Maintaining focus on the execution of our strategy

Mark FitzPatrick
Group Chief Financial Officer
and Chief Operating Officer

14%
increase in Asia adjusted operating profit[1]

$9.5bn
LCSM surplus[6] over the Group minimum capital requirement (31 December 2018: $9.7bn)

I am pleased to report that we maintained focus on the execution of our strategy alongside the successful completion of the demerger of M&G plc and that this has continued to deliver positive financial performance in 2019.

Growth has once again been led by our businesses in Asia, which reflects the benefits of our well positioned and broad-based portfolio, which has long focused on high quality, recurring premium business. In 2019, this saw our life businesses outside Hong Kong deliver overall new business profit growth of 29 per cent[1], and within this 10 markets increasing new business profit. While Hong Kong has seen a more challenging sales environment, the resilience of its business model is demonstrated by its 24 per cent[1] growth in adjusted operating profit, which contributed to the 14 per cent[1] increase in adjusted operating profit delivered by our overall Asia business.

Our US business took its first steps in the execution of its diversification strategy, broadened its presence across the US annuity market, delivered increased remittances to the Group, and early adopted the new National Association of Insurance Commissioners (NAIC) variable annuity framework. Jackson has successfully demonstrated its ability both to develop and distribute new products in order to diversify its product range. Over time, this will contribute to a more balanced mix of policyholder liabilities which will enhance statutory capital and cash generation. During 2019, this transition has resulted in a higher investment in new business than has been seen in recent periods, with resulting impacts on capital generation and new business profit margins.

During 2019 our head office activities incurred costs of $(460) million (2018: $(490) million[2]). The demerger of M&G plc provides us with the opportunity to optimise the operating model of our Group functions across our head office. We are well advanced in developing and executing plans that will deliver total savings of circa $180 million[3], targeting a revised run-rate from 1 January 2021[4]. We have already completed the first phase of this work which will deliver annual savings[5] of $55 million.

Over 2019, global equity markets rallied strongly. In the US markets the S&P 500 index increased by 29 per cent over 2019, but government bond yields were generally lower over the period, with the US 10 year government bond yield ending the year at 1.9 per cent (2018: 2.7 per cent).

The impact of these market effects are most prevalent in the US's results. Jackson's hedging programme is focused on managing the economic risks in the business and protecting statutory solvency in the circumstance of large market movements. The hedging programme does not aim to hedge IFRS accounting results and this can lead to volatility in the IFRS results in periods of significant market movements, as was seen in 2019. In particular, while higher equity markets are expected to deliver ultimately increased profitability to Jackson through higher future fee income, this benefit is not fully recognised in the IFRS results in the short term. This contrasts with the impact on the derivatives within the hedging programme, designed to provide protection when markets fall, where rises in equity markets lead to short term losses in the IFRS results. These losses have been exacerbated by falling interest rates in 2019, which have led to an increase in the IFRS liabilities for the guarantees attaching to variable annuities given lower discount rates and lower assumed future separate account growth, impacting directly on the income statement. Collectively, these factors led to an IFRS loss after tax of $(380) million for the US over 2019. The interest rate falls have also led to gains on bonds, which are recognised outside the income statement, and US's IFRS segment shareholders' equity increased from $7,163 million at the end of 2018 to $8,929 million at the end of 2019. EEV has fewer mismatches (for example future fee income is fully recognised), but fluctuations in interest rates also impact Jackson's EEV results, since EEV discount rates and future expectations of separate account returns are based on current risk free rates. While our IFRS and EEV results in 2019 may therefore show a degree of volatility, we believe that the Jackson business is positioned to enhance its capital and cash generation over time as it continues to focus on the US retirement market opportunity.

We have presented the results of the UK and Europe operations (referred to as M&G plc) as discontinued operations and have adopted the US dollar as our presentational currency which better reflects the economic footprint of our business going forward. Prior year comparatives have been restated, as required under IFRS. However comparative balance sheet amounts are not restated for discontinued operations. As in previous years, growth rates referred to are on a constant exchange rate basis unless otherwise stated.

Adjusted operating profit before tax from continuing operations

Prudential's adjusted IFRS operating profit based on longer-term investment returns (adjusted operating profit) from continuing operations increased in 2019 to $5,310 million (20 per cent higher on a constant and actual exchange rate basis). This increase was driven by higher earnings from our Asia life insurance and asset management operations, and by lower market-related DAC amortisation charges compared with the prior year in the US, as a result of the strong equity market returns achieved in 2019. Other income and expenditure generated a net cost of $(926) million (2018: $(967) million[2]). Of this, $(179) million related to interest costs in respect of debt instruments transferred to M&G plc on 18 October 2019 prior to completion of the demerger. Excluding these amounts, interest costs for the continuing Group would have been $(337) million, lower than 2018 following the redemption of debt in the first half of 2019.

IFRS basis non-operating items from continuing operations

Non-operating items in 2019 consist of short-term fluctuations in investment returns on shareholder-backed business of negative $(3,203) million (2018: negative $(791) million on an actual exchange rate basis), the net loss arising from corporate transactions undertaken in the year of negative $(142) million (2018: negative $(107) million on an actual exchange rate basis), and the amortisation of acquisition accounting adjustments of negative $(43) million (2018: negative $(61) million on an actual exchange rate basis) arising mainly from the REALIC business acquired by Jackson in 2012.

The $(142) million cost of corporate transactions reflects gains from disposals offset by the $(407) million incurred in the year in connection with the demerger of M&G plc from Prudential plc, in line with our previous guidance. Further information is set out in note D1.1 to the financial statements.

Negative short-term fluctuations comprised positive $657 million (2018: negative $(684) million on an actual exchange rate basis) for Asia, negative $(3,757) million (2018: negative $(134) million) in the US and negative $(103) million (2018: positive $27 million on an actual exchange rate basis) in other operations.

Falling interest rates in certain parts of Asia led to unrealised bond gains in the year which are accounted for within non-operating profit. In the US, rising equity markets and falling interest rates have resulted in negative effects primarily reflecting net losses on hedge instruments used to manage the market exposure of Jackson's products and by changes in the IFRS value for these features. Further discussion of Jackson's non-operating items is contained in the US section of this report.

After allowing for non-operating items, the total profit after tax from continuing items was $1,953 million (2018: $2,881 million[2]).

In addition to the effects seen above, falling interest rates resulted in unrealised gains of $2.7 billion being recognised outside the income statement as part of other comprehensive income, partially mitigating the adverse effect of market movements on the Group's IFRS shareholders' funds.

IFRS loss after tax from discontinued operations

In the period prior to demerger, $1,319 million IFRS profit after tax was recognised from the discontinued M&G plc business. On distribution to shareholders as a dividend in specie the net assets of the business were remeasured to the market value of M&G plc on listing, resulting in a gain of $188 million recognised within the loss from discontinued operations for the year. As a result of representing the historical results of M&G plc in US dollars (as opposed to sterling), a loss of $(2,668) million was recognised at the date of demerger representing cumulative foreign exchange differences held in the currency translation reserve. This arose from the fall in the sterling/US dollar exchange rate over the period since the currency translation reserve was established in 2004. This was matched by an equal and opposite gain in other comprehensive income resulting in no overall impact on shareholders' funds. Reflecting the above, the total loss from discontinued operations after tax was $(1,161) million. The rest of this report focuses solely on the continuing operations of the Group.

