these yield curves are used to derive a single implied risk discount rate, as explained in note 12(a)(viii).

This single implied risk discount rate is shown, along with the 15-year nominal rate of investment return and 15-year rate of inflation based on the inflation yield curve.

	2018 %	2017 %	
	30 Jun	30 Jun	31 Dec
Shareholder-backed annuity in-force business: note (a)			
Risk discount rate	4.1	4.3	4.0
Pre-tax expected 15-year nominal rates of investment return	2.9	2.7	2.6
With-profits and other business:			
Risk discount rate note (b):			
New business	4.8	4.9	4.7
In-force business	4.9	4.9	4.8
Pre-tax expected 15-year nominal rates of investment return:			
Overseas equities	6.6 to 10.3	6.1 to 9.9	6.2 to 10.1
Property	4.4	4.5	4.4
15-year gilt yield	1.7	1.7	1.6
Corporate bonds	3.5	3.5	3.4
Expected 15-year rate of inflation	3.4	3.5	3.5
Equity risk premium	4.0	4.0	4.0

Notes

(a) For shareholder-backed annuity business, the movements in the pre-tax long-term nominal rates of return and risk discount rates reflect the effect of changes in asset yields.

(b) The risk discount rates for with-profits and other business shown above represents a weighted average total of the rates applied to determine the present value of future cash flows, including the portion of future with-profits business shareholders' transfers recognised in net worth.

(c) The table below shows the pattern of the UK risk-free Solvency II spot yield curve at the end of all periods shown:

	1 year	5 year	10 year	15 year	20 year
30 Jun 2018	0.8%	1.2%	1.4%	1.5%	1.6%
31 Dec 2017	0.6%	0.9%	1.2%	1.3%	1.4%
30 Jun 2017	0.4%	0.8%	1.2%	1.4%	1.5%

Stochastic assumptions

Details are given below of the key characteristics of the models used to determine the time value of the financial options and guarantees as referred to in note 12(a)(iv).

(iv) Asia

- The stochastic cost of guarantees is primarily of significance for the Hong Kong, Malaysia, Singapore and Taiwan operations;
- The principal asset classes are government and corporate bonds;
- The asset return models are similar to the models as described for M&G Prudential below; and
- The volatility of equity returns ranges from 18 per cent to 35 per cent, and the volatility of government bond yields ranges from 1.1 per cent to 2.0 per cent (half year 2017: from 0.9 per cent to 2.3 per cent; full year 2017: from 1.1 per cent to 2.0 per cent) following a number of modelling changes at full year 2017 in respect of future bond returns.

(v) US (Jackson)

- Interest rates and equity returns are projected using a log-normal generator reflecting historical market data;
- Corporate bond returns are based on treasury yields plus a spread that reflects current market conditions; and
- The volatility of equity returns ranges from 18 per cent to 27 per cent for all periods, and the standard deviation of interest rates ranges from 2.6 per cent to 2.9 per cent (half year 2017: from 2.4 per cent to 2.7 per cent; full year 2017: from 2.5 per cent to 2.8 per cent).

(vi) UK and Europe (M&G Prudential)

- Interest rates are projected using a stochastic interest rate model calibrated to the current market yields;
- Equity returns are assumed to follow a log-normal distribution;
- The corporate bond return is calculated based on a risk-free return plus a mean-reverting spread;
- Property returns are also modelled based on a risk-free return plus a risk premium with a stochastic process reflecting total property returns; and
- The standard deviation of equities and property ranges from 14 per cent to 20 per cent (half year 2017: from 15 per cent to 20 per cent; full year 2017: from 14 per cent to 20 per cent).

Operating assumptions

(vii) Best estimate assumptions

Best estimate assumptions are used for the cash flow projections, where best estimate is defined as the mean of the distribution of future possible outcomes. The assumptions are reviewed actively and changes are made when evidence exists that material changes in future experience are reasonably certain.

Assumptions required in the calculation of the value of options and guarantees, for example relating to volatilities and correlations, or dynamic algorithms linking liabilities to assets, have been set equal to the best estimates and, wherever material and practical, reflect any dynamic relationships between the assumptions and the stochastic variables.

Demographic assumptions

Persistency, mortality and morbidity assumptions are based on an analysis of recent experience, but also reflect expected future experience. Where relevant, when calculating the time value of financial options and guarantees, policyholder withdrawal rates vary in line with the emerging investment conditions according to management's expectations.

Expense assumptions

Expense levels, including those of service companies that support the Group's long-term business operations, are based on internal expense analysis and are appropriately allocated to acquisition of new business and renewal of in-force business. Exceptional expenses are identified and reported separately. For mature business, it is Prudential's policy not to take credit for future cost reduction programmes until the actions to achieve the savings have been delivered. Expense overruns are reported where these are expected to be short-lived, including businesses that are growing rapidly or are sub-scale.

For Asia operations, the expenses comprise costs borne directly and recharged costs from the Asia Regional Head Office that are attributable to covered business. The assumed future expenses for these operations also include projections of these future recharges. Development expenses are charged as incurred.

Corporate expenditure, which is included in other income and expenditure, comprises:

- expenditure for Group Head Office, to the extent not allocated to the PAC with-profits funds, together with restructuring costs; and
- expenditure of the Asia Regional Head Office that is not allocated to the covered business or asset management operations which is charged as incurred. These costs are primarily for corporate related activities and are included within corporate expenditure.

(viii) Tax rates

The assumed long-term effective tax rates for operations reflect the incidence of taxable profits and losses in the projected cash flows as explained in note 12(a)(x).

The local statutory corporate tax rates applicable for the most significant operations for 2017 and 2018 are as follows:

Statutory corporate tax rates	%
Asia operations:	
Hong Kong	16.5 per cent on 5 per cent of premium income
Indonesia	25.0
Malaysia	24.0
Singapore	17.0
US operations	2017: 35.0; 2018: 21.0
UK operations	1 January 2017 until 31 March 2017: 20.0; from 1 April 2017: 19.0; from 1 April 2020: 17.0

14 Total insurance and investment products new business note (i)

Group insurance operations – new business premiums and contributions

	Single premiums			Regular premiums			Annual premium equivalents (APE) note 12(a)(ii)			Present value of new business premiums (PVNBP) note 12(a)(ii)		
	2018 £m	**2017** £m		**2018** £m	**2017** £m		**2018** £m	**2017** £m		**2018** £m	**2017** £m	
	Half year	**Half year**	**Full year**	**Half year**	**Half year**	**Full year**	**Half year**	**Half year**	**Full year**	**Half year**	**Half year**	**Full year**
Asia	**1,121**	1,131	2,299	**1,624**	1,830	3,575	**1,736**	1,943	3,805	**9,132**	10,095	20,405
US	**8,163**	9,602	16,622	**–**	–	–	**816**	960	1,662	**8,163**	9,602	16,622
UK and Europe	**6,690**	6,251	13,044	**101**	96	187	**770**	721	1,491	**7,088**	6,616	13,784
Group total note (iv)	**15,974**	16,984	31,965	**1,725**	1,926	3,762	**3,322**	3,624	6,958	**24,383**	26,313	50,811
Asia												
Cambodia	**–**	–	–	**8**	8	16	**8**	8	16	**37**	37	70
Hong Kong	**157**	368	582	**726**	877	1,667	**742**	914	1,725	**4,210**	5,190	10,027
Indonesia	**118**	126	288	**101**	131	268	**113**	144	297	**434**	558	1,183
Malaysia	**31**	33	73	**114**	125	271	**117**	128	278	**583**	623	1,398
Philippines	**22**	28	62	**36**	33	71	**38**	36	77	**134**	134	287
Singapore	**420**	323	859	**163**	163	361	**205**	195	447	**1,529**	1,451	3,463
Thailand	**124**	53	139	**41**	37	70	**53**	42	84	**289**	199	421
Vietnam	**8**	3	8	**60**	62	133	**61**	62	134	**305**	298	659
SE Asia operations including Hong Kong	**880**	934	2,011	**1,249**	1,436	2,857	**1,337**	1,529	3,058	**7,521**	8,490	17,508
China note (ii)	**30**	141	179	**184**	173	276	**187**	187	294	**759**	827	1,299
Taiwan	**180**	25	46	**90**	102	208	**108**	105	213	**426**	314	634
India note (iii)	**31**	31	63	**101**	119	234	**104**	122	240	**426**	464	964
Total	**1,121**	1,131	2,299	**1,624**	1,830	3,575	**1,736**	1,943	3,805	**9,132**	10,095	20,405
US												
Variable annuities	**5,439**	6,041	11,536	**–**	–	–	**544**	604	1,154	**5,439**	6,041	11,536
Elite Access (variable annuity)	**898**	1,101	2,013	**–**	–	–	**89**	110	201	**898**	1,101	2,013
Fixed annuities	**166**	245	454	**–**	–	–	**17**	24	45	**166**	245	454
Fixed index annuities	**125**	158	295	**–**	–	–	**13**	16	30	**125**	158	295
Wholesale	**1,535**	2,057	2,324	**–**	–	–	**153**	206	232	**1,535**	2,057	2,324
Total	**8,163**	9,602	16,622	**–**	–	–	**816**	960	1,662	**8,163**	9,602	16,622
UK and Europe												
Bonds	**1,650**	1,742	3,509	**–**	–	–	**165**	174	351	**1,650**	1,742	3,510
Corporate pensions	**43**	77	103	**70**	67	130	**75**	75	140	**275**	286	533
Individual pensions	**2,989**	2,609	5,747	**17**	18	32	**316**	279	607	**3,072**	2,690	5,897
Income drawdown	**1,226**	1,061	2,218	**–**	–	–	**123**	106	222	**1,226**	1,061	2,218
Other products	**782**	762	1,467	**14**	11	25	**91**	87	171	**865**	837	1,626
Total	**6,690**	6,251	13,044	**101**	96	187	**770**	721	1,491	**7,088**	6,616	13,784
Group total	**15,974**	16,984	31,965	**1,725**	1,926	3,762	**3,322**	3,624	6,958	**24,383**	26,313	50,811

Notes

(i) The tables shown above are provided as an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. The amounts shown are not, and not intended to be, reflective of premium income recorded in the IFRS income statement. A reconciliation of APE and gross earned premiums on an IFRS basis is provided in note II(j) within Additional financial information.

The format of the tables shown above is consistent with the distinction between insurance and investment products as applied for previous financial reporting periods. With the exception of some US institutional business, products categorised as 'insurance' refer to those classified as contracts of long-term insurance business for regulatory reporting purposes, ie falling within one of the classes of insurance specified in Part II of Schedule 1 to the Regulated Activities Order under Prudential Regulation Authority regulations.

The details shown above for insurance products include contributions for contracts that are classified under IFRS 4 'Insurance Contracts' as not containing significant insurance risk. These products are described as investment contracts or other financial instruments under IFRS. Contracts included in this category are primarily certain unit-linked and similar contracts written in UK insurance operations and Guaranteed Investment Contracts and similar funding agreements written in US operations.

(ii) New business in China is included at Prudential's 50 per cent interest in the China life operation.

(iii) New business in India is included at Prudential's 26 per cent interest in the India life operation.

(iv) During the first half of 2018, the African business sold £18 million APE of new business. Given the relative immaturity of the African business, it is incorporated into the Group's EEV results on an IFRS basis and for now it is excluded from our new business sales and profit metrics.

Investment products – funds under management notes (i)(ii)(iii)

	Half year 2018 £m				
	1 Jan 2018	Market gross inflows	Redemptions	Market exchange translation and other movements	30 Jun 2018
Eastspring Investments	46,568	10,456	(11,319)	(3,335)	42,370
M&G Prudential	163,855	21,401	(17,853)	(1,913)	165,490
Group total	210,423	31,857	(29,172)	(5,248)	207,860

	Half year 2017 £m				
	1 Jan 2017	Market gross inflows	Redemptions	Market exchange translation and other movements	30 Jun 2017
Eastspring Investments	38,042	11,536	(9,263)	4,281	44,596
M&G Prudential	136,763	22,677	(15,498)	5,176	149,118
Group total	174,805	34,213	(24,761)	9,457	193,714

Notes

(i) Investment products referred to in the tables for funds under management above are unit trusts, mutual funds and similar types of retail fund management arrangements. These are unrelated to insurance products that are classified as 'investment contracts' under IFRS 4, although similar IFRS recognition and measurement principles apply to the acquisition costs and fees attaching to this type of business.

(ii) Investment flows for half year 2018 exclude Eastspring Money Market Funds gross inflows of £95,336 million (half year 2017: gross inflows of £96,704 million) and net inflows of £665 million (half year 2017: net inflows of £499 million).

(iii) New business and market gross inflows and redemptions have been translated at an average exchange rate for the period applicable. Funds under management at points in time are translated at the exchange rate applicable to those dates.

15 Corporate transactions

The (loss) profit attaching to corporate transactions represents the following:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Transactions associated with M&G Prudential note (i)	(364)	–	–
Other note (ii)	(48)	–	80
	(412)	–	80

Notes

(i) **Transactions associated with M&G Prudential**

Intention to demerge the Group's UK business and transfer of Hong Kong insurance subsidiaries
In March 2018, the Group announced its intention to demerge its UK and Europe business (M&G Prudential) from Prudential plc, resulting in two separately listed companies. In addition, Prudential plc announced its intention to transfer the legal ownership of its Hong Kong insurance subsidiaries from The Prudential Assurance Company Limited (M&G Prudential's UK regulated insurance entity) to Prudential Corporation Asia Limited in preparation for the UK demerger process.

Sale of shareholder annuity portfolio
In March 2018, M&G Prudential announced the sale of £12.0 billion (IFRS liabilities value as at 31 December 2017) of its shareholder annuity portfolio to Rothesay Life. Under the terms of the agreement, M&G Prudential reinsured the liabilities to Rothesay Life, which is expected to be followed by a Part VII transfer of the portfolio by the end of 2019. The half year 2018 EEV results include the impact on EEV resulting from this transfer.

These transactions reduced the Group's EEV by £(364) million which primarily reflects the loss of profits on the portion of annuity liabilities sold.

(ii) **Other transactions**
In half year 2018, other corporate transactions resulted in an EEV loss of £(48) million (half year 2017: £nil; full year 2017: £80 million gain). On 15 August 2017, the Group, through its subsidiary National Planning Holdings, Inc. (NPH), sold its US independent broker-dealer network to LPL Financial LLC, which realised a post-tax gain of £80 million in full year 2017.

Other transaction costs of £(48) million incurred in the first half of 2018 primarily relate to additional costs incurred in exiting the NPH broker-dealer business and costs related to preparation for the announced demerger discussed above.

16 Impact of US tax reform

On 22 December 2017, a significant US tax reform package, The Tax Cuts and Jobs Act, was enacted into law effective from 1 January 2018. The tax reform package as a whole, which includes a reduction in the corporate income tax rate from 35 per cent to 21 per cent, and a number of specific measures affecting US life insurers, resulted in a £390 million benefit in non-operating profit reflected within the full year 2017 results. The positive impact on an EEV basis represented the benefit of future profits being taxed at a lower rate, partially offset by a reduction in the net deferred tax asset held in the balance sheet to reflect remeasurement at the new lower tax rate, together with a reduction in the benefit from the dividend received deduction on taxable profits from variable annuity business.

In June 2018, the National Association of Insurance Commissioners ('NAIC') formally approved changes to RBC capital factors that reflect the December 2017 US tax reform. The half year 2018 EEV results reflect these changes as shown in notes 6 and 9.

17 Post balance sheet events

On 25 July 2018, the Group announced that Eastspring had reached an agreement to initially acquire 65 per cent of TMB Asset Management Co., Ltd., an asset management company in Thailand, from TMB Bank Public Company Limited ('TMB'). Eastspring has an option to increase its ownership to 100 per cent in the future. As part of this acquisition, Eastspring has also entered into a distribution agreement with TMB to provide investment solutions to their customers. The completion of the transaction is subject to local regulatory approval.

In August 2018, the Group announced the extension of the geographical scope of its bancassurance partnership with Standard Chartered Bank to include Ghana. Under the partnership, a range of Prudential Ghana's life insurance products will be made available to clients through Standard Chartered's branch network.

In August 2018, the Group announced that it had entered into an agreement with the UK-based healthcare technology and services company Babylon Health to provide customers in Asia access to a suite of health services that utilise artificial intelligence technology.

05

Additional information

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* The additional financial information set out in sections I(a) to II(l) is not covered by the KPMG LLP independent review opinion on page 100.

Additional financial information

I IFRS profit and loss information

I(a) Analysis of long-term insurance business IFRS operating profit before tax based on longer-term investment returns by driver

This schedule classifies the Group's pre-tax operating earnings from long-term insurance operations into the underlying drivers of those profits, using the following categories:

i **Spread income** represents the difference between net investment income and amounts credited to certain policyholder accounts. It excludes the operating investment return on shareholder net assets, which has been separately disclosed as expected return on shareholder assets.
ii **Fee income** represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds, net of investment management expenses.
iii **With-profits** business represents the pre-tax shareholders' transfer from the with-profits fund for the period.
iv **Insurance margin** primarily represents profits derived from the insurance risks of mortality and morbidity.
v **Margin on revenues** primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.
vi **Acquisition costs and administration expenses** represent expenses incurred in the period attributable to shareholders. These exclude items such as restructuring costs which are not included in the segment profit as well as items that are more appropriately included in other sources of earnings lines (eg investment expenses are netted against investment income as part of spread income or fee income as appropriate).
vii **DAC adjustments** comprise DAC amortisation for the period, excluding amounts related to short-term fluctuations in investment returns, net of costs deferred in respect of new business.

