

**THIS DOCUMENT AND THE ACCOMPANYING DOCUMENTS ARE IMPORTANT AND REQUIRE YOUR IMMEDIATE ATTENTION.**

If you are in any doubt as to what action you should take, you are recommended to seek your own financial advice immediately from your stockbroker, bank manager, solicitor, accountant, fund manager or other appropriate independent financial adviser, who is authorised under the Financial Services and Markets Act 2000 ("FSMA 2000") if you are in the United Kingdom or, if not, from another appropriately authorised independent financial adviser.

If you sell or have sold or otherwise transferred all of your Existing Shares (other than ex-rights) in certificated form before 8 June 2010 in the case of Existing Shares held on the UK Register or the Irish Register (the "UK Ex-Rights Date") or before 3 June 2010 in the case of Existing Shares held on the HK Register (the "HK Ex-Rights Date") please send this document, together with any Provisional Allotment Letter, if and when received, at once to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for delivery to the purchaser or transferee except that such documents should not be distributed, forwarded to or transmitted in or into any jurisdiction where to do so might constitute a violation of local securities laws or regulations, including but not limited to, subject to certain exceptions, the Excluded Territories. If you sell or transfer or have sold or otherwise transferred all or some of your Existing Shares (other than ex-rights) held in uncertificated form through CREST before the UK Ex-Rights Date, a claim transaction will automatically be generated by Euroclear which, on settlement, will transfer the appropriate number of Nil Paid Rights to the purchaser or transferee. If you sell or transfer or have sold or otherwise transferred only part of your holding of Existing Shares (other than ex-rights) held in certificated form before the UK Ex-Rights Date or HK Ex-Rights Date (as appropriate), you should refer to the instructions regarding split applications in Part IX (*Terms and Conditions of the Rights Issue*) of this document and in the Provisional Allotment Letter.

This document comprises a prospectus relating to the Rights Issue prepared in accordance with the Prospectus Rules of the Financial Services Authority made under section 73A of FSMA 2000 and approved by the Financial Services Authority under section 85 of FSMA 2000. This prospectus has been filed with the Financial Services Authority and made available to the public in accordance with Rule 3.2 of the Prospectus Rules. Prudential has requested that the Financial Services Authority provide a certificate of approval and a copy of this document to the relevant competent authorities in France and Ireland. Credit Suisse, HSBC and J.P. Morgan Cazenove have acted as joint sponsors in relation to this prospectus.

This document includes particulars given in compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to Prudential. A copy of each of this prospectus and the Provisional Allotment Letter, having attached thereto the documents specified in the paragraph headed "Documents registered with the Registrar of Companies" in Part XIX (*Additional Information*) of this prospectus, have been registered with the Registrar of Companies in Hong Kong as required by Section 342C of the Companies Ordinance. The Registrar of Companies and the Securities and Futures Commission of Hong Kong take no responsibility for the contents of any of these documents.

This document and the accompanying Singapore Application Form is issued to Qualifying CDP Shareholders in connection with, and solely for the purposes of, the Rights Issue. Neither this document nor the Singapore Application Form has been or will be lodged with or registered by the Monetary Authority of Singapore (the "MAS") as a prospectus under the Securities and Futures Act, Chapter 289 of Singapore (the "Securities and Futures Act"), and the Rights Issue Shares are only offered to Qualifying CDP Shareholders and Singapore Renounees pursuant to Section 273(1)(cd) of the Securities and Futures Act. The MAS assumes no responsibility for the contents of this document. The MAS has not, in any way, considered the merits of the Prudential Group, the Existing Shares, the Rights Issue Shares, the Nil Paid Rights or the Rights Issue.

**You should read the whole of the prospectus including the discussions of certain risks and other factors as set out in Part II — "Risk Factors" of this document.**

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## Prudential plc

(incorporated and registered in England and Wales under number 01397169) (HK Stock Code: 2378)

Proposed Fully Underwritten 11 for 2 Rights Issue of 13,964,557,750 Rights Issue Shares  
at 104 pence per Rights Issue Share

**Joint Sponsors, Joint Global Co-ordinators and Joint Bookrunners:**

**Credit Suisse**

**HSBC Bank plc**

**J.P. Morgan Cazenove**

**Joint Lead Managers:**

Banca IMI  
Deutsche Bank  
UBS Investment Bank

Banco Santander  
ING

BofA Merrill Lynch  
Morgan Stanley

Citi  
RBS Hoare Govett

**Co-Lead Managers:**

Barclays Capital  
Natixis

BNP PARIBAS  
Nomura International

Credit Agricole CIB  
Scotia Capital

Mediobanca  
Société Générale Corporate  
and Investment Banking

Standard Chartered

UniCredit Bank AG

United Overseas Bank

**Co-Managers:**

BBVA  
Fortis Bank Nederland  
Macquarie

BOC International  
ICBC International  
RBC Capital Markets

COMMERZBANK  
Keefe, Bruyette & Woods

DBS Bank  
Lloyds TSB Corporate Markets

**Underwriter:**

Qatar Holding LLC

**Financial Advisers:**

Ondra Partners

Credit Suisse

HSBC Bank plc

J.P. Morgan Cazenove

Lazard

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The Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights and the Provisional Allotment Letters have not been and will not be registered under the US Securities Act of 1933, as amended (the "US Securities Act") or under any relevant securities laws of any state or other jurisdiction of the United States and may not be offered, sold, taken up, exercised, resold, renounced, transferred or delivered, directly or indirectly, within the United States absent registration or an applicable exemption from the registration requirements of the US Securities Act and in compliance with state securities laws. The Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights and the Provisional Allotment Letters have not been approved or disapproved by the US Securities and Exchange Commission (the "SEC"), any state securities commission in the United States or any other US regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights and the Provisional Allotment Letters or the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offence in the United States. Except as otherwise provided for herein, this document does not constitute an offer of Rights Issue Shares, Nil Paid Rights or Fully Paid Rights to any shareholder with a registered address in, or who is resident in, the United States. Hong Kong Exchanges and Clearing Limited, The Stock Exchange of Hong Kong Limited and Hong Kong Securities Clearing Company Limited take no responsibility for the contents of this document, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this document.

The Singapore Exchange Securities Trading Limited (the "SGX-ST") assumes no responsibility for the correctness of any of the statements or opinions made or reports contained in this document. Admission to the Singapore Official List of the SGX-ST is not to be taken as an indication of the merits of the Prudential Group, the Existing Shares, the Rights Issue Shares, the Nil Paid Rights or the Rights Issue.

The distribution of this document and/or the Provisional Allotment Letter and/or the Singapore Application Form and/or the transfer of Nil Paid Rights, Fully Paid Rights and/or Rights Issue Shares in or into jurisdictions other than the United Kingdom, Hong Kong or Singapore may be restricted by law and therefore any persons who are subject to the laws of any jurisdiction other than the United Kingdom, Hong Kong or Singapore should inform themselves about, and observe, such restrictions. Any failure to comply with the applicable restrictions may constitute a violation of the securities laws of such jurisdiction. Subject to certain exceptions, neither this document, the Singapore Application Form nor the Provisional Allotment Letter constitutes an offer or invitation to purchase, acquire or subscribe for any securities or a solicitation of an offer to buy any securities pursuant to this document, the Singapore Application Form, the Provisional Allotment Letter or otherwise in any jurisdiction in which such offer or solicitation is unlawful. Except as otherwise provided for herein, this prospectus is not for release, publication or distribution, directly or indirectly, to persons in the United States or any other Excluded Territory and should not be distributed, forwarded to or transmitted in or into any jurisdiction where to do so might constitute a violation of local securities laws or regulations. None of the Existing Shares, the Nil Paid Rights, the Fully Paid Rights or the Rights Issue Shares has been or will be registered under the relevant laws of any state, province or territory of any Excluded Territory.