IFRS effective tax rates

In 2019, the effective tax rate on adjusted operating profit based on longer-term investment returns from continuing operations was 15 per cent. This was unchanged from 2018.

The 2019 effective tax rate on total IFRS profit was negative (2) per cent (2018: 16 per cent). The decrease in the 2019 effective tax rate reflects increased derivative losses in the US where the effective tax rate on these items is higher (at 21 per cent) than the effective tax rate on profit from Asia operations.

Total tax contribution from continuing operations

The Group continues to make significant tax contributions in the jurisdictions in which it operates, with $2,168 million remitted to tax authorities in 2019. This increased from the equivalent amount of $1,829 million[2] remitted in 2018, primarily due to the timing of when various tax payments became due.

Tax strategy

The Group publishes its tax strategy annually which, in addition to complying with the mandatory UK (Finance Act 2016) requirements, also includes 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 is included as a way of demonstrating that our tax footprint (ie where we pay taxes) is consistent with our business footprint. An updated version of the tax strategy, including 2019 data, will be available on the Group's website before 31 May 2020.

IFRS profit

	Actual exchange rate			Constant exchange rate	
	2019 $m	**2018** $m	**Change** %	**2018** $m	**Change** %
Adjusted operating profit based on longer-term investment returns before tax from continuing operations					
Asia					
Long-term business	2,993	2,646	13	2,633	14
Asset management	283	242	17	239	18
Total Asia	3,276	2,888	13	2,872	14
US					
Long-term business	3,038	2,552	19	2,552	19
Asset management	32	11	191	11	191
Total US	3,070	2,563	20	2,563	20
Total segment profit from continuing operations	6,346	5,451	16	5,435	17
Other income and expenditure	(926)	(967)	4	(933)	1
Total adjusted operating profit based on longer-term investment returns before tax and restructuring costs	5,420	4,484	21	4,502	20
Restructuring costs	(110)	(75)	(47)	(73)	(51)
Total adjusted operating profit based on longer-term investment returns before tax from continuing operations	5,310	4,409	20	4,429	20
Non-operating items:					
Short-term fluctuations in investment returns on shareholder-backed business	(3,203)	(791)	(305)	(796)	(302)
Amortisation of acquisition accounting adjustments	(43)	(61)	30	(61)	30
Gain (loss) on disposal of businesses and corporate transactions	(142)	(107)	(33)	(106)	(34)
Profit from continuing operations before tax attributable to shareholders	1,922	3,450	(44)	3,466	(45)
Tax credit (charge) attributable to shareholders' returns	31	(569)	105	(570)	105
Profit from continuing operations for the year	1,953	2,881	(32)	2,896	(33)
Profit for the year from discontinued operations	1,319	1,142	15	1,092	21
Remeasurement of discontinued operations on demerger	188	–	n/a	–	n/a
Cumulative exchange loss recycled through other comprehensive income	(2,668)	–	n/a	–	n/a
(Loss) profit from discontinued operations for the year, net of related tax	(1,161)	1,142	(202)	1,092	(206)
Profit for the year	792	4,023	(80)	3,988	(80)

IFRS earnings per share

	Actual exchange rate			Constant exchange rate	
	2019 cents	**2018** cents	**Change** %	**2018** cents	**Change** %
Basic earnings per share based on adjusted operating profit after tax from continuing operations	175.0	145.2	21	146.0	20
Basic earnings per share based on:					
Total profit after tax from continuing operations	75.1	111.7	(33)	112.5	(33)
Total (loss) profit after tax from discontinued operations	(44.8)	44.3	(201)	42.4	(206)

Group capital position

Following the demerger of M&G plc from Prudential plc, the Hong Kong Insurance Authority (IA) is now the Group-wide supervisor for the Prudential Group. Ultimately, the Group will become subject to the Group-wide Supervision (GWS) Framework which is currently under development by the Hong Kong IA for the industry and is expected to be finalised in the second half of 2020. Until it comes into force, Prudential is applying the local capital summation method (LCSM) that has been agreed with the Hong Kong IA to determine Group regulatory capital requirements.

At 31 December 2019, the Group's LCSM surplus over the Group minimum capital requirement (GMCR) was estimated at $9.5 billion on a shareholder basis[6], equivalent to a solvency ratio of 309 per cent, and compares with a like-for-like position at 31 December 2018 of $9.7 billion and ratio of 356 per cent.

The high quality and recurring nature of the Group's operating capital generation and disciplined approach to managing balance sheet risk is evident from the $2.5 billion of in-force capital generation in the period, which supported $0.6 billion of investment in new business (on an LCSM basis), inorganic investment in Asia along with external dividends. The movement in LCSM surplus also includes demerger and other capital related items. More information is set out in note I(i) of the Additional unaudited financial information. The Group's LCSM position is resilient to external macro movements as demonstrated by the sensitivity disclosure contained in note I(i) of the Additional unaudited financial information, alongside further information on the basis of calculation of the LCSM measure.

The Group is no longer subject to Solvency II capital requirements nor regulated by the Bank of England.

Estimated Group LCSM capital position[6]

	31 December 2019		31 December 2018†	
	Total	Shareholder*	Total	Shareholder*
Available capital ($ billion)	33.1	14.0	27.0	13.5
Group minimum capital requirement (GMCR) ($ billion)	9.5	4.5	7.6	3.8
LCSM surplus (over GMCR) ($ billion)	23.6	9.5	19.4	9.7
LCSM ratio (over GMCR) (%)	348%	309%	355%	356%

* The shareholder LCSM amounts exclude the available capital and minimum capital requirements of the participating business in Hong Kong, Singapore and Malaysia.
† Excludes M&G plc and includes $3.7 billion of subordinated debt issued by Prudential plc that was transferred to M&G plc on 18 October 2019.

Financing and liquidity

Net core structural borrowings of shareholder-financed businesses[7]

	31 December 2019 $m			31 December 2018 $m		
	IFRS basis	Mark-to-market value	EEV basis	IFRS basis	Mark-to-market value	EEV basis
Subordinated debt substituted to M&G plc in 2019	–	–	–	3,718	82	3,800
Other core structural borrowings	5,594	633	6,227	6,043	151	6,194
Total borrowings of shareholder-financed businesses	5,594	633	6,227	9,761	233	9,994
Less: holding company cash and short-term investments	(2,207)	–	(2,207)	(4,121)	–	(4,121)
Net core structural borrowings of shareholder-financed businesses	3,387	633	4,020	5,640	233	5,873
Gearing ratio*	15%			20%		

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

The total borrowings of the shareholder-financed businesses decreased by $(4.2) billion, from $9.8 billion to $5.6 billion in 2019. This reflected the substitution of $4,161 million Tier 2 subordinated notes to M&G plc as part of the demerger (including £300 million 3.875 per cent Tier 2 subordinated notes issued in July 2019), and the redemption of £400 million 11.375 per cent Tier 2 subordinated notes in May 2019. The Group had central cash resources of $2.2 billion at 31 December 2019 (31 December 2018: $4.1 billion), resulting in net core structural borrowings of the shareholder-financed businesses of $3.4 billion at end 2019 (2018: $5.6 billion).