Analysis of IFRS operating profit before tax by source and margin analysis of Group long-term insurance business

The following analysis expresses certain of the Group's sources of operating profit as a margin of policyholder liabilities or other relevant drivers. Details on the calculation of the Group's average policyholder liability balances are given in note (iv) at the end of this section.

	Half year 2018					
	Asia £m	US £m	UK and Europe £m	Total £m	Average liability note (iv) £m	Margin note (ii) bps
Spread income	112	295	47	454	80,938	112
Fee income	108	1,185	27	1,320	172,662	153
With-profits	30	–	157	187	145,813	26
Insurance margin	723	463	27	1,213		
Margin on revenues	1,004	–	79	1,083		
Expenses:						
Acquisition costs note (i)	(721)	(384)	(28)	(1,133)	3,322	(34)%
Administration expenses	(512)	(580)	(85)	(1,177)	257,782	(91)
DAC adjustments note (v)	143	10	1	154		
Expected return on shareholder assets	58	12	33	103		
	945	1,001	258	2,204		
Share of related tax charges from joint ventures and associate note (vi)	(18)	–	–	(18)		
Longevity reinsurance and other management actions to improve solvency	–	–	63	63		
Insurance recoveries of costs associated with review of past annuity sales	–	–	166	166		
Long-term business operating profit based on longer-term investment returns	927	1,001	487	2,415		

See notes at the end of this section.

I IFRS profit and loss information continued

I(a) Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver continued

	Half year 2017 AER					
	Asia £m	US £m	UK and Europe £m	Total £m	Average liability note (iv) £m	Margin note (ii) bps
Spread income	108	401	74	583	89,314	131
Fee income	103	1,145	31	1,279	164,152	156
With-profits	30	–	142	172	132,701	26
Insurance margin	658	472	22	1,152		
Margin on revenues	1,056	–	82	1,138		
Expenses:						
Acquisition costs note (i)	(736)	(463)	(42)	(1,241)	3,624	(34)%
Administration expenses	(455)	(593)	(67)	(1,115)	259,451	(86)
DAC adjustments note (v)	66	117	3	186		
Expected return on shareholder assets	56	–	47	103		
	886	1,079	292	2,257		
Share of related tax charges from joint ventures and associate note (vi)	(16)	–	–	(16)		
Longevity reinsurance and other management actions to improve solvency	–	–	188	188		
Long-term business operating profit based on longer-term investment returns	870	1,079	480	2,429		

See notes at the end of this section.

	Half year 2017 CER note (iii)					
	Asia £m	US £m	UK and Europe £m	Total £m	Average liability note (iv) £m	Margin note (ii) bps
Spread income	102	367	74	543	85,504	127
Fee income	96	1,048	31	1,175	153,255	153
With-profits	28	–	142	170	131,600	26
Insurance margin	618	432	22	1,072		
Margin on revenues	987	–	82	1,069		
Expenses:						
Acquisition costs note (i)	(689)	(423)	(42)	(1,154)	3,411	(34)%
Administration expenses	(430)	(543)	(67)	(1,040)	244,721	(85)
DAC adjustments note (v)	63	107	3	173		
Expected return on shareholder assets	53	–	47	100		
	828	988	292	2,108		
Share of related tax charges from joint ventures and associate note (vi)	(16)	–	–	(16)		
Longevity reinsurance and other management actions to improve solvency	–	–	188	188		
Long-term business operating profit based on longer-term investment returns	812	988	480	2,280		

See notes at the end of this section.

Margin analysis of long-term insurance business – Asia

Long-term business	Half year 2018 Profit £m	Half year 2018 Average liability note (iv) £m	Half year 2018 Margin note (ii) bps	Half year 2017 AER Profit £m	Half year 2017 AER Average liability note (iv) £m	Half year 2017 AER Margin note (ii) bps	Half year 2017 CER note (iii) Profit £m	Half year 2017 CER Average liability note (iv) £m	Half year 2017 CER Margin note (ii) bps
Spread income	112	17,872	125	108	15,776	137	102	15,335	133
Fee income	108	19,903	109	103	18,170	113	96	17,548	109
With-profits	30	34,032	18	30	28,772	21	28	27,671	20
Insurance margin	723			658			618		
Margin on revenues	1,004			1,056			987		
Expenses:									
Acquisition costs note (i)	(721)	1,736	(42)%	(736)	1,943	(38)%	(689)	1,811	(38)%
Administration expenses	(512)	37,775	(271)	(455)	33,946	(268)	(430)	32,883	(262)
DAC adjustments note (v)	143			66			63		
Expected return on shareholder assets	58			56			53		
	945			886			828		
Share of related tax charges from joint ventures and associate note (vi)	(18)			(16)			(16)		
Operating profit based on longer-term investment returns	927			870			812		

See notes at the end of this section.

Analysis of Asia operating profit drivers

- Spread income has increased on a CER basis by 10 per cent (AER: 4 per cent) to £112 million in half year 2018, predominantly reflecting the growth of non-linked policyholder liabilities.
- Fee income has increased by 13 per cent on a CER basis (AER: 5 per cent) to £108 million in half year 2018, broadly in line with the increase in movement in average unit-linked policyholder liabilities.
- Insurance margin has increased by 17 per cent to £723 million in half year 2018 on a CER basis (AER: 10 per cent), primarily reflecting the continued growth of the in-force book, which contains a relatively high proportion of risk-based products.
- Margin on revenues has increased by £17 million on a CER basis from £987 million in half year 2017 to £1,004 million in half year 2018, reflecting moderate growth primarily as a result of country and product mix and higher premium allocation to policyholders.
- Acquisition costs have increased by 5 per cent on a CER basis (AER: decreased by 2 per cent) to £(721) million in half year 2018, compared to a 4 per cent decrease in APE sales on a CER basis, resulting in an increase in the acquisition cost ratio. The analysis above uses shareholder acquisition costs as a proportion of total APE. If with-profits sales were excluded from the denominator, the acquisition cost ratio would become 69 per cent (2017: 65 per cent on a CER basis), the increase being the result of product and country mix.
- Administration expenses including renewal commissions have increased by 19 per cent on a CER basis (AER: 13 per cent increase) in half year 2018, as the business continues to expand. On a CER basis, the administration expense ratio has increased from 262 basis points in half year 2017 to 271 basis points in half year 2018, the result of changes in country and product mix.

I IFRS profit and loss information continued

I(a) Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver continued

Margin analysis of long-term insurance business – US

	Half year 2018			Half year 2017 AER			Half year 2017 CER note (iii)		
Long-term business	Profit £m	Average liability note (iv) £m	Margin note (ii) bps	Profit £m	Average liability note (iv) £m	Margin note (ii) bps	Profit £m	Average liability note (iv) £m	Margin note (ii) bps
Spread income	295	36,396	162	401	39,731	202	367	36,362	202
Fee income	1,185	130,088	182	1,145	123,464	186	1,048	113,189	185
Insurance margin	463			472			432		
Expenses:									
Acquisition costs note (i)	(384)	816	(47)%	(463)	960	(48)%	(423)	879	(48)%
Administration expenses	(580)	170,666	(68)	(593)	169,180	(70)	(543)	155,513	(70)
DAC adjustments	10			117			107		
Expected return on shareholder assets	12			–			–		
Operating profit based on longer-term investment returns	1,001			1,079			988		

See notes at the end of this section.

Analysis of US operating profit drivers

— Spread income has decreased by 20 per cent on a CER basis (AER: 26 per cent) to £295 million in the first half of 2018. The reported spread margin decreased to 162 basis points from 202 basis points in the first half of 2017, primarily due to maturing swaps previously entered into to more closely match the asset and liability duration, the impact of increasing LIBOR on interest rate swaps, and lower investment yields. Excluding the effect of swaps previously entered into to more closely match the asset and liability duration, the spread margin would have been 133 basis points (half year 2017 CER:149 basis points and AER: 147 basis points).

— Fee income has increased by 13 per cent on a CER basis (AER: 3 per cent) to £1,185 million during the first half of 2018, primarily due to higher average separate account balances resulting from positive net flows from variable annuity business and market appreciation in the second half of 2017.

— Insurance margin represents operating profits from insurance risks, including variable annuity guarantees and other sundry items. Insurance margin increased to £463 million in the first half of 2018 from £432 million in half year 2017 on a CER basis. The increase is due to continued positive net flows and favourable mortality experience.

— Acquisition costs, which are commissions and expenses incurred to acquire new business, including those that are not deferrable, have decreased by 9 per cent on a CER basis. This reflects a 7 per cent decrease in APE sales and lower level of front-ended commissions.

— Administration expenses increased to £(580) million during the first half of 2018, compared to £(543) million for the first half of 2017 on a CER basis (AER: £(593) million), primarily as a result of higher asset-based commissions. Excluding these asset-based commissions, the resulting administration expense ratio would be lower at 33 basis points (half year 2017: 36 basis points at CER and AER).

— DAC adjustments declined in the first half of 2018 to £10 million from £107 million in half year 2017 on a CER basis due to an increase in the DAC amortisation charge. The higher DAC amortisation charge arises largely from an acceleration of amortisation of £(42) million (CER: credit for deceleration of £33 million) primarily relating to the reversal of the benefit received in 2015 under the mean reversion formula.

Analysis of pre-tax operating profit before and after acquisition costs and DAC adjustments

	Half year 2018 £m				Half year 2017 AER £m				Half year 2017 CER £m note (iii)			
	Other operating profits	Acquisition costs Incurred	Acquisition costs Deferred	Total	Other operating profits	Acquisition costs Incurred	Acquisition costs Deferred	Total	Other operating profits	Acquisition costs Incurred	Acquisition costs Deferred	Total
Total operating profit before acquisition costs and DAC adjustments	**1,375**			**1,375**	1,425			1,425	1,305			1,305
Less new business strain		**(384)**	**290**	**(94)**		(463)	353	(110)		(424)	323	(101)
Other DAC adjustments – amortisation of previously deferred acquisition costs:												
Normal			**(238)**	**(238)**			(272)	(272)			(249)	(249)
(Accelerated) decelerated			**(42)**	**(42)**			36	36			33	33
Total	**1,375**	**(384)**	**10**	**1,001**	1,425	(463)	117	1,079	1,305	(424)	107	988

Analysis of operating profit based on longer-term investment returns for US operations by product

	2018 £m	2017 £m		%	
				Half year 2018 vs half year 2017	
	Half year	AER Half year	CER Half year note (iii)	AER	CER
Spread business[note (a)]	**153**	176	161	(13)%	(5)%
Fee business[note (b)]	**791**	852	780	(7)%	1%
Life and other business[note (c)]	**57**	51	47	12%	21%
Total insurance operations	**1,001**	1,079	988	(7)%	1%
US asset management and broker-dealer	**1**	(6)	(6)	117%	117%
Total US operations	**1,002**	1,073	982	(7)%	2%

The analysis of operating profit based on longer-term investment returns for US operations by product represents the net profit generated by each line of business after allocation of costs. Broadly:

a) Spread business is the net operating profit for fixed annuity, fixed indexed annuity and guaranteed investment contracts and largely comprises spread income less costs.

b) Fee business represents profits from variable annuity products. As well as fee income, revenue for this product line includes spread income from investments directed to the general account and other variable annuity fees included in insurance margin.

c) Life and other business includes the profits from the REALIC business and other closed life books. Revenue allocated to this product line includes spread income and premiums and policy charges for life protection, which are included in insurance margin after claim costs. Insurance margin forms the vast majority of revenue.

I IFRS profit and loss information continued

I(a) Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver continued

Margin analysis of long-term insurance business – UK and Europe

	Half year 2018			Half year 2017		
Long-term business	Profit £m	Average liability note (iv) £m	Margin note (ii) bps	Profit £m	Average liability note (iv) £m	Margin note (ii) bps
Spread income	47	26,670	35	74	33,807	44
Fee income	27	22,671	24	31	22,518	27
With-profits	157	111,781	28	142	103,929	27
Insurance margin	27			22		
Margin on revenues	79			82		
Expenses:						
Acquisition costs note (i)	(28)	770	(4)%	(42)	721	(6)%
Administration expenses	(85)	49,341	(34)	(67)	56,325	(24)
DAC adjustments	1			3		
Expected return on shareholders' assets	33			47		
	258			292		
Longevity reinsurance and other management actions to improve solvency	63			188		
Insurance recoveries of costs associated with review of past annuity sales	166			–		
Operating profit based on longer-term investment returns	487			480		

Analysis of UK and Europe operating profit drivers

— Spread income has reduced from £74 million in half year 2017 to £47 million in half year 2018 reflecting the run-off of the in-force annuity portfolio following the withdrawal from selling new annuity business.

— Fee income principally represents asset management fees from unit-linked business (including direct investment only business to Group pension schemes where liability flows are driven by a small number of large single mandate transactions) and mostly arises within our UK and Europe asset management business. Fee income is after costs related to managing the underlying funds which include recent rationalisation activity to remove sub-scale funds. If these costs and the direct investment only schemes are excluded, the fee margin on the remaining balances would be 38 basis points (half year 2017: 40 basis points).

— Margin on revenues represents premium charges for expenses of shareholder-backed business and other sundry net income.

— Shareholder acquisition costs incurred decreased from £(42) million in half year 2017 to £(28) million in half year 2018 reflecting a change in the business mix in recent periods from selling annuities to other retirement products.

— The contribution from longevity reinsurance and other management actions to improve solvency during half year 2018 was £63 million (half year 2017: £188 million). Further explanation and analysis is provided in Additional financial information section I(d).

— The half year 2018 insurance recoveries of costs associated with undertaking a review of past annuity sales of £166 million (half year 2017: £nil) is explained in note B3.

Notes

(i) The ratio of acquisition costs is calculated as a percentage of APE sales including with-profits sales. Acquisition costs include only those relating to shareholder-backed business.

(ii) Margin represents the operating return earned in the period as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus. The margin is on an annualised basis in which half year profits are annualised by multiplying by two.

(iii) The half year 2017 comparative information has been presented at AER and CER so as to eliminate the impact of exchange translation. See note A1. CER results are calculated by translating prior period results using the current period foreign exchange rates. All CER profit figures have been translated at current period average rates. For Asia CER average liability calculations the policyholder liabilities have been translated using current period opening and closing exchange rates. For US CER average liability calculations the policyholder liabilities have been translated at the current period month end closing exchange rates.

(iv) For UK and Europe and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the period, as a proxy for average balances throughout the period. The calculation of average liabilities for Jackson is generally derived from month end balances throughout the period as opposed to opening and closing balances only. The average liabilities for fee income in Jackson have been calculated using daily balances instead of month end balances in order to provide a more meaningful analysis of the fee income, which is charged on the daily account balance. Average liabilities for spread income are based on the general account liabilities to which spread income is attached. Average liabilities used to calculate the administration expense margin exclude the REALIC liabilities reinsured to third parties prior to the acquisition by Jackson.

(v) The DAC adjustments contain a credit of £14 million in respect of joint ventures and associate in half year 2018 (half year 2017: £10 million).

(vi) Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In half year 2018, the Group altered the presentation of its analysis of Asia operating profit drivers to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the margin analysis on a consistent basis as the rest of the Asia's operations. Half year 2017 comparatives have been re-presented accordingly.

I(b) Asia operations – analysis of IFRS operating profit by business unit

Operating profit based on longer-term investment returns for Asia operations are analysed below. The table below presents the half year 2017 results on both actual exchange rates (AER) and constant exchange rates (CER) bases so as to eliminate the impact of exchange translation.

	2018 £m	2017 £m		%		2017 £m
	Half year	AER Half year	CER Half year	Half year 2018 vs half year 2017 AER	Half year 2018 vs half year 2017 CER	AER Full year
Hong Kong	**190**	157	143	21%	33%	346
Indonesia	**205**	232	205	(12)%	0%	457
Malaysia	**97**	87	88	11%	10%	173
Philippines	**20**	21	18	(5)%	11%	41
Singapore	**143**	133	129	8%	11%	272
Thailand	**46**	46	46	0%	0%	107
Vietnam	**63**	57	52	11%	21%	135
South-east Asia operations including Hong Kong	**764**	733	681	4%	12%	1,531
China	**62**	51	51	22%	22%	121
Taiwan	**19**	19	18	0%	6%	43
Other	**33**	30	29	10%	14%	71
Non-recurrent items note	**69**	54	50	28%	38%	75
Total insurance operations	**947**	887	829	7%	14%	1,841
Share of related tax charges from joint ventures and associate*	**(18)**	(16)	(16)	13%	13%	(39)
Development expenses	**(2)**	(1)	(1)	(100)%	(100)%	(3)
Total long-term business operating profit	**927**	870	812	7%	14%	1,799
Asset management (Eastspring Investments)	**89**	83	79	7%	13%	176
Total Asia operations	**1,016**	953	891	7%	14%	1,975

* Under IFRS, the Group's share of results from its investments in joint ventures and associate accounted for using the equity method is included in the Group's profit before tax on a net of related tax basis. In half year 2018, the Group altered the presentation of its analysis of Asia operating profit to show these tax charges separately in order for the contribution from the joint ventures and associate to be included in the operating profit analysis on a consistent basis as the rest of the Asia's operations. Half year 2017 comparatives have been re-presented accordingly.

Note

In half year 2018, the IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net credit of £69 million (half year 2017: £54 million; full year 2017: £75 million) representing a small number of items that are not expected to reoccur, including the impact of a refinement to the run-off of the allowance for prudence within technical provisions.