All Overseas Shareholders and any person (including, without limitation, a custodian, nominee or trustee) who has a contractual or legal obligation to forward this document or any Provisional Allotment Letter, if and when received, or any other document to a jurisdiction outside the United Kingdom, Hong Kong or Singapore should read section 7 of Part IX (*Terms and Conditions of the Rights Issue*) of this prospectus.

The Existing Shares are listed on the premium segment of the Official List and admitted to trading on the London Stock Exchange's main market for listed securities and commencement of trading on the Main Board of the Hong Kong Stock Exchange is expected to commence on 25 May 2010. Application has been made in respect of the Existing Shares to the SGX-ST for secondary listing and permission to deal on the Main Board of the SGX-ST and is expected to commence on 25 May 2010. Application will be made to the UKLA and to the London Stock Exchange for the Rights Issue Shares to be admitted to the premium segment of the Official List and to trading on the London Stock Exchange's main market for listed securities, respectively. Application has also been made to the Hong Kong Stock Exchange, and will be made to the SGX-ST, for listing of and permission to deal in the Rights Issue Shares on the Hong Kong Stock Exchange and the Main Board of the SGX-ST, respectively. It is expected that UK Admission will become effective and that dealings on the London Stock Exchange in the Rights Issue Shares (nil paid) will commence at 8.00 a.m. (London time) on 8 June 2010. It is also expected that HK Admission will become effective and that dealings in Rights Issue Shares (nil paid) will commence at 9.30 a.m. (Hong Kong time) on 10 June 2010. Further, it is expected that Singapore Admission will be effective and that dealings in the Rights Issue Shares (nil paid) will commence at 9.00 a.m. (Singapore time) on 9 June 2010.

Credit Suisse, HSBC and J.P. Morgan Cazenove each of which is authorised and regulated in the UK by the FSA, are acting solely for Prudential and no one else in connection with the Transactions and, together with the other Underwriters, the Rights Issue and will not regard as a client anyone (whether or not a recipient of this prospectus) other than Prudential in connection with the Transactions or the Rights Issue and will not be responsible to anyone (whether or not a recipient of this prospectus) other than Prudential for providing the protections afforded to their clients nor for providing advice to anyone other than Prudential in connection with the Transactions or the Rights Issue or any other matter referred to herein. Apart from the responsibilities and liabilities, if any, which may be imposed on the Underwriters by FSMA 2000 or the regulatory regime established thereunder or other applicable law, the Underwriters accept no responsibility whatsoever for, nor make any representation or warranty, express or implied, in relation to, the contents of this document, including its accuracy, completeness or verification or for any other statement purported to be made by any of them, or on behalf of them in connection with Prudential, the Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights, the Transactions or the Rights Issue. The Underwriters accordingly disclaim all and any responsibility or liability whether arising in tort, contract or otherwise (save as referred to above) which they might otherwise have in respect of this document.

Lazard, which is authorised and regulated in the United Kingdom by the FSA, is acting solely for Prudential and no one else in connection with the Acquisition and will not regard as a client anyone (whether or not a recipient of this prospectus) other than Prudential in connection with the Acquisition and will not be responsible to anyone (whether or not a recipient of this prospectus) other than Prudential for providing the protections afforded to its clients nor for providing advice to anyone other than Prudential in connection with the Acquisition or any other matter referred to herein.

Ondra Partners, which is authorised and regulated in the United Kingdom by the FSA, is acting as financial adviser solely for Prudential and no one else in connection with the Rights Issue, the Acquisition and the Scheme and will not regard as a client anyone (whether or not a recipient of this prospectus) other than Prudential in connection with the Rights Issue, the Acquisition and the Scheme and will not be responsible to anyone (whether or not a recipient of this prospectus) other than Prudential for providing the protections afforded to its clients nor for providing advice to anyone other than Prudential in connection with the Rights Issue, the Acquisition, the Scheme or any other matter referred to herein. Apart from the responsibilities and liabilities, if any, which may be imposed on Ondra Partners by FSMA 2000 or the regulatory regime established thereunder, Ondra Partners accepts no responsibility whatsoever for, nor makes any representation or warranty, express or implied, in relation to, the contents of this document, including its accuracy, completeness or verification or for any other statement purported to be made by it, or on behalf of it in connection with Prudential, the Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights or the Rights Issue. Ondra Partners accordingly disclaims all and any responsibility and liability whether arising in tort, contract or otherwise (save as referred to above) which it might otherwise have in respect of this document or any such statement.

The Directors have not authorised anyone to give any other information or make any representations other than those contained in this document and the Directors take no responsibility for any other information that others may give.

None of the AIA Group, AIA Aurora, their respective affiliates nor any of the directors, officers and employees of such persons, has authorised, or accepts responsibility for, this document or its contents for the purposes of the FSMA 2000 or the Prospectus Rules in the United Kingdom or for the purposes of the Companies Ordinance (Cap. 32 of the Laws of Hong Kong), the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong), the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, the Securities and Futures Act, Chapter 289 of Singapore, or the SGX-ST Listing Manual or the securities laws of the United States or any of its states or any other jurisdiction.

The Underwriters and any of their respective affiliates may, in accordance with applicable legal and regulatory provisions, engage in transactions (including short sales) in relation to the Nil Paid Rights, the Fully Paid Rights, the Rights Issue Shares, Prudential Shares and/or related instruments for their own account for the purposes of hedging their underwriting exposure or otherwise. Except as required by applicable law or regulation, the Underwriters do not propose to make any public disclosure in relation to such transactions.

The content of this document is not to be construed as legal, business or tax advice. You should consult your own solicitor, independent financial adviser or tax advisers for legal, financial or tax advice.

#### **NOTICE TO INVESTORS IN THE UNITED STATES**

For this Rights Issue, Prudential is relying upon exemptions from registration under the US securities laws for an offer and sale that does not involve a public offering in the United States. None of the Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights or the Provisional Allotment Letters has been recommended by any US federal or state securities commission or any other US state or foreign regulatory authorities, and they have not determined that this document is accurate or complete. Any representation to the contrary is a criminal offence.

The Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights and the Provisional Allotment Letters have not been and will not be registered under the US Securities Act or under the securities laws of any state of the United States and, accordingly, may be offered and sold in the United States only pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the US Securities Act.

If you are in the United States, you may not receive a Provisional Allotment Letter, exercise your Nil Paid Rights or Fully Paid Rights and/or purchase any Rights Issue Shares offered hereby unless you are a "qualified institutional buyer" ("QIB") within the meaning of Rule 144A under the US Securities Act. In addition, in order to receive a Provisional Allotment Letter, exercise your Nil Paid Rights or Fully Paid Rights and/or purchase any Rights Issue Shares offered hereby you must sign and deliver an investor letter, substantially in the form described in section 7 of Part IX (*Terms and Conditions of the Rights Issue*).

#### **Rule 144A under the US Securities Act is not available for the resale of any Rights Issue Shares.**

From the date of this prospectus through the 40th day after the date on which the price is set for the placing by the Underwriters of any Rights Issue Shares not taken up in the Rights Issue (which is currently expected to be on or about 4 August 2010) the US Depository will not accept deposits of any Prudential Shares in the facility unless the shareholder certifies that the Prudential Shares were not acquired in the Rights Issue.

Any envelope containing a Provisional Allotment Letter and post-marked from the United States will not be accepted unless it contains a duly executed investor letter in the appropriate form as described in section 7 of Part IX of this document. Similarly, any Provisional Allotment Letter in which the exercising holder requests Rights Issue Shares to be issued and gives an address in the United States will not be accepted unless it contains a duly executed investor letter. The payment made in respect of Provisional Allotment Letters that do not meet the foregoing criteria will be returned without interest. Any person in the United States who obtains a copy of this document and who is not a QIB is requested to disregard it.