In addition to its net core structural borrowings of shareholder-financed businesses set out above, the Group has access to funding via the medium-term note programme, the US shelf programme (the platform for issuance of SEC registered bonds in the US market), a commercial paper programme and committed revolving credit facilities. All of these are available for general corporate purposes.

Prudential plc has maintained a consistent presence as an issuer in the commercial paper market for the past decade and had $520 million in issue at the year end (2018: $601 million).

As at 31 December 2019, the Group had a total of £2.0 billion of undrawn committed facilities, expiring in 2024. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 31 December 2019.

In addition to the Group's traditional sources of liquidity and financing, Jackson also has access to funding via the Federal Home Loan Bank of Indianapolis with advances secured against collateral posted by Jackson. Given the wide range of Jackson's product set and breadth of its customer base including retail, corporate and institutional clients, further sources of liquidity also include premiums and deposits.

Prudential plc seeks to maintain its financial strength rating which derives, in part, from the high level of financial flexibility to issue debt and equity instruments which is intended to be maintained and enhanced in the future.

Cash remittances

***Holding company cash flow*[7]**

	Actual exchange rate		
	2019* $m	**2018*** $m	**Change** %
From continuing operations			
Asia	950	916	4
US	509	452	13
Other UK (including Prudential Capital)	6	49	(88)
Total net cash remitted from continuing operations	1,465	1,417	3
From discontinued operations			
M&G plc	684	842	(19)
Net cash remitted by business units	2,149	2,259	(5)
Central outflows	(522)	(572)	
Dividends paid	(1,634)	(1,662)	
Other movements	(1,999)	1,153	
Total holding company cash flow	(2,006)	1,178	
Cash and short-term investments at beginning of year	4,121	3,063	
Foreign exchange movements	92	(120)	
Cash and short-term investments at end of year	2,207	4,121	

* The holding company cash flow describes the movement in the cash and short-term investments of the centrally managed group holding companies.

Cash remitted to the Group from continuing operations in 2019 amounted to $1,465 million, included $950 million from Asia and $509 million from the US. In addition, $684 million of remittances were received pre-demerger from M&G plc (excluding the $3,841 million pre-demerger dividend used to offset the payment due to M&G plc in return for the substitution of debt).

During 2019, the Group's holding company cash flow was managed in sterling and significant remittances were hedged and recorded on that basis. Growth rates are therefore distorted by the onwards translation into US dollars for presentation purposes. If local currency remittances in Asia had been translated directly into US dollars[8], then the growth rate in Asia remittances year-on-year would have been 8 per cent (compared with 4 per cent shown in the table above). The dividend paid by the US in 2019 was $525 million (2018: $450 million). From 1 January 2020, holding company cash flow will be managed in US dollars and no such distortions will occur.

Cash remittances were used to meet central costs of $(522) million, pay dividends of $(1,634) million and meet other expenditure of $(1,999) million. Corporate expenditure includes net interest paid of $(527) million of which $(231) million relates to that expended on debt substituted to M&G plc. Corporate expenditure is net of receipts of $265 million in 2019 from tax received. The level of tax receipts is expected to decline sharply in 2020, and then is not expected to recur going forward given the demerger of UK operations and the level of UK income which can be used to offset central UK expenditure.

Other expenditure of $(1,999) million relates to amounts paid in connection with the demerger and other corporate transactions in the year, including the redemption of subordinated debt in the first half of 2019. Further information is contained in note I(iii) of the Additional unaudited financial information.

As highlighted in my report for the first half of 2019, holding company cash was expected to reduce in the second half of 2019. Cash and short-term investments totalled $2.2 billion at the end of the year (2018: $4.1 billion on an actual exchange rate basis), commensurate with the reduced size of the Group post-demerger. The Group will seek to manage its financial condition such that it has sufficient resources available to provide a buffer to support the retained businesses in stress scenarios and to provide liquidity to service central outflows.

Shareholders' funds

	IFRS		EEV	
	2019 $m	**2018** $m	**2019** $m	**2018** $m
Adjusted operating profit after tax and non-controlling interests from continuing operations[9]	4,528	3,739	6,896	7,862
Profit after tax for the year[9]	783	4,019	(645)	6,122
Exchange movements, net of related tax	2,943	(714)	666	(1,574)
Unrealised gains and losses on US fixed income securities classified as available-for-sale	2,679	(1,446)	–	–
Demerger dividend in specie of M&G plc	(7,379)	–	(7,379)	–
Other dividends	(1,634)	(1,662)	(1,634)	(1,662)
Mark-to-market value movements on Jackson assets backing surplus and required capital	–	–	206	(127)
Other	117	9	95	176
Net increase (decrease) in shareholders' funds	(2,491)	206	(8,691)	2,935
Shareholders' funds at beginning of the year	21,968	21,762	63,402	60,467
Shareholders' funds at end of the year	19,477	21,968	54,711	63,402
Shareholders' value per share[10,11]	749¢	847¢	2,103¢	2,445¢

Group IFRS shareholders' funds in the 12 months to 31 December 2019 decreased by 11 per cent to $19.5 billion (31 December 2018: $22.0 billion on an actual exchange rate basis) principally as a result of the demerger of M&G plc which reduced shareholders' funds by $(7.4) billion. Excluding this effect, shareholders' funds increased by $4.9 billion primarily as a result of profit after tax from continuing businesses of $1.9 billion, profit generated by M&G plc up to the date of demerger of $1.3 billion and unrealised gains on fixed income securities of Jackson of $2.7 billion following a decrease in US long-term interest rates. These amounts were offset by dividends paid in the year of $(1.6) billion.

The total return from continuing operations (including other comprehensive income) on Group's closing shareholders' funds for the year was 27 per cent[12], after excluding items arising from the demerger of $528 million (being costs of undertaking the demerger and interest). The demerger alters the size of the Group's shareholders' equity and the nature of its operations, rendering a comparison with the prior year return on shareholders' funds value unrepresentative.

The Group's EEV basis shareholders' funds at 31 December 2019 was $54.7 billion. This compares with $46.1 billion at 31 December 2018 if the $17.3 billion in respect of the UK & Europe operations is excluded. The growth over the year is primarily driven by EEV profit from continuing operations of $4.2 billion, total inter-group dividends from M&G plc in the period before demerger of $5.5 billion less external dividends of $(1.6) billion. On a per share basis, the Group's embedded value at 31 December 2019 equated to 2,103 cents. More information on the Group's EEV results are included in the segmental detail that follows.

Free surplus generation from continuing operations[13]

Free surplus generation is the financial metric we use to measure the internal cash generation of our business operations and is based (with adjustments) on the capital regimes that apply locally in the various jurisdictions in which the Group operates. For life insurance operations, it represents amounts emerging from the in-force business during the year, net of amounts reinvested in writing new business. For asset management businesses, it equates to post-tax adjusted operating profit for the year.

Operating free surplus generated from continuing operations before the adjustments to reflect hedge modelling changes and restructuring costs increased to $3.8 billion (2018: $3.5 billion[1]). This was after $(1,158) million of investment in new business (2018: $(946) million[1]).