I IFRS profit and loss information continued

I(c) Analysis of asset management operating profit based on longer-term investment returns

	Half year 2018 £m	
	M&G Prudential asset management note (ii)	Eastspring Investments note (ii)
Operating income before performance-related fees	553	216
Performance-related fees	8	2
Operating income (net of commission) note (i)	561	218
Operating expense note (i)	(297)	(116)
Share of associate's results	8	–
Group's share of tax on joint ventures' operating profit	–	(13)
Operating profit based on longer-term investment returns	272	89
Average funds under management	£285.3bn	£139.5bn
Margin based on operating income*	39bps	31bps
Cost/income ratio†	54%	54%

	Half year 2017 £m	
	M&G Prudential asset management note (ii)	Eastspring Investments note (ii)
Operating income before performance-related fees	495	205
Performance-related fees	6	3
Operating income (net of commission) note (i)	501	208
Operating expense note (i)	(261)	(113)
Share of associate's results	8	–
Group's share of tax on joint ventures' operating profit	–	(12)
Operating profit based on longer-term investment returns	248	83
Average funds under management	£267.2bn	£124.9bn
Margin based on operating income*	37bps	33bps
Cost/income ratio†	53%	55%

	Full year 2017 £m	
	M&G Prudential asset management note (ii)	Eastspring Investments note (ii)
Operating income before performance-related fees	1,034	421
Performance-related fees	53	17
Operating income (net of commission) note (i)	1,087	438
Operating expense note (i)	(602)	(238)
Share of associate's results	15	–
Group's share of tax on joint ventures' operating profit	–	(24)
Operating profit based on longer-term investment returns	500	176
Average funds under management	£275.9bn	£128.4bn
Margin based on operating income*	37bps	33bps
Cost/income ratio†	58%	56%

Notes

(i) Operating income and expense include the Group's share of contribution from joint ventures (but excludes any contribution from associates). In the consolidated income statement of the IFRS financial statements, the net post-tax income of the joint ventures and associates is shown as a single line item.

(ii) M&G Prudential asset management and Eastspring Investments can be further analysed as follows:

	M&G Prudential asset management						Eastspring Investments					
	Operating income before performance-related fees						Operating income before performance-related fees					
	Retail £m	Margin of FUM* bps	Institutional‡ £m	Margin of FUM* bps	Total £m	Margin of FUM* bps	Retail £m	Margin of FUM* bps	Institutional‡ £m	Margin of FUM* bps	Total £m	Margin of FUM* bps
30 Jun 2018	**331**	**84**	**222**	**21**	**553**	**39**	**128**	**54**	**88**	**19**	**216**	**31**
30 Jun 2017	285	86	210	21	495	37	120	57	85	20	205	33
31 Dec 2017	604	85	430	21	1,034	37	249	57	172	20	421	33

* Margin represents operating income before performance related fees as a proportion of the related funds under management (FUM). Half year figures have been annualised by multiplying by two. Monthly closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group's insurance operations that are managed by third parties outside the Prudential Group are excluded from these amounts.

† Cost/income ratio represents cost as a percentage of operating income before performance related fees.

‡ Institutional includes internal funds.

I IFRS profit and loss information continued

I(d) Contribution to UK life financial metrics from specific management actions undertaken to position the balance sheet more efficiently under the Solvency II regime

In the first half of 2018, further management actions were taken to improve the solvency of the UK and Europe insurance operations and to mitigate market risks. These actions included repositioning the fixed income asset portfolio to improve the trade-off between yield and credit risk. No new longevity reinsurance transactions were undertaken in the first half of 2018 (half year 2017: longevity reinsurance transactions covering £0.6 billion of IFRS annuity liabilities).

The effect of these actions on the UK's long-term IFRS operating profit, underlying free surplus generation and EEV operating profit before restructuring costs is shown in the tables below.

IFRS operating profit of UK long-term business*

	2018 £m	2017 £m	
	Half year	Half year	Full year
Shareholder-backed annuity new business	3	4	9
In-force business:			
Longevity reinsurance transactions	–	31	31
Other management actions to improve solvency	63	157	245
Changes in longevity assumption basis	–	–	204
Provision for the review of past annuity sales	–	–	(225)
Insurance recoveries in respect of above costs	166	–	–
	229	188	255
With-profits and other in-force	255	288	597
Total	487	480	861

Underlying free surplus generation of UK long-term business*

	2018 £m	2017 £m	
	Half year	Half year	Full year
Expected in-force and return on net worth	334	349	706
Longevity reinsurance transactions	–	15	15
Other management actions to improve solvency	54	178	385
Changes in longevity assumption basis	–	–	179
Provision for the review of past annuity sales	–	–	(187)
Insurance recoveries in respect of above costs	138	–	–
	192	193	392
Other in-force	62	27	(28)
Underlying free surplus generated from in-force business	588	569	1,070
New business strain	(100)	(42)	(175)
Total	488	527	895

EEV post-tax operating profit of UK long-term business*

	2018 £m	2017 £m	
	Half year	Half year	Full year
Unwind of discount and other expected return	234	232	465
Longevity reinsurance transactions	–	(6)	(6)
Other management actions to improve solvency	141	65	127
Changes in longevity assumption basis	–	–	195
Provision for the review of past annuity sales	–	–	(187)
Insurance recoveries in respect of above costs	138	–	–
	279	59	129
Other in-force	79	13	79
Operating profit from in-force business	592	304	673
New business profit	179	161	342
Total	771	465	1,015

* Before restructuring costs.

II Other information

II(a) Holding company cash flow*

	2018 £m	2017 £m	
	Half year	Half year	Full year
Net cash remitted by business units:			
Total Asia net remittances to the Group	391	350	645
US remittances to the Group	342	475	475
UK and Europe net remittances to the Group			
With-profits remittance	233	215	215
Shareholder-backed business remittance	–	–	105
Asset management remittance	108	175	323
	341	390	643
Other UK paid to the Group (including Prudential Capital)	37	15	25
Total UK net remittances to the Group	378	405	668
Net remittances to the Group from business units[1]	1,111	1,230	1,788
Net interest paid	(187)	(207)	(415)
Tax received	81	84	152
Corporate activities	(113)	(103)	(207)
Total central outflows	(219)	(226)	(470)
Operating holding company cash flow before dividend	892	1,004	1,318
Dividend paid	(840)	(786)	(1,159)
Operating holding company cash flow after dividend	52	218	159
Non-operating net cash flow[2]	(106)	(186)	(511)
Total holding company cash flow	(54)	32	(352)
Cash and short-term investments at beginning of period	2,264	2,626	2,626
Foreign exchange movements	–	(1)	(10)
Cash and short-term investments at end of period[3]	2,210	2,657	2,264

* The holding company cash flow differs from the IFRS cash flow statement, which includes all cash flows in the period including those relating to both policyholder and shareholder funds. The holding company cash flow is therefore a more meaningful indication of the Group's central liquidity.

Notes

1 Net cash remittances comprise dividends and other transfers from business units that are reflective of emerging earnings and capital generation.
2 Non-operating net cash flow principally relates to the payments for distribution rights and acquisition of subsidiaries.
3 Including central finance subsidiaries.

II Other information continued

II(b) Funds under management

(a) Summary

For our asset management businesses, funds managed on behalf of third parties are not recorded on the balance sheet. They are however a driver of profitability. We therefore analyse the movement in the funds under management each period, focusing on those which are external to the Group and those primarily held by the insurance businesses. The table below analyses, by segment, the funds of the Group held in the statement of financial position and the external funds that are managed by Prudential's asset management operations.

	2018 £bn	2017 £bn	
	30 Jun	30 Jun	31 Dec
Business area:			
Asia operations:			
Internal funds	83.7	75.8	81.4
Eastspring Investments external funds	52.4	52.9	55.9
	136.1	128.7	137.3
US operations – internal funds	183.7	174.6	178.3
M&G Prudential:			
Internal funds, including PruFund-backed products	176.4	182.5	186.8
External funds	165.5	149.1	163.9
	341.9	331.6	350.7
Other operations	2.7	3.2	3.0
Total funds under management note	664.4	638.1	669.3

Note

Total funds under management comprise:

	2018 £bn	2017 £bn	
	30 Jun	30 Jun	31 Dec
Total investments per the consolidated statement of financial position	448.0	437.4	451.4
External funds of M&G Prudential and Eastspring Investments (as analysed in note b below)	217.9	202.0	219.8
Internally managed funds held in joint ventures and other adjustments	(1.5)	(1.3)	(1.9)
Prudential Group funds under management	664.4	638.1	669.3

(b) Investment products – external funds under management

	Half year 2018 £m				
	At 1 Jan 2018	Market gross inflows	Redemptions	Market and other movements	At 30 Jun 2018
M&G Prudential Wholesale/Direct	79,697	16,471	(14,317)	(2,030)	79,821
M&G Prudential Institutional	84,158	4,930	(3,536)	117	85,669
Total M&G Prudential[1]	163,855	21,401	(17,853)	(1,913)	165,490
Eastspring Investments	55,885	105,792	(105,990)	(3,250)	52,437
Total[2]	219,740	127,193	(123,843)	(5,163)	217,927

	Half year 2017 £m				
	At 1 Jan 2017	Market gross inflows	Redemptions	Market and other movements	At 30 Jun 2017
M&G Prudential Wholesale/Direct	64,209	15,871	(10,356)	2,776	72,500
M&G Prudential Institutional	72,554	6,806	(5,142)	2,400	76,618
Total M&G Prudential[1]	136,763	22,677	(15,498)	5,176	149,118
Eastspring Investments	45,756	108,240	(105,468)	4,395	52,923
Total[2]	182,519	130,917	(120,966)	9,571	202,041

	Full year 2017 £m				
	At 1 Jan 2017	Market gross inflows	Redemptions	Market and other movements	At 31 Dec 2017
M&G Prudential Wholesale/Direct	64,209	30,949	(19,906)	4,445	79,697
M&G Prudential Institutional	72,554	15,220	(8,926)	5,310	84,158
Total M&G Prudential[1]	136,763	46,169	(28,832)	9,755	163,855
Eastspring Investments	45,756	215,907	(211,271)	5,493	55,885
Total[2]	182,519	262,076	(240,103)	15,248	219,740

Notes

1 The results exclude contribution from PruFund products (net inflows of £4.4 billion in half year 2018; funds under management of £40.3 billion as at 30 June 2018, (£30.0 billion at 30 June 2017; £35.9 billion at 31 December 2017)).

2 The £217.9 billion (30 June 2017: £202.0 billion; 31 December 2017: £219.7 billion) investment products comprise £207.9 billion (30 June 2017: £193.7 billion; 31 December 2017: £210.4 billion) plus Asia Money Market Funds of £10.0 billion (30 June 2017: £8.3 billion; 31 December 2017: £9.3 billion).

(c) M&G and Eastspring Investments – total funds under management

M&G, the asset management business of M&G Prudential and Eastspring Investments, the Group's asset management business in Asia, manage funds from external parties and also funds for the Group's insurance operations. The table below analyses the total funds under management managed by M&G and Eastspring Investments respectively.

	Eastspring Investments note			M&G		
	30 Jun 2018 £bn	30 Jun 2017 £bn	31 Dec 2017 £bn	30 Jun 2018 £bn	30 Jun 2017 £bn	31 Dec 2017 £bn
External funds under management	52.4	52.9	55.9	165.5	149.1	163.9
Internal funds under management	85.8	77.6	83.0	120.3	132.4	134.6
Total funds under management	138.2	130.5	138.9	285.8	281.5	298.5

Note

The external funds under management for Eastspring Investments include Asia Money Market Funds at 30 June 2018 of £10.0 billion (30 June 2017: £8.3 billion; 31 December 2017: £9.3 billion).

II(c) Return on IFRS shareholders' funds

Return on IFRS shareholders' funds is calculated as operating profit based on longer-term investment returns net of tax and non-controlling interests divided by opening shareholders' funds. Operating profit based on longer-term investment returns is reconciled to IFRS profit before tax in note B1 to the IFRS financial statements.

		2018 £m	2017 £m	
	Note	30 Jun	30 Jun	31 Dec
Operating profit based on longer-term investment returns, net of tax and non-controlling interests	B5	1,975	1,795	3,727
Opening shareholders' funds		16,087	14,666	14,666
Return on shareholders' funds*		25%	24%	25%

* Annualised operating profit after tax and non-controlling interests as a percentage of opening shareholders' funds. Half year profits are annualised by multiplying by two.

II Other information continued

II(d) IFRS gearing ratio

Gearing ratio is calculated as net core structural borrowings of shareholder-financed operations divided by closing IFRS shareholders' funds plus net core structural borrowings.

		2018 £m	2017 £m	
	Note	30 Jun	30 Jun	31 Dec
Core structural borrowings of shareholder-financed operations	C6.1	6,367	6,614	6,280
Less holding company cash and short-term investments	II(a)	(2,210)	(2,657)	(2,264)
Net core structural borrowings of shareholder-financed operations		4,157	3,957	4,016
Closing shareholders' funds		15,882	15,449	16,087
Shareholders' funds plus net core structural borrowings		20,039	19,406	20,103
Gearing ratio		21%	20%	20%

II(e) IFRS shareholders' funds per share

IFRS shareholders' funds per share is calculated as closing IFRS shareholders' funds divided by the number of issued shares at the balance sheet date.

	2018	2017	
	30 Jun	30 Jun	31 Dec
Closing shareholders' funds (£ million)	15,882	15,449	16,087
Number of issued shares at period end (millions)	2,592	2,586	2,587
Shareholders' funds per share (pence)	613	597	622

II(f) Solvency II capital position at 30 June 2018

The estimated Group shareholder Solvency II surplus at 30 June 2018 was £14.4 billion, before allowing for payment of the 2018 first interim ordinary dividend and after allowing for management's estimate of transitional measures reflecting operating and market conditions at 30 June 2018.

Estimated Group shareholder Solvency II capital position*	30 Jun 2018	30 Jun 2017	31 Dec 2017†
Own Funds (£bn)	27.5	25.6	26.4
Solvency Capital Requirement (£bn)	13.1	12.7	13.1
Surplus (£bn)	14.4	12.9	13.3
Solvency ratio (%)	209%	202%	202%

* The Group shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring fenced with-profit funds and staff pension schemes in surplus. The solvency positions include management's estimates of UK transitional measures reflecting operating and market conditions at each valuation date.

† Given that approval was received from the PRA to recalculate the transitional measures as at 31 December 2017, the surplus at this date reflects both management's recalculation of transitional measures and represents the approved regulatory position.

In accordance with Solvency II requirements, these results allow for:

- Capital in Jackson in excess of 250 per cent of the US local Risk Based Capital requirement. As agreed with the Prudential Regulation Authority, this is incorporated in the result above as follows:
  - Own funds: represents Jackson's local US Risk Based available capital less 100 per cent of the US Risk Based Capital requirement (Company Action Level);
  - Solvency Capital Requirement: represents 150 per cent of Jackson's local US Risk Based Capital requirement (Company Action Level); and
  - No diversification benefits are taken into account between Jackson and the rest of the Group.
- Matching adjustment for UK annuities and volatility adjustment for US dollar denominated Hong Kong with-profits business, based on approvals from the Prudential Regulation Authority and calibrations published by the European Insurance and Occupational Pensions Authority; and
- UK transitional measures, which have been recalculated using management's estimate of the impact of operating and market conditions at the valuation date. An application to recalculate the transitional measures as at 31 March 2018 was approved by the Prudential Regulation Authority. The estimated Group shareholder surplus would increase from £14.4 billion to £14.6 billion at 30 June 2018 if the approved regulatory transitional measures amount was applied instead.

The Group shareholder Solvency II capital position excludes:

- A portion of Solvency II surplus capital (£1.8 billion at 30 June 2018) relating to the Group's Asian life operations, primarily due to the Solvency II definition of 'contract boundaries' which prevents some expected future cash flows from being recognised;
- The contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds in surplus (representing £5.5 billion of surplus capital from UK with-profits funds at 30 June 2018) and from the shareholders' share of the estate of with-profits funds; and
- The contribution to Own Funds and the Solvency Capital Requirement from pension funds in surplus.

It also excludes unrealised gains on certain derivative instruments taken out to protect Jackson against declines in long-term interest rates. At Jackson's request, the Department of Insurance and Financial Services renewed its approval to carry these instruments at book value in the local statutory returns for the period 31 December 2017 to 1 October 2018. At 30 June 2018, applying this approval had the effect of decreasing local available statutory capital and surplus (and by extension Solvency II Own Funds and Solvency II surplus) by £0.1 billion, net of tax. This arrangement reflects an elective long-standing practice first put in place in 2009, which can be unwound at Jackson's discretion.

The 30 June 2018 Solvency II results above allow for the reinsurance of £12.0 billion of the UK annuity portfolio to Rothesay Life effective from 14 March 2018. This contributes £0.6 billion to UK Solvency II surplus and £0.1 billion to the Group Solvency II surplus.

Further information on the Solvency II capital position for the Group and The Prudential Assurance Company Limited is published annually in the Solvency and Financial Condition Reports. These were last published on the Group's website in May 2018.

Analysis of movement in Group capital position

A summary of the estimated movement in Group Solvency II surplus from £13.3 billion at year end 2017 to £14.4 billion at half year 2018 is set out in the table below. The movement from the Group Solvency II surplus at 31 December 2016 to the Solvency II surplus at 30 June 2017 and 31 December 2017 is included for comparison.