#### **NOTICE TO NEW HAMPSHIRE RESIDENTS ONLY**

**NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER RSA 421-B WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE OR NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS SECTION.**

#### **Notice to Canadian investors**

The distribution of the Rights Issue Shares in Canada is being made only on a private placement basis exempt from the requirement that Prudential prepare and file a prospectus with the applicable securities regulatory authorities. Prudential is not a reporting issuer in any province or territory in Canada and its securities are not listed on any stock exchange in Canada and there is currently no public market for the Rights Issue Shares in Canada. Prudential currently has no intention of becoming a reporting issuer in Canada, filing a prospectus with any securities regulatory authority in Canada to qualify the resale of the Rights Issue Shares to the public, or listing its securities on any stock exchange in Canada. Accordingly, to be made in accordance with securities laws, any resale of the Rights Issue Shares in Canada must be made under available statutory exemptions from registration and prospectus requirements or under a discretionary exemption granted by the applicable Canadian securities regulatory authority. Canadian purchasers are advised to seek legal advice prior to any resale of the Rights Issue Shares.

No representation or warranty is made as to the tax consequences to a Canadian resident of an investment in the Rights Issue Shares. Canadian residents are advised that an investment in the Rights Issue Shares may give rise to particular tax consequences affecting them. Accordingly, Canadian residents are strongly encouraged to consult with their tax advisers prior to making any investment in the Rights Issue Shares.

#### **NOTICE TO JAPANESE INVESTORS**

**THE NIL PAID RIGHTS, THE FULLY PAID RIGHTS AND THE RIGHTS ISSUE SHARES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE FINANCIAL INSTRUMENTS AND EXCHANGE LAW OF JAPAN, AS AMENDED (“FIEL”). IN PARTICULAR, NO REGISTRATION HAS BEEN MADE IN RESPECT OF THE SOLICITATION OF AN OFFER FOR THE ACQUISITION OF THE NIL PAID RIGHTS, THE FULLY PAID RIGHTS OR THE RIGHTS ISSUE SHARES PURSUANT TO ARTICLE 4, PARAGRAPH 1 OF FIEL UNDER AN EXEMPTION THEREFROM PURSUANT TO ARTICLE 2, PARAGRAPH 3, ITEM 1 OF FIEL AND RELATED CABINET ORDER. ACCORDINGLY, IN CONNECTION WITH THE OFFERING MADE HEREBY THE NIL PAID RIGHTS, THE FULLY PAID RIGHTS AND THE RIGHTS ISSUE SHARES MAY NOT, DIRECTLY OR INDIRECTLY, BE OFFERED OR SOLD IN JAPAN TO, OR FOR THE BENEFIT OF, ANY RESIDENT OF JAPAN, OR TO OTHERS FOR RE-OFFERING OR RE-SALE DIRECTLY OR INDIRECTLY IN JAPAN TO, OR FOR THE BENEFIT OF, ANY RESIDENT OF JAPAN EXCEPT PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF, AND OTHERWISE IN COMPLIANCE WITH FIEL AND OTHER RELEVANT LAWS AND REGULATIONS OF JAPAN. AS USED IN THIS PARAGRAPH, “RESIDENT OF JAPAN” MEANS ANY PERSON RESIDENT IN JAPAN, INCLUDING ANY CORPORATION OR OTHER ENTITY ORGANISED UNDER THE LAWS OF JAPAN.**

#### **Notice to European Economic Area investors**

In relation to each EEA State (except for the United Kingdom) which has implemented the Prospectus Directive (2003/71/EC) (each a “relevant member state”) with effect from and including the date on which the Prospectus Directive was implemented in that relevant member state (the “relevant implementation date”) no Nil Paid Rights, Fully Paid Rights or Rights Issue Shares have been offered or will be offered pursuant to the Rights Issue to the public in that relevant member state prior to the publication of a prospectus in relation to the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares which has been approved by the competent authority in that relevant member state or, where appropriate, approved in another relevant member state and notified to the competent authority in the relevant member state, all in accordance with the Prospectus Directive, except that with effect from and including the relevant implementation date, the offer of Nil Paid Rights, Fully Paid Rights or Rights Issue Shares may be made to the public in that relevant member state at any time:

- (a) to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (b) to any legal entity which has two or more of (i) an average of at least 250 employees during the last financial year; (ii) a total balance sheet of more than €43 million; and (iii) an annual turnover of more than €50 million, as shown in its last annual or consolidated accounts; or
- (c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Nil Paid Rights, Fully Paid Rights or Rights Issue Shares shall result in a requirement for the publication by Prudential or the Joint Sponsors, the Joint Global Co-ordinators, the Joint Bookrunners or the Underwriters of a prospectus pursuant to Article 3 of the Prospectus Directive.

For this purpose, the expression “offer of any Nil Paid Rights, Fully Paid Rights or Rights Issue Shares to the public” in relation to any Rights Issue Shares, Nil Paid Rights and Fully Paid Rights in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the Rights Issue and any Nil Paid Rights, Fully Paid Rights and Rights Issue Shares to be offered so as to enable an investor to decide to acquire any Nil Paid Rights, Fully Paid Rights or Rights Issue Shares, as the same may be varied in that relevant member state by any measure implementing the Prospectus Directive in that relevant member state.

In the case of any Nil Paid Rights, Fully Paid Rights or Rights Issue Shares being offered to a financial intermediary as that term is used in Article 3(2) of the Prospectus Directive, such financial intermediary will also be deemed to have represented, acknowledged and agreed that the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares acquired by it in the Rights Issue have not been acquired on a non-discretionary basis on behalf of, nor have they been acquired with a view to their offer or resale to persons in circumstances which may give rise to an offer of any Nil Paid Rights, Fully Paid Rights or Rights Issue Shares to the public other than their offer or resale in a relevant member state to qualified investors as so defined or in circumstances in which the prior consent of Prudential and the Joint Global Co-ordinators has been obtained to each such proposed offer or resale. Prudential and each of the Joint Sponsors, the Joint Global Co-ordinators, the Joint Bookrunners or the Underwriters and their respective affiliates will rely upon the truth and accuracy of the foregoing representation.

#### **Notice to Australian investors**

This document is not an Australian law compliant prospectus for the purposes of Divisions 3, 4 and 5 of Part 6D.2 of the Corporations Act 2001 (Cth) (other than section 718) and sections 728(1)(b) and (c), and 728(3)(b), 730(1)(b) and (c), 734 and 735 of the Corporations Act 2001 (Cth). This document has been prepared on the basis that the class order relief provided by the Australian Securities and Investments Commission Class Order 00/183 (Foreign rights issue) is available. Accordingly, the information disclosed in this document may not be the same as that which would have been disclosed if this document had been prepared in accordance with Australian law. This document will be lodged with the Australian Securities and Investments Commission.

The Rights Issue Shares issued to Qualifying Shareholders under the Rights Issue will be issued for the purpose of raising equity capital and not for the purpose of Qualifying Shareholders selling or transferring the securities or granting, issuing or transferring interests in, or options over, them.

#### **Notice to Swiss investors**

The Nil Paid Rights, the Fully Paid Rights and the Rights Issue Shares may not be publicly offered, sold or advertised, directly or indirectly, in Switzerland and neither this document nor any other offering or marketing material relating to Prudential or the Nil Paid Rights, the Fully Paid Rights or the Rights Issue Shares constitutes a prospectus within the meaning of articles 652a or 1156 of the Swiss Code of Obligations or a listing prospectus within the meaning of the listing

rules of the SIX Swiss Exchange. Neither this document nor any other offering material relating to Prudential or the Nil Paid Rights, the Fully Paid Rights or the Rights Issue Shares may be distributed or otherwise made available in Switzerland except in a manner which will not constitute a public offer in Switzerland.