Asia operating free surplus generation[14] increased by 13 per cent to $1,772 million in line with business growth, higher asset management earnings and stable levels of new business investment.

US operating free surplus generation before the 2019 hedge modelling changes was $2,028 million (2018: $1,895 million) with the increase from in-force business, including a one-off benefit from the integration of the John Hancock business, offset by higher new business investment. As part of the implementation of the NAIC's changes to the US statutory reserve and capital framework enhancements were made to the model used to allow for hedging within US statutory reporting. As a consequence, the Group has chosen to utilise this new model within its EEV results, resulting in a $3.2 billion reduction in Jackson's EEV at the start of the year and a subsequent fall in operating free surplus of $(903) million from a lower expected transfer to net worth. Further information is included in the US segmental discussion and in the EEV basis results. After allowing for this effect and restructuring costs, operating free surplus generation for the Group was down 16 per cent to $2,861 million.

Analysis of movement in free surplus for insurance and asset management operations[13]

	Actual exchange rate			Constant exchange rate	
	2019 $m	**2018** $m	**Change** %	**2018** $m	**Change** %
Operating free surplus generated before restructuring costs and US EEV hedge modelling enhancements	3,800	3,458	10	3,462	10
Restructuring costs	(36)	(48)	25	(47)	23
Operating free surplus generated before US EEV hedge modelling enhancements	3,764	3,410	10	3,415	10
Impact of 2019 US EEV hedge modelling enhancements	(903)	–	n/a	–	n/a
Operating free surplus generated	2,861	3,410	(16)	3,415	(16)
Non-operating (loss) profit	(568)	(1,649)			
Net cash flows paid to parent company	(1,475)	(1,368)			
Foreign exchange movements on foreign operations, timing differences and other items	(172)	(991)			
Total movement in free surplus from continuing operations	646	(598)			
Free surplus at 1 January from continuing operations	5,351	5,949			
Free surplus at 31 December from continuing operations	5,997	5,351			
Analysis of operating free surplus generated from in-force life business and asset management before restructuring costs and US EEV hedge modelling enhancements					
Asia	1,772	1,563	13	1,567	13
US	2,028	1,895	7	1,895	7
Total	3,800	3,458	10	3,462	10

Dividend

The Board has approved a 2019 second interim ordinary dividend of 25.97 cents per share, equivalent to the 19.60 pence per share previously indicated in the demerger Circular.

The Board considers dividends to be an important component of total shareholder return and adopted a progressive dividend policy for the Group following the demerger. The level of dividend growth will be determined after taking into account the Group's capital generation capacity, financial prospects and investment opportunities, as well as market conditions. The Group's 2020 dividend under the new progressive dividend policy will be determined from a 2019 US dollar base of $958 million[15] (36.84 cents per share), equivalent to the circa £750 million previously disclosed in the Circular.

This policy is expected to result, over the medium term, in future central outflows, ie dividends, debt interest costs and other central expenses (including central payments for bancassurance distribution agreements and restructuring costs) net of tax recoverables, being covered by remittances from business units.

The Board intends to maintain the Group's existing formulaic approach to first interim dividends, which are calculated as one-third of the previous year's full-year dividend.

Asia

Operational and financial highlights

Our 2019 Asia financial results reflect the benefits of our diverse and well-positioned portfolio across the Asia region, the resilience of the longer-term growth drivers in these markets, our long-held prioritisation of high quality, recurring premium life insurance business and focused execution on our key strategic priorities.

This is reflected in diversified growth, with 10 markets expanding new business profit and our Asia ex-Hong Kong businesses growing new business profit by 29 per cent. Our earnings continue to be supported by high quality drivers with a 14 per cent increase in insurance margin, underpinned by our protection propositions for customers, alongside 18 per cent growth in asset management earnings, helped by a 15 per cent increase in average funds under management.

This led to a 14 per cent increase in overall Asia adjusted operating profit with eight insurance markets delivering double-digit growth. These drivers are also reflected in the EEV operating profit of $6,138 million (2018: $6,052 million[1]), driving a 23 per cent increase in embedded value to $39.2 billion. At the same time, a 13 per cent increase in operating free surplus generation[14] supported a higher cash remittance of $950 million for the year.

	Actual exchange rate			Constant exchange rate	
	2019 $m	2018 $m	Change %	2018 $m	Change %
New business profit	3,522	3,477	1	3,460	2
Adjusted operating profit*	3,276	2,888	13	2,872	14
EEV operating profit*	6,138	6,070	1	6,052	1
Operating free surplus generation*	1,772	1,563	13	1,567	13

* Before restructuring costs

New business performance

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

	Actual exchange rate						Constant exchange rate			
	2019 $m		2018 $m		Change %		2018 $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
Hong Kong	2,016	2,042	2,266	2,309	(11)	(12)	2,268	2,310	(11)	(12)
China JV	590	262	403	199	46	32	386	190	53	38
Indonesia	390	227	315	163	24	39	316	163	23	39
Other life insurance markets	2,165	991	2,015	806	7	23	1,989	797	9	24
Total Asia	5,161	3,522	4,999	3,477	3	1	4,959	3,460	4	2
Total Asia excluding Hong Kong	3,145	1,480	2,733	1,168	15	27	2,691	1,150	17	29
Total new business margin		68%		70%				70%		

Life insurance new business APE sales increased by 4 per cent to $5,161 million and related **new business profit** increased by 2 per cent with eight markets achieving double-digit growth in new business profit.

Lower levels of APE sales and new business profit in Hong Kong (down 11 and 12 per cent respectively) were more than offset by higher overall APE sales and new business profit in markets outside Hong Kong (up 17 and 29 per cent respectively). Our Asia ex-Hong Kong businesses accelerated strongly, as new APE sales growth steadily increased throughout the year, with 11 per cent growth in the first quarter rising to 26 per cent growth in the fourth quarter.

We continue to favour health and protection products due to their resilience to market cycles and superior margins. Collectively, such products achieved new business profit growth of more than 20 per cent outside Hong Kong and produced 67 per cent of our overall Asia new business profit in 2019. This also contributed to our high mix of regular premiums, which comprised 93 per cent of our APE sales in 2019.

Our partnerships also made encouraging progress last year. The bancassurance channel achieved APE sales growth of 14 per cent, with particularly strong performances in our China joint venture and Vietnam and 24 per cent growth from UOB following the renewal of the strategic partnership at the beginning of the year.

In **Hong Kong**, our domestic business was resilient with new product launches and focused management actions leading to an 8 per cent increase in local APE sales. This was supported by strong take-up of our new qualified deferred annuity product which accounted for 11 per cent of our Hong Kong APE sales since its launch on 1 April 2019 as well as our VHIS plans, both of which are eligible for tax incentives that were newly introduced by the government. Our Hong Kong life insurance business serves the health and savings needs of both domestic as well as visiting mainland Chinese consumers. The social unrest drove a decline in mainland Chinese visitors in the second half of 2019 inhibiting sales to this segment which led to a 41 per cent reduction in related APE sales compared with the second half of 2018, and to a 21 per cent reduction in APE sales over the year as a whole. Overall Hong Kong APE sales and new business profit were 11 and 12 per cent lower respectively.