	Half year 2018 £bn	**Half year 2017** £bn	**Full year 2017** £bn
Analysis of movement in Group shareholder surplus	**Surplus**	**Surplus**	**Surplus**
Estimated Solvency II surplus at beginning of period	13.3	12.5	12.5
Underlying operating experience	**1.7**	1.5	3.2
Management actions	**0.1**	0.2	0.4
Operating experience	**1.8**	1.7	3.6
Non-operating experience (including market movements)	**0.0**	0.0	(0.6)
UK annuities reinsurance transaction	**0.1**	–	–
Other capital movements			
Subordinated debt issuance/redemption	–	–	(0.2)
Foreign currency translation impacts	**0.1**	(0.5)	(0.7)
Dividends paid	**(0.8)**	(0.8)	(1.2)
Model changes	**(0.1)**	0.0	(0.1)
Estimated Solvency II surplus at end of period	14.4	12.9	13.3

The estimated movement in Group Solvency II surplus in the first half of 2018 is driven by:

- *Operating experience of £1.8 billion:* generated by in-force business and new business written in 2018, after allowing for amortisation of the UK transitional measures and the impact of one-off management optimisations implemented over the period and a £0.1 billion benefit from an insurance recovery relating to the costs and any related redress of reviewing internally vesting annuities sold without advice after 1 July 2008;
- *Non-operating experience:* has been neutral overall during the first half of 2018. The positive impact of market movements, after allowing for the recalculation of the UK transitional measures at the valuation date, has been offset by the impact of US Risk Based Capital updates announced in June 2018 to reflect US tax reform changes;
- *UK annuities reinsurance transaction of £0.1 billion:* the beneficial impact on the Group Solvency II surplus of the UK annuities reinsurance transaction effective from 14 March 2018 after allowing for the impact of recalculation of the UK transitional measures as a result of the transaction;
- *Other capital movements:* comprising a benefit from foreign currency translation and a reduction in surplus from payment of dividends; and
- *Model changes:* reflecting model changes approved by the Prudential Regulation Authority in 2018.

II Other information continued

II(f) Solvency II capital position at 30 June 2018 continued

Analysis of Group Solvency Capital Requirements

The split of the Group's estimated Solvency Capital Requirement by risk type including the capital requirements in respect of Jackson's risk exposures based on 150 per cent of US Risk Based Capital requirements (Company Action Level) but with no diversification between Jackson and the rest of the Group, is as follows:

	30 Jun 2018		30 Jun 2017		31 Dec 2017	
Split of the Group's estimated Solvency Capital Requirements	% of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements	% of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements	% of undiversified Solvency Capital Requirements	% of diversified Solvency Capital Requirements
Market	56%	70%	56%	71%	57%	71%
Equity	15%	25%	13%	21%	14%	23%
Credit	21%	36%	25%	40%	24%	38%
Yields (interest rates)	14%	7%	14%	8%	13%	7%
Other	6%	2%	4%	2%	6%	3%
Insurance	25%	20%	27%	21%	26%	21%
Mortality/morbidity	5%	2%	5%	2%	5%	2%
Lapse	15%	16%	16%	17%	14%	17%
Longevity	5%	2%	6%	2%	7%	2%
Operational/expense	12%	7%	10%	6%	11%	7%
FX translation	7%	3%	7%	2%	6%	1%

Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds

Reconciliation of IFRS equity to Group Solvency II Shareholder Own Funds	30 Jun 2018 £bn	30 Jun 2017 £bn	31 Dec 2017 £bn
IFRS shareholders' equity	15.9	15.4	16.1
Restate US insurance entities from IFRS to local US statutory basis	(2.6)	(2.6)	(3.0)
Remove DAC, goodwill and intangibles	(4.1)	(3.9)	(4.0)
Add subordinated debt	5.8	6.1	5.8
Impact of risk margin (net of transitional measures)	(3.8)	(3.6)	(3.9)
Add value of shareholder transfers	5.5	4.6	5.3
Liability valuation differences	12.2	10.7	12.1
Increase in net deferred tax liabilities resulting from liability valuation differences above	(1.4)	(1.4)	(1.6)
Other	0.0	0.3	(0.4)
Estimated Solvency II Shareholder Own Funds	27.5	25.6	26.4

The key items of the reconciliation as at 30 June 2018 are:

- £(2.6) billion represents the adjustment required to the Group's shareholders' funds in order to convert Jackson's contribution from an IFRS basis to the local statutory valuation basis. This item also reflects a de-recognition of Own Funds of £0.8 billion, equivalent to the value of 100 per cent of Risk Based Capital requirements (Company Action Level), as agreed with the Prudential Regulation Authority;
- £(4.1) billion due to the removal of DAC, goodwill and intangibles from the IFRS balance sheet;
- £5.8 billion due to the addition of subordinated debt which is treated as available capital under Solvency II but as a liability under IFRS;
- £(3.8) billion due to the inclusion of a risk margin for UK and Asia non-hedgeable risks, net of £1.3 billion from transitional measures (after allowing for recalculation of the transitional measures as at 30 June 2018) which are not applicable under IFRS;
- £5.5 billion due to the inclusion of the value of future shareholder transfers from with-profits business (excluding the shareholders' share of the with-profits estate, for which no credit is given under Solvency II), which is excluded from the determination of the Group's IFRS shareholders' funds;
- £12.2 billion due to differences in insurance valuation requirements between Solvency II and IFRS, with Solvency II Own Funds partially capturing the value of in-force business which is excluded from IFRS; and
- £(1.4) billion due to the impact on the valuation of net deferred tax liabilities resulting from the liability valuation differences noted above.

Sensitivity analysis

The estimated sensitivity of the Group shareholder Solvency II capital position to significant changes in market conditions is as follows:

Impact of market sensitivities	30 Jun 2018		31 Dec 2017	
	Surplus £bn	**Ratio**	**Surplus** £bn	**Ratio**
Base position	14.4	209%	13.3	202%
Impact of:				
20% instantaneous fall in equity markets	0.4	6%	0.7	9%
40% fall in equity markets[1]	(3.3)	(20)%	(2.1)	(11)%
50 basis points reduction in interest rates[2,3]	(0.9)	(13)%	(1.0)	(14)%
100 basis points increase in interest rates[3]	0.8	18%	1.2	21%
100 basis points increase in credit spreads[4]	(1.7)	(10)%	(1.4)	(6)%

Notes

1 Where hedges are dynamic, rebalancing is allowed for by assuming an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four-week period.
2 Subject to a floor of zero for Asia and US interest rates.
3 Allowing for further transitional measures recalculation after the interest rate stress.
4 US Risk Based Capital solvency position included using a stress of 10 times expected credit defaults.

The Group believes it is positioned to withstand significant deteriorations in market conditions and we continue to use market hedges to manage some of this exposure across the Group, where we believe the benefit of the protection outweighs the cost. The sensitivity analysis above allows for predetermined management actions and those taken to date, but does not reflect all possible management actions which could be taken in the future.

UK Solvency II capital position[1, 2]

On the same basis as above, the estimated shareholder Solvency II surplus for The Prudential Assurance Company Limited ('PAC') and its subsidiaries[2] at 30 June 2018 was £7.5 billion, after allowing for recalculation of transitional measures as at 30 June 2018. This relates to shareholder-backed business including future with-profits shareholder transfers, but excludes the shareholders' share of the estate in line with Solvency II requirements.

Estimated UK shareholder Solvency II capital position*	30 Jun 2018	30 Jun 2017	31 Dec 2017†
Own Funds (£bn)	14.7	13.0	14.0
Solvency Capital Requirement (£bn)	7.2	7.7	7.9
Surplus (£bn)	7.5	5.3	6.1
Solvency ratio (%)	203%	168%	178%

* The UK shareholder capital position excludes the contribution to Own Funds and the Solvency Capital Requirement from ring-fenced with-profits funds and staff pension schemes in surplus. The solvency positions include management's estimate of UK transitional measures reflecting both operating and market conditions at each valuation date.
† Given that approval was received from the PRA to recalculate the transitional measures as at 31 December 2017, the surplus at this date reflects management's recalculation of transitional measures and represents the approved regulatory position.

The estimated movement in UK Solvency II surplus of £1.4 billion in the first half of 2018 is driven by operating experience generated from in-force business and new business written in 2018 (£0.9 billion) including a £0.1 billion benefit from an insurance recovery relating to the costs and any related redress of reviewing internally vesting annuities sold without advice after 1 July 2008, the impact of the UK annuities reinsurance transaction (£0.6 billion) and other items including the impact of market movements during 2018 (£0.2 billion) and foreign currency translation impacts (£0.1 billion) net of remittances paid to the Group (£(0.3) billion) and the impact of model changes approved by the Prudential Regulation Authority in 2018 (£(0.1) billion).

II Other information continued

II(f) Solvency II capital position at 30 June 2018 continued

Pro forma The Prudential Assurance Company Limited shareholder Solvency II capital position

The pro forma impact on the shareholder Solvency II capital position of the UK regulated insurance entity, The Prudential Assurance Company Limited, assuming that the Part VII transfer of the UK annuity portfolio to Rothesay Life and the transfer of Prudential's Hong Kong subsidiaries from The Prudential Assurance Company Limited to Prudential Corporation Asia Limited had both been completed as at 30 June 2018, is provided in the table below.

The Prudential Assurance Company Limited's shareholder Solvency II capital position	30 Jun 2018		
	As reported	Adjustments*†	Pro forma
Own funds (£bn)	14.7	(6.1)	8.6
Solvency capital requirement (£bn)	7.2	(1.6)	5.6
Surplus (£bn)	7.5	(4.5)	3.0
Solvency ratio (%)	203%	(50)%	153%

* The adjustments as shown in the table above, which result in a decrease in surplus of £4.5 billion, represent the estimated impact on The Prudential Assurance Company Limited's shareholder Solvency II capital position from the transfer of Prudential plc's Hong Kong subsidiaries to Prudential Corporation Asia Limited, and completion of the partial sale of the UK annuity portfolio by a Part VII transfer, as if both had been completed on 30 June 2018. The resulting pro forma position has been calculated based on information and assumptions at 30 June 2018 and therefore, does not necessarily represent the actual Solvency II capital position which will result following completion of the transactions. The adjustments include the following effects:
– An adjustment to Own Funds of £6.1 billion to remove the value of the shareholder Own Funds of the Hong Kong business at 30 June 2018;
– A reduction in SCR of £1.1 billion being the release of the Hong Kong business standalone SCR of £2.0 billion, partially offset by removal of diversification benefits between UK and Hong Kong of £0.9 billion;
– A reduction in SCR of £0.5 billion representing the estimated remaining capital benefit from completion of the partial sale of the UK annuity portfolio by a Part VII transfer to Rothesay Life.
† No account has been taken of any trading or other changes in Solvency II capital position of The Prudential Assurance Company Limited after 30 June 2018.

Whilst there is a large surplus in the UK with-profits funds, this is ring-fenced from the shareholder balance sheet and is therefore excluded from both the Group and the UK shareholder Solvency II surplus results. The estimated UK with-profits funds Solvency II surplus at 30 June 2018 was £5.5 billion, after allowing for recalculation of transitional measures as at 30 June 2018.

Estimated UK with-profits Solvency II capital position*	30 Jun 2018	30 Jun 2017	31 Dec 2017†
Own Funds (£bn)	9.4	8.6	9.6
Solvency Capital Requirement (£bn)	3.9	4.5	4.8
Surplus (£bn)	5.5	4.1	4.8
Solvency ratio (%)	244%	192%	201%

* The solvency positions include management's estimate of UK transitional measures reflecting operating and market conditions at each valuation date.
† Given that approval was received from the PRA to recalculate the transitional measures as at 31 December 2017, the surplus at this date reflects management's recalculation of transitional measures and represents the approved regulatory position.

Reconciliation of UK with-profits IFRS unallocated surplus to Solvency II Own Funds[1]

A reconciliation between the IFRS unallocated surplus and Solvency II Own Funds for UK with-profits business is as follows:

Reconciliation of UK with-profits funds	30 Jun 2018 £bn	30 Jun 2017 £bn	31 Dec 2017 £bn
IFRS unallocated surplus of UK with-profits funds	13.5	12.1	13.5
Adjustments from IFRS basis to Solvency II:			
Value of shareholder transfers	(2.7)	(2.5)	(2.7)
Risk margin (net of transitional measures)	(1.0)	(0.6)	(0.7)
Other valuation differences	(0.4)	(0.4)	(0.5)
Estimated Solvency II Own Funds	9.4	8.6	9.6

Statement of independent review in respect of Solvency II Capital Position at 30 June 2018[3]

The methodology, assumptions and overall result have been subject to examination by KPMG LLP.

Notes

1 The UK with-profits capital position includes the PAC with-profits sub-fund, the Scottish Amicable Insurance fund and the Defined Charge Participating sub-fund.
2 The insurance subsidiaries of PAC are Prudential General Insurance Hong Kong Limited, Prudential Hong Kong Limited, Prudential International Assurance plc and Prudential Pensions Limited.
3 This review is separate from that set out on page 100.

II(g) Foreign currency source of key metrics

The tables below show the Group's key free surplus, IFRS and EEV metrics analysis by contribution by currency group:

Half year 2018 free surplus and Group IFRS results

	Underlying free surplus generated for total insurance and asset management operations %	IFRS pre-tax operating profit notes (2)(3) %	IFRS shareholders' funds notes (2)(3) %
US dollar linked note (1)	14%	26%	21%
Other Asia currencies	17%	16%	15%
Total Asia	31%	42%	36%
UK sterling notes (2)(3)	37%	16%	52%
US dollar note (3)	32%	42%	12%
Total	100%	100%	100%

Half year 2018 Group EEV post-tax results

	New business profit %	Operating profit notes (2)(3) %	Shareholders' funds notes (2)(3) %
US dollar linked note (1)	53%	41%	37%
Other Asia currencies	11%	12%	10%
Total Asia	64%	53%	47%
UK sterling notes (2)(3)	10%	18%	29%
US dollar note (3)	26%	29%	24%
Total	100%	100%	100%

Notes

(1) US dollar linked comprise the Hong Kong and Vietnam operations where the currencies are pegged to the US dollar and the Malaysia and Singapore operations where the currencies are managed against a basket of currencies including the US dollar.

(2) For operating profit and shareholders' funds, UK sterling includes amounts in respect of M&G Prudential and other operations (including central operations and Prudential Capital). Operating profit for central operations includes amounts for corporate expenditure for Group Head Office as well as Asia Regional Head Office which is incurred in HK dollars.

(3) For shareholders' funds, the US dollar grouping includes US dollar denominated core structural borrowings. Sterling operating profits include all interest payable as sterling denominated, reflecting interest rate currency swaps in place.

II Other information continued

II(h) Option schemes

The Group presently grants share options through four schemes, and exercises of the options are satisfied by the issue of new shares. Executive Directors and eligible employees based in the UK may participate in the UK savings-related share option scheme. Executives and eligible employees based in Asia as well as eligible employees based in Europe can participate in the international savings-related share option scheme while agents based in certain regions of Asia can participate in the international savings-related share option scheme for non-employees. Employees based in Dublin are eligible to participate in the Prudential International Assurance sharesave plan, which currently has no outstanding options in issue. Further details of the schemes and accounting policies are detailed in note B2.2 of the IFRS basis consolidated financial statements in the 2017 Annual Report.

All options were granted at £nil consideration. No options have been granted to substantial shareholders, suppliers of goods or services (excluding options granted to agents under the non-employee savings-related share option scheme) or in excess of the individual limit for the relevant scheme.

The options schemes will terminate as follows, unless the Directors resolve to terminate the plans at an earlier date:

— UK savings-related share option scheme: 16 May 2023;
— International savings-related share option scheme: 31 May 2021;
— Prudential International Assurance sharesave plan: 3 August 2019; and
— International savings-related share option scheme for non-employees 2012: 17 May 2022.

The weighted average share price of Prudential plc for the period ended 30 June 2018 was £18.56 (30 June 2017: £16.77).

The following analyses show the movements in options for each of the option schemes for the period ended 30 June 2018:

UK savings-related share option scheme

Date of grant	Exercise price £	Exercise period Beginning	Exercise period End	Beginning of period	Granted	Exercised	Cancelled	Forfeited	Lapsed	End of period
21 Sep 12	6.29	01 Dec 17	31 May 18	25,239	–	(24,762)	–	–	–	477
20 Sep 13	9.01	01 Dec 18	31 May 19	66,202	–	(815)	–	–	(83)	65,304
23 Sep 14	11.55	01 Dec 17	31 May 18	156,359	–	(152,403)	–	–	(311)	3,645
23 Sep 14	11.55	01 Dec 19	31 May 20	359,247	–	(11,656)	(2,360)	(1,852)	(3,743)	339,636
22 Sep 15	11.11	01 Dec 18	31 May 19	847,546	–	(15,140)	(5,847)	(6,642)	(3,961)	815,956
22 Sep 15	11.11	01 Dec 20	31 May 21	213,547	–	(2,407)	(540)	(756)	(2,723)	207,121
21 Sep 16	11.04	01 Dec 19	31 May 20	663,871	–	(6,846)	(15,872)	(7,350)	(7,040)	626,763
21 Sep 16	11.04	01 Dec 21	31 May 22	145,658	–	(1,040)	(1,630)	(814)	(1,948)	140,226
21 Sep 17	14.55	01 Dec 20	31 May 21	809,303	–	(1,252)	(13,177)	(6,003)	(7,981)	780,890
21 Sep 17	14.55	01 Dec 22	31 May 23	138,097	–	(48)	(3,091)	(1,649)	(364)	132,945
				3,425,069	–	(216,369)	(42,517)	(25,066)	(28,154)	3,112,963

The total number of securities available for issue under the scheme is 3,112,963 which represents 0.120 per cent of the issued share capital at 30 June 2018.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £18.82.