#### **Notice to Chinese investors**

Prudential acknowledges that the Rights Issue and the circulation or distribution of this document in the People's Republic of China ("PRC") have not been and will not be approved by the relevant securities regulatory authority of the PRC in accordance with the securities laws of the PRC and that the Rights Issue will be offered through the London market and the Hong Kong market and not through the mainland China market.

Prudential represents and agrees that it has not offered or sold, and will not offer or sell, to investors in the PRC any Rights Issue Shares other than to PRC certificated and uncertificated shareholders.

Prudential shall not be responsible or liable for any approvals, registration or filing procedures required by PRC investors in connection with their exercise of rights under the Rights Issue under PRC law.

#### **Notice to Qatari investors**

This offer is made to its addressee ("recipient") exclusively and the recipient may not give it or a copy to any other person except to legal or financial advisors for the purpose of them advising the recipient about it.

This offer is not regulated by the Qatar Central Bank or any other authority in Qatar. It is not a public offer of securities in Qatar.

#### **Notice to South Korean investors**

The Nil Paid Rights, Fully Paid Rights and Rights Issue Shares have not been and will not be registered under the Financial Investment Services and Capital Market Act of the Republic of Korea ("Korea"), and the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares are not to be offered, sold or delivered and will not be offered or sold, directly or indirectly, in Korea or to, or for the account or benefit of, any resident of Korea or to others for re-offering or resale, directly or indirectly, in Korea or to, or for the account or benefit of, any resident in Korea, except (i) pursuant to an exemption from the registration requirements of, or otherwise in compliance with, the Financial Investment Services and Capital Market Act of Korea and (ii) in compliance with the other relevant laws and regulations of Korea.

#### **Notice to United Arab Emirates investors**

This prospectus has not been reviewed, approved or authorised by the UAE Central Bank, the Emirates Securities and Commodities Authority, or any other relevant authority in the United Arab Emirates ("UAE"), and it does not constitute a public offer of securities in the UAE under the Federal Law No. 8 of 1984 concerning Commercial Companies (as amended) or otherwise. For the purposes of the offering of the Rights Issue Shares, none of Prudential, the Joint Sponsors, Joint Global Co-ordinators, Joint Bookrunners or Underwriters has received any authorisation from the UAE Central Bank, or any other authority in the UAE to market, offer or sell any securities within the UAE.

This prospectus is not intended to constitute an offer, sale or delivery of shares or other securities under the laws of the UAE. The Nil Paid Rights, Fully Paid Rights and Rights Issue Shares have not been and will not be registered under the Federal Law No. 4 of 2000 Concerning the Emirates Securities and Commodities Authority and Market, with the Emirates Security and Commodity Exchange, or with the UAE Central Bank, the Dubai Financial Market, the Abu Dhabi Securities Market, or with any other UAE exchange. Nothing contained in this Prospectus is intended to constitute UAE investment, legal, tax, accounting or other professional advice. This prospectus is for information purposes only and nothing in this prospectus is intended to endorse or recommend a particular course of action. Prospective investors should consult with an appropriate professional for specific advice rendered on the basis of their situation. No marketing of any financial products or services is to be made from within the UAE and no subscription to any services, products or financial services is to be consummated within the UAE. None of Prudential, the Joint Sponsors, Joint Global Co-ordinators, Joint Bookrunners or Underwriters is a licensed broker or dealer or investment adviser under the laws applicable in the UAE, or advises individuals resident in the UAE as to the appropriateness of investing in or purchasing or selling securities or transacting in other financial products.

This prospectus is strictly private and confidential and is being distributed to a limited number of investors and must not be provided to any person other than the original recipient, and may not be reproduced or used for any other purpose. The interests in the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares may not be offered or sold directly or indirectly in the UAE.

#### **Notice to Malaysian investors**

No approval from the Securities Commission of Malaysia ("SC") has been applied for or will be obtained for the offer for subscription or purchase or invitation to subscribe for or purchase the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares under the Capital Markets and Services Act 2007 ("CMSA") as the offering of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares under the prospectus is to be such that it is a proposal not requiring SC approval under Schedule 5 of the CMSA.

No prospectus or other offering material or document in connection with the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares has been or will be registered with the SC pursuant to the CMSA as the offering of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares under the prospectus is meant to qualify as an "excluded offer" or "excluded invitation" under Schedule 6 or Schedule 7 of the CMSA. Where required under Malaysian law, the prospectus will be deposited as an information memorandum with the SC in accordance with the CMSA. This document is not intended to be circulated or distributed in Malaysia and the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares may not be made subject to an invitation to acquire for acquisition or offer for sale, directly or indirectly, in Malaysia other than to persons specified under Schedule 6 or Schedule 7 of the CMSA.

#### **Notice to Singapore investors**

This document or any written materials issued in connection with the offer is not a prospectus as defined in the Securities and Futures Act, Chapter 289 of Singapore (the "SFA"). The offer of the Nil Paid Rights, Fully Paid Rights or Rights Issue Shares is made in reliance on the offering exemption under Section 273(1)(cd) of the SFA. This document and any other document or material in connection with the offer or sale of the Nil Paid Rights, Fully Paid Rights or Rights Issue Shares may not be circulated or distributed, nor may the Nil Paid Rights, Fully Paid Rights or the Rights Issue Shares be offered or sold, whether directly or indirectly, to any person in Singapore other than to a member of the Company pursuant to Section 273(1)(cd) of the SFA or otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

This prospectus is dated 17 May 2010.

## CONTENTS

EXPECTED TIMETABLE OF PRINCIPAL EVENTS .....	6
RIGHTS ISSUE STATISTICS .....	11
PART I SUMMARY .....	12
PART II RISK FACTORS .....	16
PART III DIRECTORS, COMPANY SECRETARY AND ADVISERS .....	28
PART IV IMPORTANT NOTICES .....	31
PART V INFORMATION ABOUT THE TRANSACTIONS .....	38
PART VI INFORMATION ABOUT THE ENLARGED GROUP .....	51
PART VII INFORMATION ABOUT THE PRUDENTIAL GROUP .....	73
PART VIII INFORMATION ABOUT THE AIA GROUP .....	102
PART IX TERMS AND CONDITIONS OF THE RIGHTS ISSUE .....	143
PART X SUPERVISION AND REGULATION .....	171
PART XI SELECTED FINANCIAL INFORMATION .....	218
PART XII OPERATING AND FINANCIAL REVIEW OF THE PRUDENTIAL GROUP .....	224
PART XIII OPERATING AND FINANCIAL REVIEW OF THE AIA GROUP .....	322
PART XIV HISTORICAL FINANCIAL INFORMATION FOR PRUDENTIAL GROUP .....	380
PART XV HISTORICAL FINANCIAL INFORMATION FOR AIA GROUP .....	671
PART XVI UNAUDITED PRO FORMA FINANCIAL INFORMATION .....	791
PART XVII MANAGEMENT AND EMPLOYEES .....	806
PART XVIII TAXATION CONSIDERATIONS .....	814
PART XIX ADDITIONAL INFORMATION .....	824
DEFINITIONS .....	900
GLOSSARY .....	909
APPENDIX FIRST QUARTER 2010 INTERIM MANAGEMENT STATEMENT .....	914

## EXPECTED TIMETABLE OF PRINCIPAL EVENTS IN THE UK<sup>(1)</sup>

All references to time in this document are to London time unless otherwise stated