In our **China JV**, APE sales were 53 per cent higher at $590 million. This growth reflects a strong performance by both our agency and bancassurance channels with the latter reflecting the success of our strategy to drive increased branch activation. Higher volumes helped deliver an increase in new business profit by 38 per cent.

In **Indonesia**, the benefits of a recent restructuring of our agency channel and successful new product launches supported a 23 per cent increase in APE sales and this growth accelerated to 41 per cent in the second half from 4 per cent in the first half. The 39 per cent increase in new business profit reflected the benefit of increased volumes, as well as operational improvements from new product launches in the year.

The broad-based performance of our other life insurance markets led to a 9 per cent increase in related new sales, with particularly strong growth in the **Philippines** (34 per cent higher), while shifting towards higher-margin health and protection products. The 24 per cent increase in new business profit contribution from our other life markets is driven by higher new sales volumes, favourable assumption changes and modelling enhancements.

EEV basis results

	Actual exchange rate			Constant exchange rate	
	2019 $m	**2018** $m	**Change** %	**2018** $m	**Change** %
New business profit	3,522	3,477	1	3,460	2
Business in force	2,366	2,381	(1)	2,383	(1)
Operating profit from long-term business	5,888	5,858	1	5,843	1
Asset management	250	212	18	209	20
Operating profit from long-term business and asset management before restructuring costs	6,138	6,070	1	6,052	1
Restructuring costs	(31)	(25)	(24)	(24)	(29)
Non-operating profit (loss)	1,962	(1,235)	259	(1,232)	259
Profit for the year	8,069	4,810	68	4,796	68

Other movements	(842)	(1,681)
Net increase (decrease) in embedded value	7,227	3,129
Embedded value at 1 January	32,008	28,879
Embedded value at 31 December	39,235	32,008
% New business profit/closing embedded value	9%	11%
% Operating profit/closing embedded value	16%	19%

Asia EEV operating profit increased marginally compared with the prior period to $6,138 million (2018: $6,052 million[1]), driven by the 2 per cent increase in life new business profit, balanced by a 1 per cent reduction in the contribution from in-force life business.

The development of the in-force life result of $2,366 million (2018: $2,383 million[1]) reflects a 4 per cent reduction in the expected return, partly offset by higher, favourable operating assumption changes and experience development. Under our active EEV assumption framework, the lower expected return is a function of lower period end interest rates leading to lower period end risk discount rates. These lower risk discount rates are applied to the opening embedded value in this analysis, and result in a lower expected return compared with the prior period, only partly offset by a higher starting embedded value position. Operating assumption and experience developments were positive at $824 million (2018: $769 million[1]) and are driven by favourable persistency and mortality/morbidity effects among other factors, and again reflect the high quality of our in-force life business.

The asset management segment operating profit after tax increased by 20 per cent to $250 million (2018: $209 million[1]), which is discussed in more detail below.

Non-operating profit was $1,962 million (2018: $(1,232) million[1]), mainly reflecting higher than assumed equity and fixed income returns in the period, partly offset by the effect of lower period end interest rates leading to a reduction in future assumed investment returns, among other factors.

Overall Asia segment embedded value increased by 23 per cent to $39.2 billion (2018: $32.0 billion). Of this, $37.8 billion (2018: $31.0 billion) relates to the value of the long-term business. The remainder represents Asia asset management and goodwill which are carried at IFRS net asset value under the EEV framework.

Asia analysis of movement in free surplus[13]

	Actual exchange rate			Constant exchange rate	
	2019 $m	**2018** $m	**Change** %	**2018** $m	**Change** %
Operating free surplus generated from in-force life business and asset management before restructuring costs	2,391	2,215	8	2,213	8
Investment in new business	(619)	(652)	5	(646)	4
Operating free surplus generated before restructuring costs	1,772	1,563	13	1,567	13
Restructuring costs	(31)	(25)	(24)	(24)	(29)
Operating free surplus generated	1,741	1,538	13	1,543	13
Non-operating (loss) profit	1,195	(525)			
Net cash flows to parent company	(950)	(916)			
Foreign exchange movements on foreign operations, timing differences and other items	(357)	(847)			
Total movement in free surplus	1,629	(750)			
Free surplus at 1 January	2,591	3,341			
Free surplus at 31 December	4,220	2,591			

Overall Asia operating free surplus generated[14], after investment in new business, was $1,772 million, an increase of 13 per cent compared with the prior period, driven by higher in-force generation and a lower level of investment in new business. The 8 per cent increase in the in-force return reflects growth in the in-force life portfolio, favourable operating experience effects and strong growth in asset management earnings, which more than offsets less favourable economic effects. The level of investment in new business reduced by 4 per cent, despite higher new sales, and reflects the net impact of assumption changes and various country and business mix effects. In turn, this growth in operating free surplus generation supported an increased net cash remittance of $950 million for the year (2018: $916 million). Non-operating profit of $1,195 million mainly relates to the net effect of bond and equity gains across most Asia markets.

Local statutory capital

We maintained a resilient balance sheet with a robust shareholder LCSM surplus of $4.7 billion and coverage ratio of 253 per cent at 31 December 2019 (31 December 2018: $3.6 billion and 244 per cent) supported by our expertise in risk management and a conservative approach to credit risk. We seek to safeguard our business from market volatility through our strong focus on protection products and our prudent asset and liability management strategy, which continues to be well-matched by both currency and duration. This is demonstrated by the relatively low sensitivity of our new business profit and our embedded value to a wide range of capital market fluctuations.

IFRS earnings

Overall, Asia adjusted operating profit increased by 14 per cent to $3,276 million, with life insurance earnings up 14 per cent and asset management earnings up 18 per cent. Our Asia life insurance earnings growth is broad-based and at scale, reflecting the benefits of our focus on high quality recurring premium business and well diversified business portfolio. 86 per cent[16] of our total life income (excluding other income described below) arises from insurance margin and fee income, again supporting stable profit progression across market cycles.

Overall, eight insurance markets reported double-digit growth, with five delivering growth of 20 per cent or more. Six markets delivered annual adjusted operating profit of above $200 million and three in the region of $500 million or higher. At a market level, highlights include Hong Kong (up 24 per cent) driven by the high quality of its in-force growth, China JV (up 20 per cent), Vietnam (up 20 per cent) and the Philippines (up 26 per cent). Adjusted operating profit in Indonesia of $540 million remains at a high level, but was 3 per cent below the prior period.

Profit margin analysis of Asia long-term insurance and asset management operations[17]

	Actual exchange rate				Constant exchange rate	
	2019		2018		2018	
	$m	Margin bps	$m	Margin bps	$m	Margin bps
Spread income	321	108	310	125	305	124
Fee income	286	105	280	106	277	106
With-profits	107	18	95	20	94	20
Insurance margin	2,244		1,978		1,966	
Other income	3,229		2,982		2,962	
Total life income	6,187		5,645		5,604	
Expenses:						
Acquisition costs	(2,156)	(42)%	(2,007)	(40)%	(1,991)	(40)%
Administration expenses	(1,437)	(252)	(1,374)	(269)	(1,359)	(268)
DAC adjustments	430		435		430	
Share of related tax charges from joint ventures and associates	(31)		(53)		(51)	
Long-term insurance business pre-tax adjusted operating profit	2,993		2,646		2,633	
Eastspring	283		242		239	
Adjusted operating profit from long-term business and asset management before restructuring costs	3,276		2,888		2,872	
Tax charge	(436)		(411)		(408)	
Adjusted operating profit after tax for the year before restructuring costs	2,840		2,477		2,464	
Non-operating profit after tax	885		(662)		(665)	
Profit for the year after tax before restructuring costs	3,725		1,815		1,799	

Our earnings continue to be based on high-quality drivers. The overall 14 per cent growth in Asia life insurance adjusted operating profit to $2,993 million (2018: $2,633 million[1]) was driven principally by 14 per cent growth in insurance margin related revenues and reflects our ongoing focus on recurring premium health and protection products, and the associated continued growth of our in-force business. Renewal premiums[10], reflecting the long-term nature of our insurance business, grew 12 per cent.