International savings-related share option scheme

		Exercise period		Number of shares under options						
Date of grant	Exercise price £	Beginning	End	Beginning of period	Granted	Exercised	Cancelled	Forfeited	Lapsed	End of period
21 Sep 12	6.29	01 Dec 17	31 May 18	662	–	(662)	–	–	–	–
20 Sep 13	9.01	01 Dec 18	31 May 19	38,352	–	–	(1,331)	(301)	–	36,720
23 Sep 14	11.55	01 Dec 17	31 May 18	2,414	–	(2,414)	–	–	–	–
23 Sep 14	11.55	01 Dec 19	31 May 20	4,464	–	–	–	–	–	4,464
22 Sep 15	11.11	01 Dec 18	31 May 19	23,556	–	(2,386)	(2,474)	–	–	18,696
22 Sep 15	11.11	01 Dec 20	31 May 21	3,240	–	–	(540)	–	–	2,700
21 Sep 16	11.04	01 Dec 19	31 May 20	15,516	–	–	(4,088)	(652)	–	10,776
21 Sep 17	14.55	01 Dec 20	31 May 21	12,542	–	–	(1,857)	–	–	10,685
21 Sep 17	14.55	01 Dec 22	31 May 23	3,298	–	–	–	–	–	3,298
				104,044	–	(5,462)	(10,290)	(953)	–	87,339

The total number of securities available for issue under the scheme is 87,339 which represents 0.003 per cent of the issued share capital at 30 June 2018.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £18.89.

Prudential International Assurance sharesave plan

There are no securities available for issue under the scheme at 30 June 2018.

Non-employee savings-related share option scheme

		Exercise period		Number of shares under options						
Date of grant	Exercise price £	Beginning	End	Beginning of period	Granted	Exercised	Cancelled	Forfeited	Lapsed	End of period
21 Sep 12	6.29	01 Dec 17	31 May 18	15,264	–	(15,264)	–	–	–	–
20 Sep 13	9.01	01 Dec 18	31 May 19	388,250	–	–	(2,496)	–	–	385,754
23 Sep 14	11.55	01 Dec 17	31 May 18	237,637	–	(235,593)	(1,265)	–	–	779
23 Sep 14	11.55	01 Dec 19	31 May 20	472,145	–	–	(5,192)	–	–	466,953
22 Sep 15	11.11	01 Dec 18	31 May 19	452,343	–	(225)	(4,147)	–	–	447,971
22 Sep 15	11.11	01 Dec 20	31 May 21	383,962	–	–	(4,050)	–	–	379,912
21 Sep 16	11.04	01 Dec 19	31 May 20	329,712	–	–	–	–	–	329,712
21 Sep 16	11.04	01 Dec 21	31 May 22	198,415	–	–	–	–	–	198,415
21 Sep 17	14.55	01 Dec 20	31 May 21	267,661	–	–	–	–	–	267,661
21 Sep 17	14.55	01 Dec 22	31 May 23	174,351	–	–	–	–	–	174,351
				2,919,740	–	(251,082)	(17,150)	–	–	2,651,508

The total number of securities available for issue under the scheme is 2,651,508 which represents 0.102 per cent of the issued share capital at 30 June 2018.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £18.84.

II Other information continued

II(i) Reconciliation between IFRS and EEV shareholders' funds

The table below shows the reconciliation of EEV shareholders' funds and IFRS shareholders' funds at the end of the period:

	2018 £m	2017 £m	
	30 Jun	30 Jun	31 Dec
EEV shareholders' funds	**47,443**	40,520	44,698
Less: Value of in-force business of long-term business[note (a)]	**(31,555)**	(26,104)	(29,410)
Deferred acquisition costs assigned zero value for EEV purposes	**9,652**	9,076	9,227
Other[note (b)]	**(9,658)**	(8,043)	(8,428)
IFRS shareholders' funds	**15,882**	15,449	16,087

Notes

(a) The EEV shareholders' funds comprises the present value of the shareholders' interest in the value of in-force business, net worth of long-term business operations and IFRS shareholders' funds of asset management and other operations. The value of in-force business reflects the present value of future shareholder cash flows from long-term in-force business which are not captured as shareholders' interest on an IFRS basis. Net worth represents the net assets for EEV reporting purposes that reflect the regulatory basis position, sometimes with adjustments to achieve consistency with the IFRS treatment of certain items.

(b) Other adjustments represent asset and liability valuation differences between IFRS and the local regulatory reporting basis used to value net worth for long-term insurance operations. For the UK, this would be the difference between IFRS and Solvency II.

It also includes the mark to market of the Group's core structural borrowings which are fair valued under EEV but not IFRS. The most significant valuation differences relate to changes in the valuation of insurance liabilities. For example, in Jackson where IFRS liabilities are higher than the local regulatory basis as they are principally based on policyholder account balances (with deferred acquisition costs recognised as an asset) whereas the local regulatory basis used for EEV is based on future cash flows due to the policyholder on a prudent basis with consideration of an expense allowance as applicable, but with no separate deferred acquisition cost asset.

II(j) Reconciliation of APE new business sales to earned premiums

The Group reports APE new business sales as a measure of the new policies sold in the period. This differs from the IFRS measure of premiums earned as shown below:

	2018 £m	2017 £m	
	Half year	Half year	Full year
Annual premium equivalents as published	**3,322**	3,624	6,958
Adjustment to include 100% of single premiums on new business sold in the period[note (a)]	**14,377**	15,286	28,769
Premiums from in-force business and other adjustments[note (b)]	**3,642**	3,195	8,278
Gross premiums earned	**21,341**	22,105	44,005
Outward reinsurance premiums[note(c)]	**(12,961)**	(947)	(2,062)
Earned premiums, net of reinsurance as shown in the IFRS financial statements	**8,380**	21,158	41,943

Notes

(a) APE new business sales only include one-tenth of single premiums, recorded on policies sold in the period. Gross premiums earned include 100 per cent of such premiums.

(b) Other adjustments principally include amounts in respect of the following:
- Gross premiums earned include premiums from existing in-force business as well as new business. The most significant amount is recorded in Asia, where a significant portion of regular premium business is written. Asia in-force premiums form the vast majority of the other adjustment amount;
- APE includes new policies written in the period which are classified as investment contracts without discretionary participation features under IFRS 4, arising mainly in Jackson for guaranteed investment contracts and in M&G Prudential for certain unit-linked savings and similar contracts. These are excluded from gross premiums earned and recorded as deposits;
- APE new business sales are annualised while gross premiums earned are recorded only when revenues are due; and
- For the purpose of reporting APE new business sales, we include the Group's share of amounts sold by the Group's insurance joint ventures and associates. Under IFRS, joint ventures and associates are equity accounted and so no amounts are included within gross premiums earned.

(c) Outward reinsurance premiums in half year 2018 include £(12,130) million in respect of the reinsurance of the UK annuity portfolio.

II(k) Calculation of return on embedded value

Return on embedded value is calculated as the EEV post-tax operating profit based on longer-term investment returns, as a percentage of opening EEV basis shareholders' funds.

	2018	2017	
	Half year	Half year	Full year
Operating profit based on longer-term investment returns (£ million)	3,443	2,870	6,598
Opening EEV basis shareholders' funds (£ million)	44,698	38,968	38,968
Return on embedded value*	15%	15%	17%

* Annualised return on embedded value is based on EEV post-tax operating profit after non-controlling interests, as a percentage of opening EEV basis shareholders' equity. Half year profits are annualised by multiplying by two.

II(l) Calculation of EEV shareholders' funds per share

EEV shareholders' funds per share is calculated as closing EEV shareholders' funds divided by the number of issued shares at the balance sheet date. EEV shareholders' funds per share excluding goodwill attributable to shareholders is calculated in the same manner, except goodwill attributable to shareholders is deducted from closing EEV shareholders' funds.

	2018	2017	
	30 Jun	30 Jun	31 Dec
Closing EEV shareholders' funds (£ million)	47,443	40,520	44,698
Less: Goodwill attributable to shareholders (£ million)	(1,459)	(1,475)	(1,458)
Closing EEV shareholders' funds excluding goodwill attributable to shareholders (£ million)	45,984	39,045	43,240
Number of issued shares at period end (millions)	2,592	2,586	2,587
Shareholders' funds per share (pence)	1,830	1,567	1,728
Shareholders' funds per share excluding goodwill attributable to shareholders (pence)	1,774	1,510	1,671

Risk factors

A number of risk factors affect Prudential's operating results and financial condition and, accordingly, the trading price of its shares. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The information given is as of the date of this document, and any forward-looking statements are made subject to the reservations specified below under 'Forward-Looking Statements'.

Prudential's approaches to managing risks are explained in the 'Group Chief Risk Officer's Report on the risks facing our business and how these are managed' section of this document.

Risks relating to Prudential's business

Prudential's businesses are inherently subject to market fluctuations and general economic conditions

Uncertainty, fluctuations or negative trends in international economic and investment climates could have a material adverse effect on Prudential's business and profitability. Prudential operates in a macroeconomic and global financial market environment that presents significant uncertainties and potential challenges. For example, government interest rates in the US, the UK and some Asian countries in which Prudential operates remain low relative to historical levels.

Global financial markets are subject to uncertainty and volatility created by a variety of factors. These factors include the reduction in accommodative monetary policies in the US, the UK and other jurisdictions together with its impact on the valuation of all asset classes, effects on interest rates and the risk of disorderly repricing of inflation expectations and global bond yields, concerns over sovereign debt, a general slowing in world growth, the increased level of geopolitical risk and policy-related uncertainty (including the imposition of trade barriers) and potentially negative socio-political events.

The adverse effects of such factors could be felt principally through the following items:

— Reduced investment returns arising on the Group's portfolios including impairment of debt securities and loans, which could reduce Prudential's capital and impair its ability to write significant volumes of new business, increase the potential adverse impact of product guarantees, and/or have a negative impact on its assets under management and profit;

— Higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses;

— Failure of counterparties who have transactions with Prudential (eg banks and reinsurers) to meet commitments that could give rise to a negative impact on Prudential's financial position and on the accessibility or recoverability of amounts due or, for derivative transactions, adequate collateral not being in place;

— Estimates of the value of financial instruments becoming more difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain such values require substantial elements of judgement, assumptions and estimates (which may change over time); and

— Increased illiquidity, which also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline. This could occur where external capital is unavailable at sustainable cost, increased liquid assets are required to be held as collateral under derivative transactions or redemption restrictions are placed on Prudential's investments in illiquid funds. In addition, significant redemption requests could also be made on Prudential's issued funds and while this may not have a direct impact on the Group's liquidity, it could result in reputational damage to Prudential. The potential impact of increased illiquidity is more uncertain than for other risks such as interest rate or credit risk.

In general, upheavals in the financial markets may affect general levels of economic activity, employment and customer behaviour. As a result, insurers may experience an elevated incidence of claims, lapses, or surrenders of policies, and some policyholders may choose to defer or stop paying insurance premiums. The demand for insurance products may also be adversely affected. In addition, there may be a higher incidence of counterparty failures. If sustained, this environment is likely to have a negative impact on the insurance sector over time and may consequently have a negative impact on Prudential's business and its balance sheet and profitability. For example, this could occur if the recoverable value of intangible assets for bancassurance agreements and deferred acquisition costs are reduced. New challenges related to market fluctuations and general economic conditions may continue to emerge.

For some non-unit-linked investment products, in particular those written in some of the Group's Asian operations, it may not be possible to hold assets which will provide cash flows to match those relating to policyholder liabilities. This is particularly true in those countries where bond markets are not developed and in certain markets where regulated premium and claim values are set with reference to the interest rate environment prevailing at the time of policy issue. This results in a mismatch due to the duration and uncertainty of the liability cash flows and the lack of sufficient assets of a suitable duration. While this residual asset/liability mismatch risk can be managed, it cannot be eliminated. Where interest rates in these markets remain lower than those used to calculate premium and claim values over a sustained period, this could have a material adverse effect on Prudential's reported profit.

In the US, Jackson writes a significant amount of variable annuities that offer capital or income protection guarantees. The value of these guarantees is affected by market factors (such as interest rates, equity values, bond spreads and realised volatility) and policyholder behaviour. Jackson uses a derivative hedging programme to reduce its exposure to market risks arising on these guarantees. There could be market circumstances where the derivatives that Jackson enters into to hedge its market risks may not cover its exposures under the guarantees. The cost of the guarantees that remain unhedged will also affect Prudential's results.

In addition, Jackson hedges the guarantees on its variable annuity book on an economic basis (with consideration of the local regulatory position) and, thus, accepts variability in its accounting results in the short term in order to achieve the appropriate result on these bases. In particular, for Prudential's Group IFRS reporting, the measurement of the Jackson variable annuity guarantees is typically less sensitive to market movements than for the corresponding hedging derivatives, which are held at market value. However, depending on the level of hedging conducted regarding a particular risk type, certain market movements can drive volatility in the economic or local regulatory results that may be less significant under IFRS reporting.

Also, in the US, fluctuations in prevailing interest rates can affect results from Jackson which has a significant spread-based business, with the significant proportion of its assets invested in fixed income securities. In particular, fixed annuities and stable value products written by Jackson expose Prudential to the risk that changes in interest rates, which are not fully reflected in the interest rates credited to customers, will reduce spread. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the policyholders' liabilities and the amounts that are credited to policyholders in the form of benefit increases, subject to minimum crediting rates. Declines in spread from these products or other spread businesses that Jackson conducts, and increases in surrender levels arising from interest rate rises, could have a material impact on its businesses or results of operations.

On 29 March 2017 the UK submitted the formal notification of its intention to withdraw from the EU pursuant to Article 50 of the Treaty on the European Union, as amended. Following submission of this notification, the UK has a maximum period of two years to negotiate the terms of its withdrawal from the EU. If no formal withdrawal agreement is reached between the UK and the EU, then it is expected the UK's membership of the EU will automatically terminate at 11.00pm GMT on 29 March 2019. The UK's decision to leave the EU will have political, legal and economic ramifications for both the UK and the EU, although these are expected to be more pronounced for the UK. The Group has several UK domiciled operations, principally M&G Prudential, and these will be impacted by a UK withdrawal from the EU, although contingency plans have been developed and enacted since the referendum result to ensure that Prudential's business is not unduly affected by the UK withdrawal. The outcome of the negotiations on the UK's withdrawal and any subsequent negotiations on trade and access to the country's major trading markets, including the single EU market, is currently unknown. As a result, there is ongoing uncertainty over the terms under which the UK will leave the EU, in particular after the transitional period ending in December 2020 (which itself is yet to be agreed in a legally binding manner), and the potential for a disorderly exit by the UK without a negotiated agreement. This uncertainty may increase volatility in the markets where the Group operates and create the potential for a general downturn in economic activity and for further or prolonged interest rate reductions in some jurisdictions due to monetary easing and investor sentiment. While the Group has undertaken significant work to plan for and mitigate such risks, there can be no assurance that these plans and efforts will be successful.

A significant part of the profit from M&G Prudential's insurance operations is related to bonuses for policyholders declared on with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns. This profit could be lower in a sustained low interest rate environment.

Prudential is subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio

Investing in sovereign debt creates exposure to the direct or indirect consequences of political, social or economic changes (including changes in governments, heads of state or monarchs) in the countries in which the issuers are located and the creditworthiness of the sovereign. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. In addition, the issuer of the debt or the governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or pay interest when due in accordance with the terms of such debt, and Prudential may have limited recourse to compel payment in the event of a default. A sovereign debtor's willingness or ability to repay principal and to pay interest in a timely manner may be affected by, among other factors, its cash flow situation, its relations with its central bank, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor's policy toward local and international lenders, and the political constraints to which the sovereign debtor may be subject.

Moreover, governments may use a variety of techniques, such as intervention by their central banks or imposition of regulatory controls or taxes, to devalue their currencies' exchange rates, or may adopt monetary and other policies (including to manage their debt burdens) that have a similar effect, all of which could adversely impact the value of an investment in sovereign debt even in the absence of a technical default. Periods of economic uncertainty may affect the volatility of market prices of sovereign debt to a greater extent than the volatility inherent in debt obligations of other types of issuers.

In addition, if a sovereign default or other such events described above were to occur, other financial institutions may also suffer losses or experience solvency or other concerns, and Prudential might face additional risks relating to any debt held in such financial institutions held in its investment portfolio. There is also risk that public perceptions about the stability and creditworthiness of financial institutions and the financial sector generally might be adversely affected, as might counterparty relationships between financial institutions. If a sovereign were to default on its obligations, or adopted policies that devalued or otherwise altered the currencies in which its obligations were denominated this could have a material adverse effect on Prudential's financial condition and results of operations.

Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses

Due to the geographical diversity of Prudential's businesses, Prudential is subject to the risk of exchange rate fluctuations. Prudential's operations in the US and Asia, which represent a significant proportion of operating profit based on longer-term investment returns and shareholders' funds, generally write policies and invest in assets denominated in local currencies. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in Prudential's consolidated financial statements upon the translation of results into pounds sterling. This exposure is not currently separately managed. The currency exposure relating to the translation of reported earnings could impact financial reporting ratios such as dividend cover, which is calculated as operating profit after tax on an IFRS basis, divided by the dividends relating to the reporting year. The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within other comprehensive income. Consequently, this could impact Prudential's gearing ratios (defined as debt over debt plus shareholders' funds). The Group's surplus capital position for regulatory reporting purposes may also be affected by fluctuations in exchange rates with possible consequences for the degree of flexibility that Prudential has in managing its business.

Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations and any accounting standards in the markets in which it operates.

Changes in government policy and legislation (including in relation to tax), capital control measures on companies and individuals, regulation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates, or decisions taken by regulators in connection with their supervision of members of the Group, which in some circumstances may be applied retrospectively may adversely affect Prudential. The adverse impact from these changes may affect Prudential's product range, distribution channels, competitiveness, profitability, capital requirements, risk management approaches, corporate or governance structure and, consequently, reported results and financing requirements. Also, regulators in jurisdictions in which Prudential operates may impose requirements affecting the allocation of capital and liquidity between different business units in the Group, whether on a geographic, legal entity, product line or other basis. Regulators may change the level of capital required to be held by individual businesses or could introduce possible changes in the regulatory framework for pension arrangements and policies, the regulation of selling practices and solvency requirements. Furthermore, as a result of interventions by governments in light of financial and global economic conditions, there may continue to be changes in government regulation and supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transactions and enhanced supervisory powers.