Prudential Shares quoted ex-dividend . . . . .	Wednesday 7 April 2010
Record date for 2009 final dividend <sup>(2)</sup> . . . . .	6.00 p.m. on Friday 9 April 2010
Record date for entitlement of Prudential ADR holders to instruct US Depository with respect to US Depository's voting at Court Meeting and General Meeting . . . . .	5.00 p.m. (New York time) on Friday 30 April 2010
<b>Annual General Meeting</b> . . . . .	11.00 a.m. on Wednesday 19 May 2010 <sup>(3)</sup>
Dividend payment date . . . . .	Thursday 27 May
Suspension of removals of Existing Shares from the UK Register to the HK Register . . . . .	3.00 p.m. on Tuesday 1 June 2010
Latest time and date for receipt by the US Depository of Voting Instruction Cards for the Court Meeting and General Meeting . . . . .	12.00 noon (New York time) on Thursday 3 June 2010
Voting Record Time for the Reconvened Annual General Meeting, Court Meeting and General Meeting . . . . .	6.00 p.m. on Thursday 3 June 2010 <sup>(4)</sup>
Latest time and date for receipt by the Registrar of the White Form of Proxy for the Reconvened Annual General Meeting . . . . .	6.00 p.m. on Thursday 3 June 2010
Latest time and date for receipt by the Registrar of the Blue Form of Proxy for the Court Meeting . . . . .	6.00 p.m. on Thursday 3 June 2010 <sup>(5)</sup>
Latest time and date for receipt by the Registrar of the Pink Form of Proxy for the General Meeting . . . . .	6.00 p.m. on Thursday 3 June 2010 <sup>(6)</sup>
UK Record Date for entitlements under the Rights Issue . . . . .	5.00 p.m. on Friday 4 June 2010
<b>Reconvened Annual General Meeting</b> . . . . .	11.00 a.m. on Monday 7 June 2010
<b>Court Meeting</b> . . . . .	11.15 a.m. on Monday 7 June 2010 <sup>(7)</sup>
<b>General Meeting</b> . . . . .	11.20 a.m. on Monday 7 June 2010 <sup>(8)</sup>
Despatch of Provisional Allotment Letters (to Qualifying Non-CREST Shareholders only) <sup>(9)</sup> . . . . .	Monday 7 June 2010
Dealings in Rights Issue Shares, nil paid, commence on the London Stock Exchange . . . . .	8.00 a.m. on Tuesday 8 June 2010
Existing Shares marked "ex-rights" by the London Stock Exchange . . . . .	8.00 a.m. on Tuesday 8 June 2010
Nil Paid Rights credited to stock accounts in CREST (of Qualifying CREST Shareholders only) <sup>(10)</sup> . . . . .	8.00 a.m. on Tuesday 8 June 2010
Nil Paid Rights and Fully Paid Rights enabled in CREST . . . . .	8.00 a.m. on Tuesday 8 June 2010
Suspension of removals of Existing Shares from the UK Register to the HK Register ends . . . . .	8.00 a.m. on Tuesday 8 June 2010

(1) The times and dates given are based upon the Directors' expectations and may be subject to change.

(2) One of the consequences of adjourning the Annual General Meeting is that, in order to pay a dividend of 13.56 pence on 27 May 2010 (as announced on 1 March 2010), that dividend will be paid as a second interim dividend. Accordingly, references in this prospectus to the 2009 final dividend should be read as references to the second interim dividend of the same amount.

(3) In order to minimise the inconvenience to shareholders of having two shareholder meetings within a short period, the Board proposes to adjourn the Annual General Meeting on 19 May 2010 and to reconvene it at 11.00 am on 7 June 2010.

(4) If either the Reconvened Annual General Meeting, Court Meeting or General Meeting is adjourned, the Voting Record Time for the relevant adjourned meeting will be 6.00 p.m. on the day which is two business days before the day of the adjourned meeting.

(5) It is requested that the Blue Forms of Proxy for the Court Meeting be lodged not later than 6.00 p.m. on 3 June 2010. Blue Forms of Proxy not so lodged may be handed to the Registrar or the Chairman of the Court Meeting at the Court Meeting.

(6) The Pink Forms of Proxy for the General Meeting must be lodged not later than 6.00 p.m. on 3 June 2010.

(7) Or as soon thereafter as the Reconvened Annual General Meeting concludes or is further adjourned.

(8) Or as soon thereafter as the Court Meeting concludes or is adjourned.

(9) Subject to certain restrictions relating to Overseas Shareholders, details of which are set out in Part IX (*Terms and Conditions of the Rights Issue*) of this prospectus.

(10) Subject to certain restrictions relating to Overseas Shareholders, details of which are set out in Part IX (*Terms and Conditions of the Rights Issue*) of this prospectus.

Recommended latest time for requesting withdrawal of Nil Paid Rights and Fully Paid Rights from CREST (i.e. if your Nil Paid Rights and Fully Paid Rights are in CREST and you wish to convert them to certificated form) . . . . .	4.30 p.m. on Wednesday 16 June 2010
Latest time and date for Cashless Take Up or sale of rights using the Equiniti Dealing Facility . . . . .	5.00 p.m. on Thursday 17 June 2010
Latest time for depositing renounced Provisional Allotment Letters, nil or fully paid, into CREST or for dematerialising Nil Paid Rights or Fully Paid Rights into a CREST stock account (i.e. if your Nil Paid Rights and Fully Paid Rights are represented by a Provisional Allotment Letter and you wish to convert them to uncertificated form) . . . . .	3.00 p.m. on Friday 18 June 2010
Latest time for splitting Provisional Allotment Letters, nil or fully paid . . . . .	3.00 p.m. on Monday 21 June 2010
<b>Latest time for acceptance, payment in full and registration of renunciation of Provisional Allotment Letters</b> . . . . .	11.00 a.m. on Wednesday 23 June 2010 by Thursday 24 June 2010
Announcement of results of the Rights Issue . . . . .	
Dealings in Rights Issue Shares, fully paid, commence on the London Stock Exchange . . . . .	8.00 a.m. on Thursday 24 June 2010
Rights Issue Shares credited to CREST stock accounts . . . . .	8.00 a.m. on Thursday 24 June 2010
Despatch of definitive share certificates for the Rights Issue Shares in certificated form . . . . .	by Thursday 1 July 2010
Suspension of removals of Prudential Shares from the UK Register to the HK Register . . . . .	3.00 p.m. on the third business day preceding the Scheme Record Date
Scheme Record Time . . . . .	6.00 p.m. on the business day immediately preceding the Scheme Effective Date
Court hearing to sanction the Scheme and confirm the Prudential reduction of capital; <b>Scheme Effective Date</b> . . . . .	Q3 2010 <sup>(11)</sup>
Scheme Effective Time . . . . .	4.30 p.m. on the Scheme Effective Date
Dealings in New Prudential ADRs commence on the New York Stock Exchange . . . . .	11.30 a.m. (New York time) on the Scheme Effective Date
Suspension of removals of Prudential Shares from the UK Register to the HK Register ends . . . . .	8.00 a.m. on the business day immediately following the Scheme Effective Date
Delisting of Prudential Shares from the London Stock Exchange; Dealings in New Prudential Shares commence on the London Stock Exchange; Completion of Acquisition . . . . .	8.00 a.m. on the business day immediately following the Scheme Effective Date
New Prudential Shares credited to CREST stock accounts . . . . .	8.00 a.m. on the business day immediately following the Scheme Effective Date
Court hearing to confirm the New Prudential Reduction of Capital . . . . .	the business day immediately following the Scheme Effective Date
New Prudential Reduction of Capital becomes effective . . . . .	the business day immediately following the Scheme Effective Date
Despatch of definitive share certificates for the New Prudential Shares in certificated form . . . . .	by no later than 5 business days from the Scheme Effective Date

(11) This date and the dates below are indicative only and will depend, among other things, on the timing of receipt of regulatory approvals and change of control consents in respect of the Scheme and the date upon which the Court sanctions the Scheme. An announcement confirming the expected dates in respect of the Scheme will be made in due course.