Fee income increased by three per cent, broadly in line with the increase in average unit-linked liabilities, while spread income rose by five per cent given changes in product and geographical mix and lower interest rates in the period.

With-profits earnings relate principally to the shareholders' share in bonuses declared to policyholders. As these bonuses are typically weighted to the end of a contract, under IFRS, with-profit earnings consequently emerge only gradually over time. The 14 per cent growth in with-profits earnings reflects the ongoing growth in these portfolios.

Other income primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses. As such, the 9 per cent increase in margin on revenues largely reflects ongoing business growth and the associated continued growth in overall premiums received. Acquisition costs borne by shareholders increased by 8 per cent in relation to a 4 per cent increase in overall APE sales. The ratio of shareholder acquisition costs to shareholder related APE sales (excluding with-profits related sales) reduced to 66 per cent (2018: 69 per cent on an actual exchange rate) as a result of changes in product mix. Administration expenses, including renewal commissions, increased by 6 per cent reflecting ongoing business growth.

Asset management

	Actual exchange rate		
	2019 $m	**2018** $m	**Change** %
Total external net flows	8,909	(2,118)	n/a
External funds under management ($bn)	124.7	77.8	60
Internal funds under management ($bn)	116.4	114.9	1
Total funds under management ($bn)	241.1	192.7	25
Analysis of adjusted operating profit			
Retail operating income	392	336	17
Institutional operating income	244	230	6
Operating income before performance-related fees	636	566	12
Performance-related fees	12	23	(48)
Operating income (net of commission)	648	589	10
Operating expense	(329)	(311)	(6)
Group's share of tax on joint ventures' adjusted operating profit	(36)	(36)	–
Adjusted operating profit	283	242	17
Adjusted operating profit post-tax	250	212	18
Average funds managed by Eastspring	$214.0bn	$186.3bn	15
Margin based on operating income	30bps	30bps	–
Cost/income ratio[10]	52%	55%	(3) ppts

Eastspring delivered a strong performance in 2019 reflecting positive operating momentum and the benefit of recent acquisitions. Overall funds under management of $241.1 billion and adjusted operating profit of $283 million, are at record levels.

The increase in external funds under management to $124.7 billion (2018: $77.8 billion) reflected $8.9 billion[18] (2018: $(2.1) billion[18]) in positive third-party net flows, favourable market performance and $7.5 billion from the TFUND acquisition in December 2019. In addition, following the demerger of M&G plc, $26.7 billion of M&G related assets have been reclassified to external from internal funds under management.

Third party net inflows were positive in both retail and institutional products and across both equity and fixed income funds, reflecting the benefit of new products and mandates. Overall funds under management were also supported by continued positive internal net flows resulting in total funds under management of $241.1 billion at year end (2018: $192.7 billion on an actual exchange rate basis).

An increase in average funds managed by Eastspring of 15 per cent[2] resulted in adjusted operating profit rising by 18 per cent (up 17 per cent on an actual exchange rate basis) to $283 million and growth in operating income of 10 per cent[2]. Disciplined cost management has led to an improvement in its cost-income ratio[10] to 52 per cent (2018: 55 per cent on an actual exchange rate basis), with operating expenses increasing at a slower rate of 8 per cent (6 per cent on an actual exchange rate basis).

Return on segment equity

Asia return on closing IFRS shareholders' funds

	2019	**2018**
Operating return on closing shareholders' funds (%)	26	30
Total comprehensive return on closing shareholders' funds (%)	36	20

The benefit of our focus on profitable and capital efficient health and protection, with-profit and asset management businesses is evident in the attractive 26 per cent (2018: 30 per cent) return delivered on closing segment equity over 2019.

United States

Operational and financial highlights

The financial performance of the US business in the period reflects the impact of the execution of the first steps of its strategic diversification together with the varying financial effects of strong US equity market performance and lower interest rates in the period. We have decided to adopt early as at 31 December 2019 the new National Association of Insurance Commissioners (NAIC) capital rules related to variable annuities and have made consequential updates to our EEV basis results. All of the results below reflect the whole US segment, except for the discussion on local statutory capital which covers Jackson National Life only.

	2019 $m	2018 $m	Change %
New business profit	883	1,230	(28)
Adjusted operating profit*	3,070	2,563	20
EEV operating profit*	1,782	2,828	(37)
Jackson RBC ratio (%)	366	458	(92) ppts

* Before restructuring costs

New business performance

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

	2019 $m	2018 $m	Change %
Variable annuities	1,270	1,443	(12)
Elite Access (variable annuity)	200	225	(11)
Fixed annuities	119	46	159
Fixed index annuities	382	33	1,058
Wholesale	252	312	(19)
Total APE sales	2,223	2,059	8
% APE variable annuities	66	81	(15)
% APE other products	34	19	15
Total new business profit	883	1,230	(28)
New business margin	40%	60%	

Overall new US APE sales increased to $2,223 million (2018: $2,059 million), with the proportion of general account products (fixed annuities, fixed index annuities and wholesale business) at 34 per cent (2018: 19 per cent) of new sales reflecting our intention to diversify our product mix over time to balance the overall risk profile of Jackson better. This was supported by new product launches and additional distribution initiatives. New business profit was lower at $883 million (2018: $1,230 million). Of this $(347) million reduction, $(155) million is a result of lower interest rates and other changes in economic assumptions compared with the prior period. The remainder reflects the change in product mix and other assumption change impacts.

Movement in policyholder liabilities

	2019 $m		2018 $m	
	Separate account liabilities	General account and other liabilities	Separate account liabilities	General account and other liabilities
At 1 January	163,301	73,079	176,578	67,905
Premiums	12,776	8,200	14,646	3,967
Surrenders	(12,767)	(4,575)	(11,746)	(4,465)
Maturities/deaths	(1,564)	(1,823)	(1,449)	(1,238)
Net flows	(1,555)	1,802	1,451	(1,736)
Addition for closed block of group pay-out annuities in the US	–	–	–	5,532
Transfers from general to separate account	951	(951)	708	(708)
Investment-related items and other movements	32,373	549	(15,436)	2,086
At 31 December	195,070	74,479	163,301	73,079

Overall US net flows were $0.2 billion over the year (2018: $(0.3) billion). Separate account net flows were negative at $(1.6) billion (2018: positive $1.5 billion), reflecting lower new sales of variable annuities in the period and expected higher levels of surrenders as the in-force book develops. Investment related movements reflect favourable investment performance driven by strong capital market returns. General account net flows were $1.8 billion (2018: $(1.7) billion), driven by higher new sales in the period. Total year-end policyholder liabilities were $269.5 billion (2018: $236.4 billion), with separate account liabilities at $195.1 billion and general account and other liabilities at $74.5 billion.