Recent shifts in the focus of some national governments toward more protectionist or restrictive economic and trade policies could impact on the degree and nature of regulatory changes and Prudential's competitive position in some geographic markets. This could take effect, for example, through increased friction in cross-border trade or measures favouring local enterprises such as changes to the maximum level of non-domestic ownership by foreign companies.

The European Union's Solvency II Directive came into effect on 1 January 2016. This measure of regulatory capital is more volatile than under the previous Solvency I regime and regulatory policy may evolve under the new regime. The European Commission began a review in late 2016 of some aspects of the Solvency II legislation, which is expected to continue until 2021 and covers, among other things, a review of the Long Term Guarantee measures (on which the European Insurance and Occupational Pensions Authority (EIOPA) is expected to report later in 2018). Prudential applied for, and has been granted approval by the UK Prudential Regulation Authority to use the following measures when calculating its Solvency II capital requirements: the use of an internal model, the 'matching adjustment' for UK annuities, the 'volatility adjustment' for selected US Dollar-denominated business, and UK transitional measures on technical provisions. Prudential also has permission to use 'deduction and aggregation' as the method by which the contribution of the Group's US insurance entities to the Group's solvency is calculated, which in effect recognises surplus in US insurance entities in excess of 250 per cent of local US Risk Based Capital requirements. There is a risk that in the future changes are required to be made to the approved internal model and these related applications which could have a material impact on the Group Solvency II capital position. Where internal model changes are subject to regulatory approval, there is a risk that the approval is delayed or not given. In such circumstances, changes in our risk profile would not be able to be appropriately reflected in our internal model, which could have a material impact on the Group's Solvency II capital position.

The UK's decision to leave the EU could result in significant changes to the legal and regulatory regime under which the Group operates (and, in particular, M&G Prudential), the nature and extent of which are uncertain while the outcome of negotiations regarding the UK's withdrawal from the EU and the extent and terms of any future access to the single EU market remains unknown.

Currently, there are also a number of other global regulatory developments which could impact Prudential's businesses in its many jurisdictions. These include the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in the US, the work of the Financial Stability Board (FSB) on Global Systemically Important Insurers (G-SIIs), the Insurance Capital Standard (ICS) being developed by the International Association of Insurance Supervisors (IAIS), The EU Markets in Financial Instruments Directive (the 'MiFID II Directive') and associated implementing measures, which came into force on 3 January 2018 and the EU General Data Protection Regulation, which came into force on 25 May 2018. In addition, regulators in a number of jurisdictions in which the Group operates are further developing local capital regimes; this includes potential future developments under Solvency II in the UK (as referred to above), National Association of Insurance Commissioners' (NAIC) reforms in the US and amendments to certain local statutory regimes in some territories in Asia. There remains a high degree of uncertainty over the potential impact of these changes on the Group.

The Dodd-Frank Act provides for a comprehensive overhaul of the financial services industry within the US including reforms to financial services entities, products and markets. The full impact of the Dodd-Frank Act on Prudential's businesses remains unclear, as many of its provisions are primarily focused on the banking industry, have a delayed effectiveness and/or require rulemaking or other actions by various US regulators over the coming years. There is also potential uncertainty surrounding future changes to the Dodd-Frank Act under the current US administration.

Prudential's designation as a G-SII was reaffirmed on 21 November 2016. Although the FSB did not publish a new list of G-SIIs in 2017, the policy measures set out in the FSB's 2016 communication on G-SIIs continue to apply to the Group. As a result, Prudential is subject to additional regulatory requirements, including a requirement to submit enhanced risk management plans (such as a Group-wide Recovery Plan, a Systemic Risk Management Plan and a Liquidity Risk Management Plan) to a Crisis Management Group (CMG) comprised of an international panel of regulators.

The G-SII regime also considers enhanced capital requirements in the form of a Higher Loss Absorbency (HLA) measure. While this requirement was initially intended to come into force in 2019, this has now been postponed to 2022. The HLA is also now intended to be based on the ICS. The IAIS has announced that the implementation of ICS will be conducted in two phases – a five-year monitoring phase followed by an implementation phase. During the monitoring phase, Internationally Active Insurance Groups, for which Prudential satisfies the criteria, will be required to report on compliance with the ICS to the group-wide supervisor on a confidential basis, although these results will not be used as a basis to trigger supervisory action. The Common Framework (ComFrame) for the supervision of Internationally Active Insurance Groups will more generally establish a set of common principles and standards designed to assist regulators in addressing risks that arise from insurance groups with operations in multiple jurisdictions.

The NAIC is continuing its industry consultation with the aim of reducing the non-economic volatility in the variable annuity statutory balance sheet and risk management. Following two industry quantitative impact studies, proposed changes to the current framework have been released by the NAIC. Jackson continues to assess and test the changes. The NAIC also has an ongoing review of the C-1 bond factors in the required capital calculation, on which further information is expected to be provided in due course. The Group's preparations to manage the impact of these reforms will continue.

On 27 July 2017, the UK FCA announced that it will no longer persuade, or use its powers to compel, panel banks to submit rates for the calculation of LIBOR after 2021. Beyond 2021, to the extent that LIBOR continues to be administered, LIBOR may perform differently than it did in the past. The discontinuation of LIBOR in its current form or a change to alternative benchmark rates could, among other things, impact the Group through an adverse effect on the value of Prudential's assets and liabilities which are linked to or which reference LIBOR, a reduction in market liquidity during any period of transition and increased legal and conduct risks to the Group arising from changes required to documentation and its related obligations to its stakeholders.

Various jurisdictions in which Prudential operates have created investor compensation schemes that require mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant in the majority of its chosen markets, circumstances could arise in which Prudential, along with other companies, may be required to make such contributions.

The Group's accounts are prepared in accordance with current International Financial Reporting Standards (IFRS) applicable to the insurance industry. The International Accounting Standards Board (IASB) introduced a framework that it described as Phase I which, under its standard IFRS 4 permitted insurers to continue to use the statutory basis of accounting for insurance assets and liabilities that existed in their jurisdictions prior to January 2005. In May 2017, the IASB published its replacement standard on insurance accounting (IFRS 17, 'Insurance Contracts'), which will have the effect of introducing fundamental changes to the statutory reporting of insurance entities that prepare accounts according to IFRS from 2021. The European Union will apply its usual process for assessing whether the standard meets the necessary criteria for endorsement. The Group is reviewing the complex requirements of this standard and considering its potential impact. The effect of changes required to the Group's accounting policies as a result of implementing the new standard is currently uncertain, but these changes can be expected to, among other things, alter the timing of IFRS profit recognition. The implementation of this standard is also likely to require significant enhancements to IT, actuarial and finance systems of the Group, and so will have an increase on the Group's expenses.

Any changes or modification of IFRS accounting policies may require a change in the way in which future results will be determined and/or a retrospective adjustment of reported results to ensure consistency.

The resolution of several issues affecting the financial services industry could have a negative impact on Prudential's reported results or on its relations with current and potential customers

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally. Such actions may relate to the application of current regulations for example the FCA's principles and conduct of business rules or the failure to implement new regulations. These actions could involve a review of types of business sold in the past under acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pensions and mortgage endowment policies, changes to the tax regime affecting products, and regulatory reviews of products sold and industry practices, including, in the latter case, lines of business it has closed. Current regulatory actions include the UK insurance business's undertaking to the FCA to review annuities sold without advice after 1 July 2008 to its contract-based defined contribution pension customers. This will result in the UK insurance business being required to provide redress to certain such customers. A provision has been established to cover the costs of undertaking the review and any related redress but the ultimate amount required remains uncertain.

Regulators may also focus on the approach that product providers use to select third-party distributors and to monitor the appropriateness of sales made by them. In some cases, product providers can be held responsible for the deficiencies of third-party distributors.

In the US, there has been significant attention on the different regulatory standards applied to investment advice delivered to retail customers by different sectors of the industry. As a result of reports relating to perceptions of industry abuses, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms. This includes focus on the suitability of sales of certain products, alternative investments and the widening of the circumstances under which a person or entity providing investment advice with respect to certain employee benefit and pension plans would be considered a fiduciary subjecting the person or entity to certain regulatory requirements. There is a risk that new regulations introduced may have a material adverse effect on the sales of the products by Prudential and increase Prudential's exposure to legal risks.

Litigation, disputes and regulatory investigations may adversely affect Prudential's profitability and financial condition

Prudential is, and may in the future be, subject to legal actions, disputes and regulatory investigations in various contexts, including in the ordinary course of its insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of Prudential's businesses and operations that are specific to Prudential, or that are common to companies that operate in Prudential's markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by Prudential, and may be class actions. Although Prudential believes that it has adequately provided in all material respects for the costs of litigation and regulatory matters, no assurance can be provided that such provisions are sufficient. Given the large or indeterminate amounts of damages sometimes sought, other sanctions that might be imposed and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could have an adverse effect on Prudential's reputation, results of operations or cash flows.

Prudential's businesses are conducted in highly competitive environments with developing demographic trends and continued profitability depends upon management's ability to respond to these pressures and trends

The markets for financial services in the UK, US and Asia are highly competitive, with several factors affecting Prudential's ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, the ability to respond to developing demographic trends, customer appetite for certain savings products and technological advances. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential's potential to grow its business as quickly as planned.

In Asia, the Group's principal competitors include global life insurers such as Allianz, AXA, and Manulife together with regional insurers such as AIA and Great Eastern, and multinational asset managers such as Franklin Templeton, HSBC Global Asset Management, J.P. Morgan Asset Management and Schroders. In most markets, there are also local companies that have a material market presence.

M&G Prudential's principal competitors include many of the major retail financial services companies and fund management companies including, in particular, Aviva, Janus Henderson, Jupiter, Legal & General, Schroders and Standard Life Aberdeen.

Jackson's competitors in the US include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies such as Aegon, AIG, Allianz, AXA Equitable Holdings Inc., Brighthouse, Lincoln Financial Group, MetLife and Prudential Financial.

Prudential believes competition will intensify across all regions in response to consumer demand, digital and other technological advances, the need for economies of scale and the consequential impact of consolidation, regulatory actions and other factors. Prudential's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures.

Downgrades in Prudential's financial strength and credit ratings could significantly impact its competitive position and damage its relationships with creditors or trading counterparties

Prudential's financial strength and credit ratings, which are used by the market to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in Prudential's products, and as a result its competitiveness. Downgrades in Prudential's ratings as a result of, for example, decreased profitability, increased costs, increased indebtedness or other concerns could have an adverse effect on its ability to market products, retain current policyholders, and on the Group's financial flexibility. In addition, the interest rates Prudential pays on its borrowings are affected by its credit ratings, which are in place to measure the Group's ability to meet its contractual obligations.

Prudential plc's long-term senior debt is rated as A2 by Moody's, A by Standard & Poor's, and A- by Fitch. These ratings are all on a stable outlook.

Prudential plc's short-term debt is rated as P-1 by Moody's, A-1 by Standard & Poor's, and F1 by Fitch.

The Prudential Assurance Company Limited's financial strength is rated Aa3 by Moody's, A+ by Standard & Poor's, and AA- by Fitch. These ratings are all on a stable outlook.

Jackson's financial strength is rated AA- by Standard & Poor's and Fitch and A1 by Moody's. These ratings all have a stable outlook. Jackson's financial strength also has an A+ Rating with the outlook on Under Review with Developing Implications by A.M. Best.

Prudential Assurance Co. Singapore (Pte) Ltd's financial strength is rated AA- by Standard & Poor's. This rating is on a stable outlook.

All ratings above are stated as at the date of this document.

In addition, changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or Prudential's financial condition.

Adverse experience in the operational risks inherent in Prudential's business could disrupt its business functions and have a negative impact on its results of operations

Operational risks are present in all of Prudential's businesses, including the risk (from both Prudential and its outsourcing partners) of direct or indirect loss resulting from inadequate or failed internal and external processes, systems or human error, the effects of natural or man-made catastrophic events (such as natural disasters, pandemics, cyber-attacks, acts of terrorism, civil unrest and other catastrophes) or from other external events. Exposure to such events could disrupt Prudential's systems and operations significantly, which may result in financial loss and reputational damage.

Prudential's business is dependent on processing a large number of transactions across numerous and diverse products, and it employs a large number of models, and user developed applications, some of which are complex, in its processes. The long-term nature of much of the Group's business also means that accurate records have to be maintained for significant periods. Further, Prudential operates in an extensive and evolving legal and regulated environment (including in relation to tax) which adds to the operational complexity of its business processes and controls.

These factors, among others, result in significant reliance on and require significant investment in information technology (IT), compliance and other operational systems, personnel and processes.

As part of the implementation of its business strategies, Prudential has commenced a number of change initiatives across the Group, some of which are interconnected and/or of large scale, that may have financial, operational, and reputational implications if such initiatives fail (either wholly or in part) to meet their objectives and could place strain on the operational capacity of the Group. These initiatives include the combination of M&G and Prudential UK & Europe, the proposed demerger of M&G Prudential and the intended sale of part of the UK annuity portfolio. Operational execution risks arise from these initiatives, including in relation to the separation and establishment of standalone governance, business functions and processes, third party arrangements and IT systems. In addition, Prudential also relies on a number of outsourcing partners to provide several business operations, including a significant part of its back office and customer facing operations as well as a number of IT support functions and investment operations, resulting in reliance upon the operational processing performance of its outsourcing partners. The failure of an outsourcing provider could result in significant disruption to business operations and customers.

Although Prudential's IT, compliance and other operational systems, models and processes incorporate controls designed to manage and mitigate the operational and model risks associated with its activities, there can be no assurance that such controls will always be effective. Due to human error among other reasons, operational and model risk incidents do happen periodically and no system or process can entirely prevent them although there have not been any material events to date. Prudential's legacy and other IT systems and processes, as with operational systems and processes generally, may be susceptible to failure or security breaches.

Such events could, among other things, harm Prudential's ability to perform necessary business functions, result in the loss of confidential or proprietary data (exposing it to potential legal claims and regulatory sanctions) and damage its reputation and relationships with its customers and business partners. Similarly, any weakness in administration systems (such as those relating to policyholder records or meeting regulatory requirements) or actuarial reserving processes could have a material adverse effect on its results of operations during the effective period.

The proposed demerger of M&G Prudential carries with it execution risk and will require significant management attention

The proposed demerger of M&G Prudential (Prudential's UK and Europe business), is subject to a number of factors and dependencies (including prevailing market conditions, transfer of the Hong Kong business from The Prudential Assurance Company Limited to Prudential Corporation Asia Limited, the appropriate allocation of debt and capital between the two groups and approvals from regulators and shareholders). In addition, preparing for and implementing the proposed demerger is expected to require significant time from management, which may divert management's attention from other aspects of Prudential's business.

Therefore, there can be no certainty as to the timing of the demerger, or that it will be completed as proposed (or at all). Further, if the proposed demerger is completed, there can be no assurance that either Prudential plc or M&G Prudential will realise the anticipated benefits of the transaction, or that the proposed demerger will not adversely affect the trading value or liquidity of the shares of either or both of the two businesses.

Attempts by third parties to access or disrupt Prudential's IT systems, and loss or misuse of personal data, could result in loss of trust from Prudential's customers, reputational damage and financial loss

Prudential and its business partners are increasingly exposed to the risk that third parties may attempt to disrupt the availability, confidentiality and integrity of its IT systems, which could result in disruption to key operations, make it difficult to recover critical services, damage assets and compromise the integrity and security of data (both corporate and customer). This could result in loss of trust from Prudential's customers, reputational damage and direct or indirect financial loss. The cyber-security threat continues to evolve globally in sophistication and potential significance. Prudential's increasing profile in its current markets and those in which it is entering, growing customer interest in interacting with their insurance providers and asset managers through the internet and social media, improved brand awareness and the classification of Prudential as a G-SII could also increase the likelihood of Prudential being considered a target by cyber criminals. Further, there have been changes to the threat landscape and the risk from untargeted but sophisticated and automated attacks has increased.

There is an increasing requirement and expectation on Prudential and its business partners, to not only hold customer, shareholder and employee data securely, but use it in a transparent and appropriate way. Developments in data protection worldwide (such as the implementation of EU General Data Protection Regulation that came into force on 25 May 2018) may also increase the financial and reputational implications for Prudential following a significant breach of its (or its third-party suppliers') IT systems. To date, Prudential has not identified a failure or breach, or an incident of data misuse, which has had a material impact in relation to its legacy and other IT systems and processes. However, it has been, and likely will continue to be, subject to potential damage from computer viruses, attempts at unauthorised access and cyber-security attacks such as 'denial of service' attacks (which, for example, can cause temporary disruption to websites and IT networks), phishing and disruptive software campaigns.

Prudential is continually enhancing its IT environment to remain secure against emerging threats, together with increasing its ability to detect system compromise and recover should such an incident occur. However, there can be no assurance that such events will not take place which may have material adverse consequential effects on Prudential's business and financial position.

The failure to understand and respond effectively to the impacts of transitional and physical risks associated with climate change could adversely affect Prudential's results of operations and its long-term strategy

Climate change poses potentially significant risks to Prudential and its customers, not only from the physical impacts of climate change, driven by specific climate-related events such as natural disasters, but also from transition risks associated with the shift to a low carbon economy.

The climate risk landscape continues to evolve and is moving up the agenda of many regulators, governments, non-governmental organisations, customers and investors. For example, the FSB's Task Force for Climate-related Disclosures recommendations were published in 2017 to provide a voluntary framework on corporate climate-related financial disclosures following the FSB's concern that there may be systemic risk in the financial system related to climate change.