## EXPECTED TIMETABLE OF PRINCIPAL EVENTS IN HONG KONG<sup>(12)</sup>

**All references to time below are to Hong Kong time unless otherwise stated**

<b>Annual General Meeting (held in the UK)</b> . . . . .	6.00 p.m. on Wednesday 19 May 2010 <sup>(13)</sup>
Dealings in Existing Shares commence on the Hong Kong Stock Exchange . . . . .	9.30 a.m. on Tuesday 25 May 2010
Suspension of removals of Existing Shares from the HK Register to the UK Register . . . . .	4.30 p.m. on Tuesday 1 June 2010
Suspension of movements of Existing Shares into and out of CDP's account in CCASS . . . . .	4.30 p.m. on Tuesday 1 June 2010
Existing Shares marked "ex-rights" by the Hong Kong Stock Exchange . . . . .	9.30 a.m. on Thursday 3 June 2010
Latest time and date for which re-registration of Existing Shares are accepted on the HK Register for voting at the Reconvened Annual General Meeting, Court Meeting and General Meeting . . . . .	4.30 p.m. on Thursday 3 June 2010
Voting Record Time for the Reconvened Annual General Meeting, Court Meeting and General Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(14)</sup>
Latest time and date for receipt by the HK Registrar of the White Form of Proxy for the Reconvened Annual General Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(15)</sup>
Latest time and date for receipt by the HK Registrar of the Blue Form of Proxy for the Court Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(16)</sup>
Latest time and date for receipt by the HK Registrar of the Pink Form of Proxy for the General Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(17)</sup>
Hong Kong Record Date for entitlements under the Rights Issue . . . . .	4.30 p.m. on Friday 4 June 2010
Latest time and date for which re-registration of Existing Shares are accepted on the HK Register for participation in the Rights Issue . . . . .	4.30 p.m. on Friday 4 June 2010
<b>Reconvened Annual General Meeting (held in the UK)</b> . . . . .	6.00 p.m. on Monday 7 June 2010
<b>Court Meeting (held in the UK)</b> . . . . .	6.15 p.m. on Monday 7 June 2010 <sup>(18)</sup>
<b>General Meeting (held in the UK)</b> . . . . .	6.20 p.m. on Monday 7 June 2010 <sup>(19)</sup>
Despatch of Provisional Allotment Letters (to Qualifying Non-CCASS Shareholders and HKSCC Nominees only) . . . . .	Tuesday 8 June 2010
Suspension of removals of Existing Shares from the HK Register to the UK Register ends . . . . .	9.30 a.m. on Tuesday 8 June 2010
Suspension of movements of Existing Shares into and out of CDP's account in CCASS ends . . . . .	9.30 a.m. on Tuesday 8 June 2010
Nil Paid Rights credited to stock accounts in CCASS <sup>(20)</sup> . . . . .	Tuesday 8 June 2010
<b>HK Admission and Dealings in Rights Issue Shares, nil paid, commence on the Hong Kong Stock Exchange</b> . . . . .	9.30 a.m. on Thursday 10 June 2010
Latest time and date for splitting Provisional Allotment Letters, for rights traded on the Hong Kong Stock Exchange . . . . .	4.30 p.m. on Monday 14 June 2010
Last day of dealings in Rights Issue Shares, nil paid, on the Hong Kong Stock Exchange . . . . .	4.00 p.m. on Friday 18 June 2010
<b>Latest time and date in Hong Kong for acceptance, payment in full and registration of Provisional Allotment Letters</b> . . . . .	4.00 p.m. on Wednesday 23 June 2010
Announcement of results of the Rights Issue . . . . .	by Thursday 24 June 2010

(12) The times and dates given are based upon the Directors' expectations and may be subject to change.

(13) In order to minimise the inconvenience to shareholders of having two shareholder meetings within a short period, the Directors propose to adjourn the Annual General Meeting on 19 May 2010 and to reconvene it at 6.00 p.m. on 7 June 2010.

(14) If any of the Reconvened Annual General Meeting, Court Meeting or General Meeting is adjourned, the Voting Record Time for the relevant adjourned meeting will be the time and day in Hong Kong that corresponds to 6:00 p.m. (London time) on the day which is two business days before the adjourned meeting.

(15) The White Forms of Proxy for the Reconvened Annual General Meeting must be lodged not later than 1.00 a.m. on 4 June 2010.

(16) It is requested that the Blue Forms of Proxy for the Court Meeting be lodged not later than 1.00 a.m. on 4 June 2010. Blue Forms of Proxy not so lodged may be handed to the Registrars or the Chairman of the Court Meeting at the Court Meeting.

(17) The Pink Forms of Proxy for the General Meeting must be lodged not later than 1.00 a.m. on 4 June 2010.

(18) Or as soon thereafter as the Reconvened Annual General Meeting concludes or is further adjourned.

(19) Or as soon thereafter as the Court Meeting concludes or is adjourned.

(20) Subject to certain restrictions relating to Overseas Shareholders, details of which are set out in Part IX (*Terms and Conditions of the Rights Issue*) of this prospectus.

Despatch of definitive share certificates for the Rights Issue Shares in certificated form . . . . .	by Friday 25 June 2010
Rights Issue Shares credited to stock accounts in CCASS . . . . .	Friday 25 June 2010
Dealings in Rights Issue Shares, fully paid, commence on the Hong Kong Stock Exchange . . . . .	by 9.30 a.m. on Monday 28 June 2010
Suspension of removals of Prudential Shares from the HK Register to the UK Register . . . . .	4.30 p.m. on the third HK Business Day preceding the Scheme Record Date
Suspension of movements of Prudential Shares into and out of CDP's account in CCASS. . . . .	4.30 p.m. on the third HK Business Day preceding the Scheme Record Date
<b>Scheme Effective Date</b> . . . . .	Q3 2010 <sup>(21)</sup>
Suspension of removals of Prudential Shares from the HK Register to the UK Register ends . . . . .	9.30 a.m. on the HK Business Day immediately following the Scheme Effective Date
Suspension of movements of Prudential Shares into and out of CDP's account in CCASS ends . . . . .	9.30 a.m. on the HK Business Day immediately following the Scheme Effective Date
Delisting of Prudential Shares from the Hong Kong Stock Exchange; Dealings in New Prudential Shares commence on the Hong Kong Stock Exchange . . . . .	9.30 a.m. on the HK Business Day immediately following the Scheme Effective Date
New Prudential Shares credited to stock accounts in CCASS . . . . .	on the HK Business Day immediately following the Scheme Effective Date
Completion of Acquisition . . . . .	3.00 p.m. on the business day immediately following the Scheme Effective Date
Definitive share certificates for the New Prudential Shares made available for collection by HK holders of New Prudential Shares from the HK Registrar . . . . .	9.00 a.m. to 4.00 p.m. on the HK Business Day immediately following the Scheme Effective Date
Despatch of definitive share certificates for the New Prudential Shares in certificated form . . . . .	after 4.00 p.m. on the HK Business Day immediately following the Scheme Effective Date

(21) This date and the dates below are indicative only and will depend, among other things, on the timing of receipt of regulatory approvals and change of control consents in respect of the Scheme and the date upon which the Court sanctions the Scheme. An announcement confirming the expected dates in respect of the Scheme will be made in due course.