IFRS earnings

Profit margin analysis of US long-term insurance and asset management operations[17]

	2019		2018	
	$m	Margin bps	$m	Margin bps
Spread income	642	112	778	155
Fee income	3,292	182	3,265	183
Insurance margin	1,317		1,267	
Other income	26		14	
Total life income	5,277		5,324	
Expenses:				
Acquisition costs	(1,074)	(48)%	(1,013)	(49)%
Administration expenses	(1,675)	(68)	(1,607)	(69)
DAC adjustments	510		(152)	
Long-term insurance business pre-tax adjusted operating profit	3,038		2,552	
Asset management	32		11	
Adjusted operating profit from long-term business and asset management before restructuring costs	3,070		2,563	
Tax charge	(437)		(402)	
Adjusted operating profit after tax for the year before restructuring costs	2,633		2,161	
Non-operating profit after tax	(3,013)		(179)	
(Loss) profit for the year after tax before restructuring costs	(380)		1,982	

Adjusted operating profit

US long-term adjusted operating profit was $3,038 million (2018: $2,552 million), and reflects the benefit of favourable market-related DAC adjustments in the period compared with unfavourable DAC adjustments in the prior period.

Fee income was marginally higher compared with the prior period, with the benefit of a 2 per cent increase in average separate account balances largely offset by a modest decline in the average fee margin[17].

Spread income declined to $642 million (2018: $778 million) reflecting the combination of lower core spread income and lower income derived from swaps held for duration management purposes. The development of the core spread income was driven by the effect of lower invested asset yields and the full consolidation of the assets acquired with the John Hancock transaction towards the end of 2018, resulting in a reduction in the spread margin to 112 basis points (2018: 155 basis points).

Insurance margin primarily represents income from variable annuity guarantees and profits from legacy life businesses. This increased by 4 per cent to $1,317 million (2018: $1,267 million) mainly as a result of higher income from variable annuity guarantees.

Acquisition costs increased by 6 per cent, broadly in line with the 8 per cent increase in new APE sales. Administrative expenses increased from $(1,607) million in 2018 to $(1,675) million in 2019, primarily as a result of higher asset-based commissions. Excluding these asset-based commissions, the resulting administration expense ratio would be 33 basis points (2018: 34 basis points).

DAC adjustments, being the cost deferred on sales in the period net of amortisation of amounts deferred previously, of $510 million (2018: $(152) million) were favourable compared with the prior period, in part due to higher sales in the period. Over 2019, strong capital market returns resulted in a separate account investment performance materially in excess of that assumed within the DAC mean reversion formula which led to a favourable DAC deceleration effect of $280 million (2018: unfavourable DAC acceleration effect of $(259) million).

Non-operating items

The non-operating result was negative $(3,795) million pre-tax (2018: negative $(241) million pre-tax) and contributed to a net loss after tax of $(380) million (2018: net income $1,982 million).

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. Jackson charges fees for these guarantees which are in turn used to purchase downside protection, in particular options and futures to mitigate the effect of equity market falls. Under IFRS, accounting for the movement in the valuation of these derivatives, which are all fair valued, is asymmetrical to the movement in guarantee liabilities, which are not fair valued in all cases. Jackson designs its hedge programme to protect the economics of the business from large movements in investment markets and accepts the variability in accounting results. Non-operating losses of $(3,795) million in the year mainly reflect the effect of lower interest rates on guarantee liabilities and the impact of higher equity markets on both guarantee liabilities and associated derivatives given that the S&P 500 index ended the year 28.9 per cent higher than at the start of the year. While the resulting negative mark-to-market movements on these hedging instruments are recorded in the current year, the related increases in fee income that arise from the higher asset values managed, will be recognised and reported in future years.

In addition to the effects seen above, falling interest rates resulted in gains of $2.7 billion being recognised outside the income statement on bonds held by Jackson's general account. In total, Jackson's segment shareholders' funds increased to $8,929 million (2018: $7,163 million).

EEV basis results

	2019 $m	2018 $m	Change %
New business profit	883	1,230	(28)
Business in force	874	1,594	(45)
Operating profit from long-term business	1,757	2,824	(38)
Asset management	25	4	525
Operating profit from long-term business and asset management before restructuring costs	1,782	2,828	(37)
Restructuring costs	(5)	(23)	78
Non-operating loss	(3,802)	(1,695)	(124)
Profit for the year	(2,025)	1,110	(282)
Other movements (including dividends)	(342)	(654)	
Net increase (decrease) in embedded value	(2,367)	456	
Embedded value at 1 January	18,709	18,253	
Embedded value at 31 December	16,342	18,709	
% New business profit / closing embedded value	5%	7%	
% Operating profit / closing embedded value	11%	15%	

EEV operating profit from the long-term business reduced to $1,757 million (2018: $2,824 million) reflecting lower new business profit in the period and a reduction in the level of expected return on business in force.

During 2019, following the implementation of the NAIC's changes to the US statutory reserve and capital framework, enhancements were made to the model used to allow for hedging within US statutory reporting. As a consequence, the Group has chosen to utilise the model for its EEV reporting to update its allowance for the long-term cost of hedging, resulting in a $(3,233) million reduction in Jackson's EEV at the start of the year.

The reduction in expected return from business in force reflects lower period end interest rates which reduce the expected unwind, and a lower starting balance of EEV shareholders' funds compared with the prior period. This is a function of weak equity markets in the fourth quarter of 2018, and the adoption of a new hedge model as discussed above.

The EEV non-operating loss of $(3,802) million mainly includes negative $(3,233) million from the adoption of the new hedging model (as discussed above), and negative $(1,201) million from economic effects, offset by positive $876 million from favourable investment movements.

The investment return variances are driven by the benefit of strong capital market performance in the period leading to separate account returns materially in excess of those assumed, more than offsetting hedging losses on instruments held for risk management purposes.

Economic assumption changes of $(1,201) million largely reflect the impact of lower interest rates in the period on the projected future fund growth rates for the variable annuity business. These projected lower growth rates reduce the expected growth in fund values for policyholders and hence the expected profitability for shareholders.

Overall segment embedded value ended the year at $16.3 billion (2018: $18.7 billion).

US analysis of movement in free surplus[13]

	2019 $m	2018 $m	Change %
Operating free surplus generated from in-force life business and asset management before restructuring costs and EEV hedge modelling enhancements	2,567	2,195	17
Investment in new business	(539)	(300)	(80)
Operating free surplus generated before restructuring costs and EEV hedge modelling enhancements	2,028	1,895	7
Restructuring costs	(5)	(23)	78
Operating free surplus generated before EEV hedge modelling enhancements	2,023	1,872	8
Impact of 2019 EEV hedge modelling enhancements	(903)	–	–
Operating free surplus generated	1,120	1,872	(40)
Non-operating (loss) profit	(1,763)	(1,124)	
Net flows paid to parent company	(525)	(452)	
Timing differences and other items	185	(144)	
Total movement in free surplus	(983)	152	
Free surplus at 1 January	2,760	2,608	
Free surplus at 31 December	1,777	2,760	

The US in-force business generated $2,567 million (2018: $2,195 million) prior to allowing for the change to the allowance for hedging costs discussed above. This included a $355 million benefit following the integration of the John Hancock business acquired in 2018. Offsetting this increase was a higher investment in new business (up 80 per cent to $(539) million). The increase in investment in new business to $(539) million (2018: $(300) million) is a function of a higher weight of general account new sales in the period.