Global commitments to limit climate change were recently agreed and governmental and corporate efforts to transition to a low carbon economy in the coming decades could have an adverse impact on global investment assets. In particular, there is a risk that this transition including the related changes to technology, policies and regulations and the speed of their implementation, could result in some sectors (such as, but not limited to, the fossil fuel industry) facing significantly higher costs and a disorderly adjustment to their asset values. This could lead to an adverse impact on the value and the future performance of the investment assets of the Group if climate considerations are not effectively integrated into investment decisions and fiduciary and stewardship duties. Where Prudential's investment horizons are long term, the relevant assets are potentially more exposed to the long-term impact of climate change.

Adverse experience relative to the assumptions used in pricing products and reporting business results could significantly affect Prudential's results of operations

In common with other life insurers, the profitability of the Group's businesses depends on a mix of factors including mortality and morbidity levels and trends, policy surrenders and take-up rates on guarantee features of products, investment performance and impairments, unit cost of administration and new business acquisition expenses.

Prudential needs to make assumptions about a number of factors in determining the pricing of its products, for setting reserves, and for reporting its capital levels and the results of its long-term business operations. For example, the assumption that Prudential makes about future expected levels of mortality is particularly relevant for its UK annuity business, where payments are guaranteed for at least as long as the policyholder is alive. Prudential conducts rigorous research into longevity risk, using industry data as well as its own substantial annuitant experience. As part of its pension annuity pricing and reserving policy, Prudential's UK business assumes that current rates of mortality continuously improve over time at levels based on adjusted data and informed by models from the Continuous Mortality Investigation (CMI) as published by the Institute and Faculty of Actuaries. Assumptions about future expected levels of mortality are also of relevance to the Guaranteed Minimum Withdrawal Benefit (GMWB) of Jackson's variable annuity business. If mortality improvement rates significantly exceed the improvement assumed, Prudential's results of operations could be adversely affected.

A further factor is the assumption that Prudential makes about future expected levels of the rates of early termination of products by its customers (known as persistency). This is relevant to a number of lines of business in the Group, especially for Jackson's portfolio of variable annuities. Prudential's persistency assumptions reflect a combination of recent past experience for each relevant line of business and expert judgement, especially where a lack of relevant and credible experience data exists. Any expected change in future persistency is also reflected in the assumption. If actual levels of future persistency are significantly different than assumed, the Group's results of operations could be adversely affected. Furthermore, Jackson's variable annuity products are sensitive to other types of policyholder behaviour, such as the take-up of its GMWB product features.

In addition, Prudential's business may be adversely affected by epidemics and other effects that give rise to a large number of deaths or additional sickness claims. Significant influenza epidemics have occurred a number of times historically but the likelihood, timing, or the severity of future epidemics cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Group's loss experience.

As a holding company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments

The Group's insurance and investment management operations are generally conducted through direct and indirect subsidiaries, which are subject to the risks discussed elsewhere in this 'Risk factors' section.

As a holding company, Prudential's principal sources of funds are remittances from subsidiaries, shareholder-backed funds, the shareholder transfer from long-term funds and any amounts that may be raised through the issuance of equity, debt and commercial paper.

Certain of Prudential's subsidiaries are restricted by applicable insurance, foreign exchange and tax laws, rules and regulations that can limit remittances. In some circumstances, this could limit Prudential's ability to pay dividends to shareholders or to make available funds held in certain subsidiaries to cover operating expenses of other members of the Group.

Prudential operates in a number of markets through joint ventures and other arrangements with third parties, involving certain risks that Prudential does not face with respect to its consolidated subsidiaries

Prudential operates, and in certain markets is required by local regulation to operate, through joint ventures and other similar arrangements. For such Group operations, management control is exercised in conjunction with other participants. The level of control exercisable by the Group depends on the terms of the contractual agreements, in particular, the allocation of control among, and continued cooperation between, the participants. In addition, the level of control exercisable by the Group could also be subject to changes in the maximum level of non-domestic ownership imposed on foreign companies in certain jurisdictions. Prudential may face financial, reputational and other exposure (including regulatory censure) in the event that any of its partners fails to meet its obligations under the arrangements, encounters financial difficulty, or fails to comply with local or international regulation and standards such as those pertaining to the prevention of financial crime. In addition, a significant proportion of the Group's product distribution is carried out through arrangements with third parties not controlled by Prudential and is therefore dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements, such as through significant deterioration in the reputation, financial position or other circumstances of the third party or material failure in controls (such as those pertaining to the third-party system failure or the prevention of financial crime) could adversely affect the results of operations of Prudential.

Prudential's Articles of Association contain an exclusive jurisdiction provision

Under Prudential's Articles of Association, certain legal proceedings may only be brought in the courts of England and Wales. This applies to legal proceedings by a shareholder (in its capacity as such) against Prudential and/or its directors and/or its professional service providers. It also applies to legal proceedings between Prudential and its directors and/or Prudential and Prudential's professional service providers that arise in connection with legal proceedings between the shareholder and such professional service provider. This provision could make it difficult for US and other non-UK shareholders to enforce their shareholder rights.

Changes in tax legislation may result in adverse tax consequences

Tax rules, including those relating to the insurance industry, and their interpretation may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its scope or interpretation could affect Prudential's financial condition and results of operations.

Hong Kong listing obligations

The Directors confirm that the Company has complied with all the provisions of the Corporate Governance Code issued by the Hong Kong Stock Exchange Limited (HK Code) throughout the accounting period, except that the Company does not comply with provision B.1.2(d) of the HK Code which requires companies, on a comply or explain basis, to have a remuneration committee which makes recommendations to a main board on the remuneration of non-executive directors. This provision is not compatible with supporting provision D.2.3 of the UK Corporate Governance Code which recommends the board determines the remuneration of non-executive directors. Prudential has chosen to adopt a practice in line with the recommendations of the UK Corporate Governance Code.

The Directors also confirm that the financial results contained in this document have been reviewed by the Group Audit Committee.

The Company has adopted securities dealing rules relating to transactions in Prudential securities by Directors on terms no less exacting than those set out in Appendix 10 to the Hong Kong Listing Rules except that a waiver in respect of certain requirements of Appendix 10 to the Hong Kong Listing Rules was granted by the Hong Kong Stock Exchange Limited, originally on 28 February 2011, to take into account accepted practices in the UK. Having made specific enquiry of all Directors, the Directors of the Company have complied with these rules throughout the accounting period.

Pursuant to Rule 13.51(2) of the Hong Kong Listing Rules, and as previously announced by the Company on 11 June 2018, Alice Schroeder was appointed as an independent non-executive director of Quorum Health Corporation with effect from 8 June 2018.

Going concern

In accordance with the requirements of the guidance issued by the Financial Reporting Council in September 2014 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting', after making sufficient enquiries the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue their operations for a period of at least 12 months from the date the financial statements are approved.

In support of this expectation, an update of the Group's business activities, together with the factors likely to affect its future development, successful performance and position in the current economic climate are set out in the Business Performance section. The risks facing the Group's liquidity and capital positions and their sensitivities are referred to in the 'Chief Financial Officer's report on the 2018 first half financial performance', the 'Group Chief Risk Officer's report of the risks facing our business and how these are managed' and note II (f) 'Solvency II capital position at 30 June 2018' within Additional financial information. The Group's IFRS financial statements include cash flow details in the 'Condensed consolidated statement of cash flows' and borrowings information in note C6.

The Directors therefore consider it appropriate to continue to adopt the going concern basis of accounting in preparing the financial statements for the period ended 30 June 2018.

Disclosure of interests of Directors

Outstanding share options

The following table sets out the share options held by the Executive Directors in the UK Savings-Related Share Option Scheme (SAYE) as at the end of the period.

				Exercise period		Number of options						
	Date of grant	Exercise price (pence)	Market price at 30 June 2018 (pence)	Beginning	End	Beginning of period (or on date of appointment)	Granted	Exercised	Cancelled	Forfeited	Lapsed	End of period
Mark FitzPatrick	21 Sep 17	1,455	1,734.5	01 Dec 22	31 May 23	2,061	–	–	–	–	–	2,061
John Foley	21 Sep 16	1,104	1,734.5	01 Dec 19	31 May 20	815	–	–	–	–	–	815
John Foley	21 Sep 17	1,455	1,734.5	01 Dec 20	31 May 21	618	–	–	–	–	–	618
Nic Nicandrou	23 Sep 14	1,155	1,734.5	01 Dec 19	31 May 20	1,311	–	–	–	–	–	1,311
Nic Nicandrou	21 Sep 16	1,104	1,734.5	01 Dec 21	31 May 22	1,358	–	–	–	–	–	1,358
Anne Richards	21 Sep 16	1,104	1,734.5	01 Dec 19	31 May 20	1,630	–	–	–	–	–	1,630
James Turner	21 Sep 17	1,455	1,734.5	01 Dec 20	31 May 21	1,237	–	–	–	–	–	1,237
Mike Wells	22 Sep 15	1,111	1,734.5	01 Dec 18	31 May 19	1,620	–	–	–	–	–	1,620

Buy-out award

Details of the outstanding buy-out award made to Anne Richards in order to facilitate her appointment as Chief Executive, M&G, in 2016 and pursuant to rule 9.4.2 of the UK LA Listing Rules are set out below. This award, which could not be granted under any of the Company's existing incentive plans, entitles Anne Richards to receive a cash amount equal to the market value of the specified notional number of Prudential plc shares on the date of exercise, less an award price of 5 pence per share. The award will vest on the dates detailed below. During the reporting period no award was exercised by Anne Richards. The market value of Prudential plc shares on the date of the award (23 June 2016) was £13.22. Anne Richards is the sole participant in this arrangement and no further awards will be made to Anne Richards under the arrangement.

Exercise period	Number of notional shares
1 December 2018 to 1 January 2019	25,078
1 December 2019 to 1 January 2020	25,078
1 December 2020 to 1 January 2021	13,426

Directors' shareholdings and substantial shareholdings

The Company and its Directors, Chief Executives and shareholders have been granted a partial exemption from the disclosure requirements under Part XV of the Securities and Futures Ordinance (SFO). As a result of this exemption, Directors, Chief Executives and shareholders do not have an obligation under the SFO to notify the Company of shareholding interests, and the Company is not required to maintain a register of Directors' and Chief Executives' interests under section 352 of the SFO, nor a register of interests of substantial shareholders under section 336 of the SFO. The Company is, however, required to file with the Stock Exchange of Hong Kong Limited any disclosure of interests notified to it in the United Kingdom.

The following table sets out the interests of Directors, including the interests of persons connected with Directors as at the end of the period. This includes shares acquired under the Share Incentive Plan and deferred annual bonus awards as detailed in the table on 'Other share awards' on page 174.

	1 January 2018 (or on date of appointment)	30 June 2018		
	Total beneficial interest (number of shares)	**Total beneficial interest** (number of shares)	**Number of shares subject to performance conditions**	**Total interest in shares**
Chairman				
Paul Manduca	42,500	42,500	–	42,500
Executive Directors				
Mark FitzPatrick	81	28,020	207,971	235,991
John Foley	250,116	328,631	370,280	698,911
Nic Nicandrou	292,309	294,176	384,039	678,215
Anne Richards	86,361	142,808	258,461	401,269
Barry Stowe[1]	282,346	370,330	737,088	1,107,418
James Turner[2]	9,701	18,983	153,488	172,471
Mike Wells[3]	662,623	808,705	854,084	1,662,789
Non-executive Directors				
Howard Davies	9,278	9,433	–	9,433
David Law	9,066	9,066	–	9,066
Kaikhushru Nargolwala	70,000	70,000	–	70,000
Anthony Nightingale	50,000	50,000	–	50,000
Philip Remnant	6,916	6,916	–	6,916
Alice Schroeder[4]	8,500	8,500	–	8,500
Lord Turner	6,552	6,661	–	6,661
Tom Watjen[5]	5,500	5,500	–	5,500

Notes

1 For the 1 January 2018 figure Barry Stowe's beneficial interest in shares is made up of 141,173 ADRs (representing 282,346 ordinary shares) (8,513.73 of these ADRs are held within an investment account which secures premium financing for a life assurance policy). For the 30 June 2018 figure the beneficial interest in shares is made up of 185,165 ADRs (representing 370,330 ordinary shares).

2 James Turner was appointed to the Board on 1 March 2018. Total interest in shares is shown from this date.

3 For the 1 January 2018 figure Mike Wells' beneficial interest in shares is made up of 249,811 ADRs (representing 499,622 ordinary shares) and 163,001 ordinary shares. For the 30 June 2018 figure his beneficial interest in shares is made up of 297,320 ADRs (representing 594,640 ordinary shares) and 214,065 ordinary shares.

4 For the 1 January 2018 and 30 June 2018 figure Alice Schroeder's beneficial interest in shares is made up of 4,250 ADRs (representing 8,500 ordinary shares).

5 For the 1 January 2018 and 30 June 2018 figure Tom Watjen's beneficial interest in shares is made up of 2,750 ADRs (representing 5,500 ordinary shares).

Directors' outstanding long-term incentive awards
Share-based long-term incentive awards

	Plan name	Year of award	Conditional share awards outstanding at 1 Jan 2018 (Number of shares)	Conditional awards in 2018 (Number of shares)	Market price at date of award (pence)	Dividend equivalents on vested shares[3] (Number of shares released)	Rights exercised in 2018	Rights lapsed in 2018	Conditional share awards outstanding at 30 June 2018 (Number of shares)	Date of end of performance period
Mark FitzPatrick	PLTIP	2017	101,360		1,828				101,360	31 Dec 19
	PLTIP	2018		106,611	1,750				106,611	31 Dec 20
			101,360	106,611		–	–	–	207,971	
John Foley	PLTIP	2015	122,808		1,672	10,683	117,693	5,115	–	31 Dec 17
	PLTIP	2016	144,340		1,279				144,340	31 Dec 18
	PLTIP	2017	114,177		1,672				114,177	31 Dec 19
	PLTIP	2018		111,763	1,750				111,763	31 Dec 20
			381,325	111,763		10,683	117,693	5,115	370,280	
Nic Nicandrou	PLTIP	2015	104,117		1,672	9,057	99,781	4,336	–	31 Dec 17
	PLTIP	2016	136,836		1,279				136,836	31 Dec 18
	PLTIP	2017	108,357		1,672				108,357	31 Dec 19
	PLTIP	2018		138,846	1,750				138,846	31 Dec 20
			349,310	138,846		9,057	99,781	4,336	384,039	
Anne Richards	PLTIP	2016	45,906		1,358.5				45,906	31 Dec 18
	PLTIP	2017	107,461		1,672				107,461	31 Dec 19
	PLTIP	2018		105,094	1,750				105,094	31 Dec 20
			153,367	105,094		–	–	–	258,461	
Barry Stowe[1]	PLTIP	2015	113,940		1,672	9,238	101,788	12,152	–	31 Dec 17
	PLTIP	2015	50,668		1,611.5	7,770	45,264	5,404	–	31 Dec 17
	PLTIP	2016	274,100		1,279				274,100	31 Dec 18
	PLTIP	2017	247,690		1,672				247,690	31 Dec 19
	PLTIP	2018		215,298	1,750				215,298	31 Dec 20
			686,398	215,298		17,008	147,052	17,556	737,088	
James Turner	PLTIP	2015	18,927		1,672	1,643	18,139	788	–	31 Dec 17
	PLTIP	2015	2,993		1,417.5				2,993	31 Dec 17
	PLTIP	2016	33,116		1,279				33,116	31 Dec 18
	PLTIP	2017	27,940		1,672				27,940	31 Dec 19
	PLTIP	2018		89,439	1,750				89,439	31 Dec 20
			82,976	89,439		1,643	18,139	788	153,488	
Mike Wells[2]	PLTIP	2015	209,222		1,672	18,198	200,508	8,714	–	31 Dec 17
	PLTIP	2015	30,132		1,611.5	2,658	28,878	1,254	–	31 Dec 17
	PLTIP	2016	332,870		1,279				332,870	31 Dec 18
	PLTIP	2017	263,401		1,672				263,401	31 Dec 19
	PLTIP	2018		257,813	1,750				257,813	31 Dec 20
			835,625	257,813		20,856	229,386	9,968	854,084	

Notes

1 The awards for Barry Stowe were made in ADRs (1 ADR = 2 ordinary shares). The figures in the table are represented in terms of ordinary shares.

2 The award in 2015 for Mike Wells was made in ADRs (1 ADR = 2 ordinary shares). All of the awards from 2016 onwards were made in ordinary shares. The figures in the table are represented in terms of ordinary shares.

3 A dividend equivalent was accumulated on these awards.

Other share awards

The table below sets out Executive Directors' deferred bonus share awards.