*Note: If there is a tropical cyclone warning signal number 8 or above or a "black" rainstorm warning signal:*

- (a) *in force in Hong Kong at any time before 12.00 noon but no longer in force after 12.00 noon on the latest date for acceptance in Hong Kong, the latest time for acceptance of and payment for the Rights Issue will be extended to 5.00 p.m. on the same date; or*
- (b) *in force in Hong Kong at any time between 12.00 noon and 4.00 p.m. on the latest date for acceptance in Hong Kong, the latest time for acceptance of and payment for the Rights Issue will be postponed to 4.00 p.m. on the following HK Business Day when there is no tropical cyclone warning signal number 8 or above or a "black" rainstorm warning signal.*

*An announcement will be made by Prudential in such event.*

## EXPECTED TIMETABLE OF PRINCIPAL EVENTS IN SINGAPORE<sup>(22)</sup>

All references to time below are to Singapore time unless otherwise stated

<b>Annual General Meeting (held in the UK)</b> . . . . .	6.00 p.m. on Wednesday 19 May 2010 <sup>(23)</sup>
Dealings in Existing Shares commence on the SGX-ST . . . . .	10.00 a.m. on Tuesday 25 May 2010
Suspension of movements of Existing Shares into and out of CDP's account in CCASS . . . . .	5.00 p.m. on Tuesday 1 June 2010
Existing Shares commence trading "ex-rights" on the SGX-ST . . . . .	9.00 a.m. on Wednesday 2 June 2010
Voting Record Time for Reconvened Annual General Meeting, Court Meeting and General Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(24)</sup>
Latest time and date for receipt by the HK Registrar of the White Form of Proxy for the Reconvened Annual General Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(25)</sup>
Latest time and date for receipt by the HK Registrar of the Blue Form of Proxy for the Court Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(25)</sup>
Latest time and date for receipt by the HK Registrar of the Pink Form of Proxy for the General Meeting . . . . .	1.00 a.m. on Friday 4 June 2010 <sup>(25)</sup>
Singapore Record Date for entitlements under the Rights Issue . . . . .	5.00 p.m. on Friday 4 June 2010
<b>Reconvened Annual General Meeting (held in the UK)</b> . . . . .	6.00 p.m. on Monday 7 June 2010
<b>Court Meeting (held in the UK)</b> . . . . .	6.15 p.m. on Monday 7 June 2010 <sup>(26)</sup>
<b>General Meeting (held in the UK)</b> . . . . .	6.20 p.m. on Monday 7 June 2010 <sup>(27)</sup>
Suspension of movements of Existing Shares into and out of CDP's account in CCASS ends . . . . .	9.00 a.m. on Tuesday 8 June 2010
<b>Start of offer period in Singapore</b> . . . . .	Wednesday 9 June 2010
Despatch of Singapore Application Forms and this prospectus . . . . .	Wednesday 9 June 2010
Nil Paid Rights credited to CDP securities accounts (of Qualifying CDP Shareholders only) <sup>(28)</sup> . . . . .	Wednesday 9 June 2010
Dealings in Nil Paid Rights commence on the SGX-ST . . . . .	9.00 a.m. on Wednesday 9 June 2010
Last day of dealings in Nil Paid Rights on the SGX-ST . . . . .	5.00 p.m. on Friday 11 June 2010
Latest time and date in Singapore for acceptance of Singapore Application Forms . . . . .	5.00 p.m. on Thursday 17 June 2010
Latest time and date in Singapore for acceptance of electronic applications via ATMs . . . . .	9.30 p.m. on Thursday 17 June 2010
Announcement of results of the Rights Issue . . . . .	by Thursday 24 June 2010
CDP to credit securities account holders . . . . .	after 5.00 p.m. on Friday 25 June 2010
Dealings in Rights Issue Shares, fully paid, commence on the SGX-ST . . . . .	9.00 a.m. on Monday 28 June 2010
Suspension of movements of Prudential Shares into and out of CDP's account in CCASS . . . . .	5.00 p.m. on the third Singapore Business Day preceding the Scheme Record Date Q3 2010 <sup>(29)</sup>
<b>Scheme Effective Date</b> . . . . .	
Suspension of movements of Prudential Shares into and out of CDP's account in CCASS ends . . . . .	9.00 a.m. on the Singapore Business Day immediately following the Scheme Effective Date
Delisting of Prudential Shares from the SGX-ST; Dealings in New Prudential Shares commence on the SGX-ST . . . . .	9.00 a.m. on the Singapore Business Day immediately following the Scheme Effective Date
Completion of Acquisition . . . . .	3.00 p.m. on the business day immediately following the Scheme Effective Date
New Prudential Shares credited to securities accounts in CDP . . . . .	after 5.00 p.m. on the Singapore Business Day immediately following the Scheme Effective Date

(22) The times and dates given are based upon the Directors' expectations and may be subject to change.

(23) In order to minimise the inconvenience to shareholders of having two shareholder meetings within a short period, the Directors propose to adjourn the Annual General Meeting on 19 May 2010 and to reconvene it at 6.00 p.m. on 7 June 2010.

(24) If either the Reconvened Annual General Meeting, Court Meeting or General Meeting is adjourned, the Voting Record Time for the relevant adjourned meeting will be the time and day in Singapore that corresponds to 6.00 p.m. (London time) on the day which is two business days before the day of the adjourned meeting.

(25) CDP will require Singapore Shareholders to submit the relevant CDP Form of Proxy to CDP before 1.00 a.m. on 4 June 2010. The relevant deadline will be notified to Singapore Shareholders in due course.

(26) Or as soon thereafter as the Reconvened Annual General Meeting concludes or is further adjourned.

(27) Or as soon thereafter as the Court Meeting concludes or is adjourned.

(28) Subject to certain restrictions relating to Overseas Shareholders, details of which are set out in Part IX (*Terms and Conditions of the Rights Issue*) of this prospectus.

(29) This date and the dates below are indicative only and will depend, among other things, on the timing of receipt or regulatory approvals and change of control consents in respect of the Scheme and the date upon which the Court sanctions the Scheme. An announcement confirming the expected dates in respect of the Scheme will be made in due course.

## RIGHTS ISSUE STATISTICS

Price per Rights Issue Share . . . . .	104 pence <sup>(30)</sup>
Basis of Rights Issue . . . . .	11 Rights Issue Shares for every 2 Existing Shares
Number of Existing Shares (including the Prudential Shares expected to be issued on 27 May 2010 to shareholders who have elected to receive the scrip dividend alternative for the 2009 final dividend) . . .	2,539,010,500
Number of Rights Issue Shares to be issued by Prudential . . . . .	13,964,557,750
Number of Prudential Shares in issue immediately following completion of the Rights Issue <sup>(31)</sup> . . . . .	16,503,568,250
Rights Issue Shares as a percentage of enlarged issued ordinary share capital of Prudential immediately following completion of the Rights Issue <sup>(31)</sup> . . . . .	84.6%
Gross proceeds of the Rights Issue (approximate) . . . .	£14,523 million
Estimated net proceeds receivable by Prudential after Rights Issue and Transaction related expenses. . . .	£13,843 million

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(30) The Issue Price for HK Shareholders and Singapore Shareholders is HK\$11.78 per Rights Issue Share (calculated using an exchange rate of £1:HK\$11.3277).

(31) Assuming (i) the issue of 4,538,026 Prudential Shares to shareholders who have elected to receive the scrip dividend alternative for the 2009 final dividend, expected to be issued on 27 May 2010; (ii) no options granted under the Prudential Share Schemes are exercised between the date of this document and completion of the Rights Issue; and (iii) no other Prudential Shares or New Prudential Shares are issued between the date of this prospectus and completion of the Rights Issue.