Operating free surplus generated[14] after allowing for the impact of changes to hedge modelling was $1,120 million.

Non-operating assumptions and variances related to free surplus development were $(1,763) million (2018: $(1,124) million) and reflect higher losses on hedge instruments compared with those assumed under the new basis. Circa $395 million of these hedge losses were incurred in managing the risk profile of the business as Jackson transitioned from the previous US statutory and reserving framework to the new framework following updates made by the NAIC which is further discussed below.

Local statutory capital – Jackson National Life (Jackson)

Jackson applies the US statutory reserve and capital framework required by the NAIC and adopted the NAIC's changes to this framework for variable annuities with effect from 31 December 2019. This new capital methodology incorporates a unified approach to reserving and required capital determination. In addition, with effect from 1 October 2019, Jackson chose not to renew its long-standing permitted practice to exclude unrealised gains on certain derivative instruments taken out to protect Jackson against declines in long-term interest rates.

After adopting this new regime, the surplus of available capital over required capital (set at 100 per cent of the Company Action Level) was $3,795 million. This equated to a risk-based capital ratio of 366 per cent (2018: 458 per cent using the previous NAIC framework). An analysis of the estimated movement in Jackson's risk-based capital position over 2019 is set out below. Jackson continues to remain within its existing risk appetite and expects the new capital regime to result in a more stable RBC ratio than under the previous regime, in low interest rate scenarios.

	Total available capital $m	Required capital $m	Surplus $m	Ratio %
1 January 2019	5,519	1,204	4,315	458
Capital generation from new business written during 2019	119	263	(144)	(75)
Operating capital generation from business in force at 1 January 2019*	1,406	(125)	1,531	141
Operating capital generation	1,525	138	1,387	66
Adoption of NAIC reforms (see above)	279	137	142	(17)
Other non-operating movements, including market effects and removal of the permitted practice	(1,577)	(53)	(1,524)	(104)
Dividends paid	(525)	–	(525)	(37)
31 December 2019	5,221	1,426	3,795	366

* Includes operating experience variances and the impact of John Hancock

Over the period, statutory operating capital generation of $1.4 billion increased the RBC ratio by 66 percentage points, comprising 118 percentage points ($1.2 billion) from in-force capital generation, reduced by 75 percentage points ($(0.1) billion) for the capital strain of writing new business, and 23 percentage points ($0.3 billion) of one-off benefits related to the recent John Hancock acquisition. In line with the product diversification strategy previously outlined and Jackson's accelerated sales growth of fixed index and new fixed annuity products, the capital strain from selling non-VA products was 64 percentage points of the total 75 percentage points of new business strain.

Non-operating and other capital movements reduced the RBC ratio by 121 percentage points ($(1.4) billion) due to:

- adoption of the new capital regime at 31 December 2019, resulting in a one-off reduction in the RBC ratio of 17 percentage points;
- one-off hedge losses in respect of managing through the changeover to the new regime representing a 28 percentage point fall in the RBC ratio;
- an increase in deferred tax assets not admitted as statutory capital, which reduced the RBC ratio by 26 percentage points, bringing the total non-admitted DTA to $0.9 billion at 31 December 2019. $0.5 billion of this non-admitted DTA balance relates to hedge losses incurred in 2019 which are required to be spread over three years for tax purposes and so is expected to be carried forward to be deducted from Jackson's taxable income in the next two years; and
- other non-operating items that reduced the RBC ratio by 50 percentage points, primarily representing variable annuity net hedge losses in the period given asymmetries between the statutory accounting basis and the economics hedged by Jackson.

During 2019 Jackson remitted $(525) million to Prudential, representing around half of Jackson's operating capital generation in the period (excluding John Hancock effects), which reduced the RBC ratio by 37 percentage points. As previously announced, from 2020 Jackson's remittances are expected to be more evenly spread over the calendar year than in prior periods.

In respect of the previously noted ongoing NAIC review of the C-1 bond factors in the required capital calculation, the expected implementation has been delayed to 2021 or thereafter. After adoption of the new capital regime, the estimated reduction in RBC ratio under the current proposal is circa 10 to 20 points.

Return on segment equity
US return on closing IFRS shareholders' funds.

	2019	2018
Operating return on closing shareholders' funds (%)	29	30
Total comprehensive return on closing shareholders' funds (%)	26	7

The US operating return on segment equity was 29 per cent (2018: 30 per cent). The total comprehensive return on segment equity, including non-operating and other comprehensive income movements, described above, was 26 per cent (2018: 7 per cent).

Notes

1 On a constant exchange rate basis.
2 On an actual exchange rate basis.
3 As compared with 2018 and before a planned $10 million increase in Africa costs as business grows.
4 Approximately half of the corporate expenditure is incurred in sterling and our assumptions forecast an exchange rate of £1=$1.2599.
5 From 1 January 2021.
6 Surplus over Group minimum capital requirement and estimated before allowing for second interim ordinary dividend. Shareholder business excludes the available capital and minimum requirement of participating business in Hong Kong, Singapore and Malaysia. Further information on the basis of calculation of the LCSM measure is contained in note I(i) of the Additional unaudited financial information.
7 Net cash remitted by business units are included in the holding company cash flow, which is disclosed in detail in note I(iii) of the Additional unaudited financial information. This comprises dividends and other transfers from business units that are reflective of emerging earnings and capital generation.
8 Using the relevant month-end spot rate.
9 Excluding profit for the year attributable to non-controlling interests.
10 See note II of the Additional unaudited financial information for definition and reconciliation to IFRS balances.
11 For EEV shareholders' value per share, see note II(x) of the Additional unaudited financial information.
12 See note I(iii) of the Additional unaudited financial information for the basis of calculation.
13 For insurance operations, operating 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 operating profit for the period. Restructuring costs are presented separately from the operating business unit amount. Further information is set out in note 11 of the EEV basis results.
14 Operating free surplus generated before restructuring costs.
15 The pro forma dividend for 2019 of the $958 million represents the first interim ordinary dividend paid of $528 million (£428 million based on spot exchange rate at the payment date) plus the second interim ordinary dividend of $675 million (£510 million based on spot rate at 31 December 2019) less the contribution of remittances from the discontinued M&G plc business to the second interim ordinary dividend of $245 million (£185 million based on spot exchange rates at 31 December 2019).
16 Total insurance margin ($2,244 million) and fee income ($286 million) of $2,530 million divided by total life income excluding other income of $2,958 million (Comprised of total life income of $6,187 million less other income of $3,229 million).
17 For discussion on the basis of preparation of the sources of earnings in the table see note I(iv) of the Additional unaudited financial information.
18 Excludes Money Market Funds.