	Year of grant	Conditional share awards outstanding at 1 Jan 2018 (Number of shares)	Conditionally awarded in 2018 (Number of shares)	Dividends accumulated in 2018[3] (Number of shares)	Shares released in 2018 (Number of shares)	Conditional share awards outstanding at 30 June 2018 (Number of shares)	Date of end of restricted period	Date of release	Market price at date of award (pence)	Market price at date of vesting or release (pence)
Mark FitzPatrick										
Deferred 2017 annual incentive award	2018		27,414	463		27,877	31 Dec 20		1,750	
		–	27,414	463	–	27,877				
John Foley										
Deferred 2014 annual incentive award	2015	44,783			44,783	–	31 Dec 17	03 Apr 18	1,672	1,747
Deferred 2015 annual incentive award	2016	67,418		1,140		68,558	31 Dec 18		1,279	
Deferred 2016 annual incentive award	2017	31,139		526		31,665	31 Dec 19		1,672	
Deferred 2017 annual incentive award	2018		29,373	496		29,869	31 Dec 20		1,750	
		143,340	29,373	2,162	44,783	130,092				
Nic Nicandrou										
Deferred 2014 annual incentive award	2015	30,662			30,662	–	31 Dec 17	03 Apr 18	1,672	1,747
Deferred 2015 annual incentive award	2016	40,121		678		40,799	31 Dec 18		1,279	
Deferred 2016 annual incentive award	2017	30,269		512		30,781	31 Dec 19		1,672	
Deferred 2017 annual incentive award	2018		30,788	520		31,308	31 Dec 20		1,750	
		101,052	30,788	1,710	30,662	102,888				
Anne Richards										
Deferred 2016 annual incentive award	2017	33,514		567		34,081	31 Dec 19		1,672	
Deferred 2017 annual incentive award	2018		54,951	929		55,880	31 Dec 20		1,750	
		33,514	54,951	1,496	–	89,961				
Barry Stowe[1]										
Deferred 2014 annual incentive award	2015	29,800			29,800	–	31 Dec 17	03 Apr 18	1,672	1,747
Deferred 2015 annual incentive award	2016	114,518		1,928		116,446	31 Dec 18		1,279	
Deferred 2016 annual incentive award	2017	138,028		2,324		140,352	31 Dec 19		1,672	
Deferred 2017 annual incentive award	2018		111,652	1,880		113,532	31 Dec 20		1,750	
		282,346	111,652	6,132	29,800	370,330				

	Year of grant	Conditional share awards outstanding at 1 Jan 2018 (Number of shares)	Conditionally awarded in 2018 (Number of shares)	Dividends accumulated in 2018[3] (Number of shares)	Shares released in 2018 (Number of shares)	Conditional share awards outstanding at 30 June 2018 (Number of shares)	Date of end of restricted period	Date of release	Market price at date of award (pence)	Market price at date of vesting or release (pence)
James Turner										
Deferred 2014 group deferred bonus plan award	2015	3,917			3,917	–	31 Dec 17	03 Apr 18	1,672	1,747
Deferred 2015 group deferred bonus plan award	2016	5,305		89		5,394	31 Dec 18		1,279	
		9,222	–	89	3,917	5,394				
Mike Wells[2]										
Deferred 2014 annual incentive award	2015	123,822			123,822	–	31 Dec 17	03 Apr 18	1,672	1,747
Deferred 2015 annual incentive award	2016	109,890		1,859		111,749	31 Dec 18		1,279	
Deferred 2016 annual incentive award	2017	52,703		891		53,594	31 Dec 19		1,672	
Deferred 2017 annual incentive award	2018		47,443	802		48,245	31 Dec 20		1,750	
		286,415	47,443	3,552	123,822	213,588				

Notes

1 The awards for Barry Stowe were made in ADRs (1 ADR = 2 ordinary shares). The figures in the table are represented in terms of ordinary shares.
2 The award for Mike Wells in 2015 was made in ADRs (1 ADR = 2 ordinary shares). All of the awards made from 2016 onwards were made in ordinary shares. The figures in the table are represented in terms of ordinary shares.
3 A dividend equivalent was accumulated on these awards.

All-employee share plans

It is important that all employees are offered the opportunity to own shares in Prudential plc, connecting them both to the success of the Company and to the interests of other shareholders. Executive Directors are invited to participate in these plans on the same basis as other staff in their location.

Save As You Earn (SAYE) schemes

UK-based Executive Directors are eligible to participate in the HM Revenue & Customs (HMRC) approved Prudential Savings-Related Share Option Scheme. This scheme allows all eligible employees to save towards the exercise of options over Prudential plc shares with the option price set at the beginning of the savings period at a discount of up to 20 per cent of the market price.

Since 2014 participants have been able to elect to enter into savings contracts of up to £500 per month for a period of three or five years. At the end of this term, participants may exercise their options within six months and purchase shares. If an option is not exercised within six months, participants are entitled to a refund of their cash savings plus interest if applicable under the rules. Shares are issued to satisfy those options which are exercised. No options may be granted under the schemes if the grant would cause the number of shares which have been issued, or which remain issuable pursuant to options granted in the preceding 10 years under the scheme and any other option schemes operated by the Company, or which have been issued under any other share incentive scheme of the Company, to exceed 10 per cent of the Company's ordinary share capital at the proposed date of grant.

Details of Executive Directors' rights under the SAYE scheme are set out in the 'Outstanding share options' table.

Share Incentive Plan (SIP)

UK-based Executive Directors are also eligible to participate in the Company's Share Incentive Plan (SIP). From April 2014, all UK-based employees were able to purchase Prudential plc shares up to a value of £150 per month from their gross salary (partnership shares) through the SIP. For every four partnership shares bought, an additional matching share is awarded which is purchased by Prudential plc on the open market. Dividend shares accumulate while the employee participates in the plan. If the employee withdraws from the plan, or leaves the Group, matching shares may be forfeited.

The table below provides information about shares purchased under the SIP together with matching shares (awarded on a 1:4 basis) and dividend shares.

	Year of initial grant	**Share Incentive Plan awards held in Trust at 1 Jan 2018** (Number of shares)	**Partnership shares accumulated in 2018** (Number of shares)	**Matching shares accumulated in 2018** (Number of shares)	**Dividend shares accumulated in 2018** (Number of shares)	**Share Incentive Plan awards held in Trust at 30 June 2018** (Number of shares)
Mark FitzPatrick	2017	81	49	12	1	143
John Foley	2014	576	49	13	10	648
Nic Nicandrou*	2010	1,766	–	–	31	1,797
James Turner	2011	479	117	30	8	634
Mike Wells	2015	408	49	12	8	477

* Following Nic Nicandrou's appointment as Chief Executive of Prudential Corporation Asia on 17 July 2017, he is no longer eligible to participate in the SIP. However, while his shares remain in the SIP Trust he will receive any dividends payable on these shares.

Cash-settled long-term incentive awards

This information has been prepared in line with the reporting requirements of the Hong Kong Stock Exchange and sets out Executive Directors' outstanding share awards and share options. For details of the cash-settled long-term incentive awards held by some Executive Directors, please see our Annual Report.

Shareholder information

Dividends

2018 first interim dividend	Shareholders registered on the UK register and Irish branch register	Shareholders registered on the Hong Kong branch register	Holders of US American Depository Receipts	Shareholders with ordinary shares standing to the credit of their Singapore CDP securities accounts
Ex-dividend date	23 August 2018	23 August 2018	–	21 August 2018
Record date	24 August 2018	24 August 2018	24 August 2018	24 August 2018
Payment of 2018 first interim dividend	27 September 2018	27 September 2018	On or about 4 October 2018	On or about 4 October 2018

Shareholder enquiries

For enquiries about shareholdings, including dividends and lost share certificates, please contact the Company's registrars:

Register	*By post*	*By telephone*
Principal UK register	Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex, BN99 6DA, UK.	Tel 0371 384 2035 Textel 0371 384 2255 (for hard of hearing). Lines are open from 8.30am to 5.30pm (UK), Monday to Friday. International shareholders Tel +44 121 415 7026
Irish branch register	Link Asset Services, Link Registrars Limited, PO Box 7117, Dublin 2, Ireland.	Tel +353 1 553 0050
Hong Kong branch register	Computershare Hong Kong Investor Services Limited, 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong.	Tel +852 2862 8555
Singapore register	Shareholders who have shares standing to the credit of their securities accounts with The Central Depository (PTE) Limited (CDP) in Singapore may refer queries to the CDP at 9 North Buona Vista Drive, #01-19/20, The Metropolis, Singapore 138588. Enquiries regarding shares held in Depository Agent Sub-accounts should be directed to your Depository Agent or broker.	Tel +65 6535 7511
ADRs	JPMorgan Chase Bank N.A, PO Box 64504, St. Paul, MN 55164-0854, USA.	Tel +1 800 990 1135, or from outside the US +1 651 453 2128 or log on to www.adr.com

Dividend mandates
Shareholders may have their dividends paid directly to their bank or building society account. If you wish to take advantage of this facility, please call Equiniti Limited (Equiniti) and request a Cash Dividend Mandate form. Alternatively, shareholders may download a form from https://www.shareview.co.uk/4/Info/Portfolio/default/en/home/shareholders/Pages/Mandate.aspx

Cash dividend alternative
The Company has a Dividend Re-investment Plan (DRIP).

Shareholders who have elected for the DRIP will automatically receive shares for all future dividends in respect of which a DRIP alternative is offered. The election may be cancelled at any time by the shareholder. Further details of the DRIP and the timetable are available on the Shareview website at www.shareview.co.uk/4/Info/Portfolio/default/en/home/shareholders/Pages/ReinvestDividends.aspx

Electronic communications
Shareholders are encouraged to elect to receive shareholder documents electronically by registering with Shareview at www.shareview.co.uk. This will save on printing and distribution costs, and create environmental benefits. Shareholders who have registered, will be sent an email notification whenever shareholder documents are available on the Company's website and a link will be provided to that information. When registering, you will need your shareholder reference number which can be found on your share certificate or proxy form. The option to receive shareholder documents electronically is not available to shareholders holding shares through The Central Depository (Pte) Limited (CDP) in Singapore. Please contact Equiniti if you require any assistance or further information.

Equiniti Shareview service
Information on how to manage shareholdings can be found at https://help.shareview.co.uk

The pages at this web address provide the following:

— answers to commonly asked questions regarding shareholder registration;

— links to downloadable forms, guidance notes and Company history factsheets; and

— a choice of contact methods – via email, telephone or post.

Share dealing services
The Company's Registrars, Equiniti, offer a postal dealing facility for buying and selling Prudential plc ordinary shares; please see the Equiniti address on the previous page or telephone 0371 384 2248. They also offer a telephone and internet dealing service, Shareview, which provides a simple and convenient way of selling Prudential plc shares. For telephone sales call 0345 603 7037. between 8.30am and 4.30pm, Monday to Friday excluding UK bank holidays, and for internet sales log on to www.shareview.co.uk/dealing

ShareGift
Shareholders who have only a small number of shares, the value of which makes them uneconomic to sell, may wish to consider donating them to ShareGift (Registered Charity 1052686). The relevant share transfer form may be obtained from our website www.prudential.co.uk/investors/shareholder-information/forms or from Equiniti. Further information about ShareGift may be obtained on +44 (0)20 7930 3737 or from www.ShareGift.org

There are no implications for capital gains tax purposes (no gain or loss) on gifts of shares to charity and it is also possible to obtain income tax relief.

How to contact us

Prudential plc

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Board

Paul Manduca
Chairman

Mike Wells
Group Chief Executive

Mark FitzPatrick
Chief Financial Officer

James Turner
Group Chief Risk Officer

John Foley
Chief Executive,
M&G Prudential

Nic Nicandrou
Chief Executive,
Prudential Corporation Asia

Barry Stowe
Chairman and Chief Executive Officer
of North American Business Unit

Group Executive Committee

Julian Adams
Group Regulatory and Government
Relations Director

Jonathan Oliver
Group Communications Director

Alan Porter
Group General Counsel and Company
Secretary

Al-Noor Ramji
Group Chief Digital Officer

Tim Rolfe
Group Human Resources Director

Our businesses

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Prudential public limited company
Incorporated and registered in England and Wales

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Laurence Pountney Hill
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Registered number 1397169
www.prudential.co.uk

Principal place of business in Hong Kong
13th Floor
One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Prudential plc is a holding company, subsidiaries of which are authorised and regulated, as applicable, by the Prudential Regulation Authority and the Financial Conduct Authority.

Forward-looking statements
This Prudential Half Year Financial Report may contain 'forward-looking statements' with respect to certain of Prudential's plans and its goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements that are not historical facts, including statements about Prudential's beliefs and expectations and including, without limitation, statements containing the words 'may', 'will', 'should', 'continue', 'aims', 'estimates', 'projects', 'believes', 'intends', 'expects', 'plans', 'seeks' and 'anticipates', and words of similar meaning, are forward-looking statements. These statements are based on plans, estimates and projections as at the time they are made, and therefore undue reliance should not be placed on them. By their nature, all forward-looking statements involve risk and uncertainty. A number of important factors could cause Prudential's actual future financial condition or performance or other indicated results to differ materially from those indicated in any forward-looking statement. Such factors include, but are not limited to, the timing, costs and successful implementation of the demerger of the M&G Prudential business; the future trading value of the shares of Prudential plc and the trading value and liquidity of the shares of the to-be-listed M&G Prudential business following such demerger; future market conditions, including fluctuations in interest rates and exchange rates, the potential for a sustained low-interest rate environment, and the performance of financial markets generally; the policies and actions of regulatory authorities, including, for example, new government initiatives; the political, legal and economic effects of the UK's decision to leave the European Union; the impact of continuing designation as a Global Systemically Important Insurer or 'G-SII'; the impact of competition, economic uncertainty, inflation and deflation; the effect on Prudential's business and results from, in particular, mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; the impact of internal projects and other strategic actions failing to meet their objectives; disruption to the availability, confidentiality or integrity of Prudential's IT systems (or those of its suppliers); the impact of changes in capital, solvency standards, accounting standards or relevant regulatory frameworks, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate; and the impact of legal and regulatory actions, investigations and disputes. These and other important factors may, for example, result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. Further discussion of these and other important factors that could cause Prudential's actual future financial condition or performance or other indicated results to differ, possibly materially, from those anticipated in Prudential's forward-looking statements can be found under the 'Risk Factors' section of this Half Year Financial Report.

Any forward-looking statements contained in this Half Year Financial Report speak only as of the date on which they are made. Prudential expressly disclaims any obligation to update any of the forward-looking statements contained in this report or any other forward-looking statements it may make, whether as a result of future events, new information or otherwise except as required pursuant to the UK Prospectus Rules, the UK Listing Rules, the UK Disclosure and Transparency Rules, the Hong Kong Listing Rules, the SGX-ST listing rules or other applicable laws and regulations.

Providing financial security since 1848

Successive generations have looked to Prudential to safeguard their financial security – from industrial workers and their families in Victorian Britain to over 26 million customers worldwide today. Our financial strength, heritage, prudence and focus on our customers' long-term needs ensure that people continue to turn to our trusted brands to help them plan for today and tomorrow.

1848
Prudential is established as Prudential Mutual Assurance, Investment and Loan Association in Hatton Garden, London, offering loans and life assurance to professional people.

1854
Prudential opens the Industrial Department to sell a new type of insurance, Industrial Insurance, to the working classes, for premiums of a penny and upwards.

1871
The Company becomes one of the first in the City to employ women. Calculating machines are also introduced, bringing efficiencies to the processing of an increasing volume of business.

1879
Prudential moves into Holborn Bars, a purpose-built office complex designed by Alfred Waterhouse. The building becomes a London landmark, and remains part of Prudential's property portfolio to this day.

1912
Following the National Insurance Act, Prudential works with the government to run Approved Societies, providing sickness and unemployment benefits to five million people.

1923
Prudential's first overseas life branch is established in India, with the first policy being sold to a tea planter in Assam.

1924
Prudential shares are floated on the London Stock Exchange.

1949
The 'Man from the Pru' advertising campaign is launched.

1986
Prudential acquires Jackson National Life Insurance Company in the United States.

1994
Prudential Corporation Asia is formed in Hong Kong as a regional head office to expand operations beyond an existing presence in Malaysia, Singapore and Hong Kong.

1999
Prudential acquires M&G, pioneer of unit trusts in the UK and a leading provider of investment products.

2000
Prudential plc is listed on the New York Stock Exchange. Prudential becomes the first UK life insurer to enter the Mainland China market through its joint venture with CITIC Group.

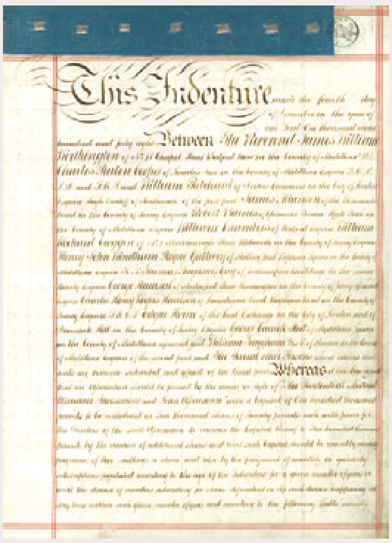
2010
Prudential plc is listed on stock exchanges in Hong Kong and Singapore.

2014
Prudential acquires businesses in Ghana and Kenya, marking its entry into the fast-growing African life insurance industry.

2017
M&G and Prudential UK & Europe combine to form M&G Prudential, a leading savings and investments business ideally positioned to target growing customer demand for comprehensive financial solutions.

2018
Prudential plc announces its intention to demerge its UK and Europe business, M&G Prudential, resulting in two separately listed companies, with different investment characteristics and opportunities.

www.prudentialhistory.co.uk



Adding more to life:
The founding of Prudential

The Prudential Mutual Assurance, Investment and Loan Association was formed on 30 May 1848, in a room at 12 Hatton Garden, London (the premises of Hanslip and Manning solicitors).

The Company's leather-bound Deed of Settlement lists the first shareholders and Directors, and outlines the Company's purpose – to offer life assurance and loans to the middle classes. Shareholders including lawyers, doctors, a wine merchant and a number of 'gentlemen' accounted for the first 1,530 shares in the Company.

Prudential's first policies were issued in 1849. The Company's first annual report, published in 1850, stated that: 'the Directors are pleased to think that they might infix habits of Prudence among many individuals', focusing on customers such as 'the clergyman who requires advances for the erection of his parsonage and the officer who seeks the price of his commission'.

Prudential public limited company
Incorporated and registered in
England and Wales

Registered office
Laurence Pountney Hill
London EC4R 0HH
Registered number 1397169

www.prudential.co.uk

Prudential plc is a holding company, subsidiaries of which are authorised and regulated, as applicable, by the Prudential Regulation Authority and the Financial Conduct Authority.

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