## PART I

### SUMMARY

*This summary should be read as an introduction to the prospectus. Any decision to invest in Prudential or the Rights Issue Shares should be based on consideration of the prospectus as a whole by the investor. Where a claim relating to the information contained in the prospectus is brought before a court, the plaintiff investor might, under the national legislation of the EEA States, have to bear the costs of translating the prospectus before legal proceedings are initiated. Civil liability attaches to those persons who are responsible for this summary including any translation of this summary, but only if this summary is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus.*

#### **1. Introduction**

On 1 March 2010, Prudential announced the proposed combination of the Prudential Group and AIA Group. The combination of the Prudential Group and AIA Group will be effected by New Prudential, a newly incorporated company, acquiring each of Prudential and AIA. The acquisition of AIA by New Prudential is proposed to be substantially financed, along with other sources of financing, by a fully underwritten Rights Issue by Prudential of 13,964,557,750 Rights Issue Shares at an Issue Price of 104 pence per Rights Issue Share and on a basis of 11 Rights Issue Shares for every 2 Existing Shares.

Prudential believes that the Acquisition is a compelling and rare opportunity with strong strategic, operational and financial rationale that will contribute significantly to the achievement of Prudential's strategic objective to focus on its Asian growth. The Acquisition will create a leading Asian life insurer and is expected to yield significant value for Prudential shareholders, its other stakeholders and AIG.

#### **2. Description of the Transactions**

##### **2.1 Acquisition**

Prudential, New Prudential, AIG and AIA Aurora have entered into an agreement ("Acquisition Agreement") under which New Prudential will acquire the entire issued share capital of AIA. AIA Aurora will receive consideration with a notional value of US\$35.5 billion from New Prudential, comprising US\$25.0 billion in cash (subject to reduction in an amount equal to the aggregate nominal value of any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter), New Prudential Shares with a notional value of £3.613 billion (approximately US\$5.5 billion), US\$3.0 billion in Mandatory Convertible Notes, US\$2.0 billion in Tier 1 Notes, and any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter. The cash component of the consideration will be financed by Prudential through a combination of US\$20.0 billion from the Rights Issue and up to US\$5.0 billion from Bond Offerings.

If the Prudential Shares were listed on the Hong Kong Stock Exchange, the applicable percentage ratios for the Acquisition would have exceeded 100% and the Acquisition would have constituted a very substantial acquisition in accordance with the Hong Kong Listing Rules.

Prudential has entered into hedging arrangements in respect of its requirement to convert the pounds sterling proceeds of the Rights Issue into US dollars, which is the currency in which New Prudential must pay the cash element of the consideration.

Completion of the Acquisition is subject to certain pre-conditions, including: (i) Prudential shareholders approving the Scheme and certain other resolutions relating to the Transactions; (ii) obtaining the necessary regulatory and antitrust approvals; (iii) there having been no material adverse change in AIA prior to commencement of the Rights Issue; (iv) there having been no breach of warranty or covenant resulting in a material adverse change in AIA prior to completion; (v) there having been no material breach of the New Prudential warranties having a material adverse effect on the ability of New Prudential or Prudential to complete the Acquisition; (vi) the Court sanctioning the Scheme; and (vii) admission of the Rights Issue Shares to be issued pursuant to the Rights Issue, New Prudential Shares (both to be issued pursuant to the Scheme and as consideration), MCNs and Tier 1 Notes (as consideration under the Acquisition Agreement) to listing and trading.

A termination fee of £153 million (including any VAT due in respect thereof) is payable by Prudential to AIA Aurora in the event of termination in specified circumstances. Additional consideration of 5/1200ths of the cash consideration outstanding is payable per month by New Prudential to AIA Aurora from 1 September 2010 to the completion date in the event that completion has not occurred (and the Acquisition Agreement has not been terminated) by 31 August 2010.

## 2.2 *Scheme*

The acquisition of Prudential by New Prudential that, with the Acquisition, results in the combination of the AIA Group and the Prudential Group to form the Enlarged Group will be effected by means of the Scheme between Prudential and Prudential shareholders (which is not conditional upon completion of the Rights Issue or the Acquisition). Under the terms of the Scheme, the Prudential Shares will be cancelled and, in consideration for this cancellation, Prudential shareholders on the register at the Scheme Record Time will receive:

### **for each Prudential Share one New Prudential Share**

Implementation of the Scheme will require approval at the Court Meeting and the General Meeting.

## **3. Information on the Enlarged Group**

Prudential believes that the combination of its Asian operations with AIA will create a unique business with a significant focus on the Asian markets and leading positions in seven countries with highly complementary products and distribution channels across the region. It is anticipated that the Enlarged Group will be the leading life insurer in Hong Kong, Singapore, Malaysia, Indonesia, Vietnam, Thailand and the Philippines, and the leading foreign life insurance business in China and India<sup>(32)</sup>, as well as having strong and highly cash generative operations in the US and the UK. Prudential expects to have from 25 May 2010, a dual-primary listing in London and Hong Kong and a secondary listing in Singapore.

## **4. Information on Prudential**

The Prudential Group is a large international financial services group, providing retail financial services in Asia, the United Kingdom and the United States. It has been in existence for over 160 years and has £290 billion in assets under management (as at 31 December 2009). Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

## **5. Information on AIA**

The AIA Group is a leading life insurance organisation in the Asia Pacific region which provides individuals and businesses with products and services for their insurance, protection, savings, investments and retirement needs in 15 geographical markets in the region. As of 30 November 2009, the AIA Group (excluding AIA India) had approximately 15,500 employees serving the holders of its approximately 21.3 million in-force policies and approximately 9 million participating members of its clients for group life, medical, credit life coverage and pensions products.

## **6. Strengths and strategy**

The central objective of the Enlarged Group will be to deliver sustainable value to shareholders. To achieve this, the strategy of the Enlarged Group will be to meet, profitably, customers' changing needs for savings, income and protection products in its chosen markets across Asia, the US and the UK. In particular, the Enlarged Group will focus on the objective of allocating capital to the most attractive opportunities and geographical markets, both in terms of return and payback period.

Prudential believes that the Prudential Group and the AIA Group have complementary capabilities, and key growth opportunities for the Enlarged Group will include: improvements in AIA sales force productivity based upon Prudential's agency management capabilities; increasing effectiveness of AIA's current bancassurance relationships by leveraging Prudential's capabilities in Asia with banks such as Standard Chartered Bank, ICICI Bank Limited and United Overseas Bank Limited; managing the AIA product mix; and increasing utilisation of customer management and data mining tools.

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(32) As set out in Part VI of this prospectus, (a) Prudential is ranked as the leading life insurer in Singapore, Malaysia, Indonesia and Vietnam, (b) AIA is ranked as the leading life insurer in the Philippines and Thailand, (c) ICICI Prudential is ranked as the leading private life insurer in India and (d) AIA is ranked as the leading foreign life insurer in China. According to the OCI, the combined market share of Prudential and AIA is greater than the market share of any other company in the Hong Kong life insurance market.

## 7. Dividend policy

The Directors intend to focus on delivering a growing dividend for the Enlarged Group, which will be determined after taking into account the Enlarged Group's financial flexibility and the Directors' assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times post-tax operating earnings is appropriate.

The 2010 interim dividend is expected to reflect the pro forma earnings of the Enlarged Group as if the Acquisition had taken place on 1 January 2010.

## 8. Principal terms of the Rights Issue

The substantial part of the cash financing for the Acquisition will be the net proceeds of the Rights Issue, which will be made on the basis of:

### 11 Rights Issue Shares at 104 pence each for every 2 Existing Shares

held by Qualifying Shareholders on the Record Date.

The Rights Issue is expected to raise proceeds of approximately £13,843 million, net of Rights Issue and Transaction-related expenses. The Issue Price for UK Shareholders of 104 pence per Rights Issue Share represents a discount of approximately 80.8% to the Closing Price of 542.5 pence per Prudential Share on 14 May 2010, being the last business day before the announcement of the terms of the Rights Issue and a 39.3% discount to the theoretical ex-rights price based on that Closing Price. The Issue Price per Rights Issue Share for HK Shareholders and Singapore Shareholders is HK\$ 11.78. The Rights Issue is fully underwritten and the terms of the Underwriting Agreement are summarised in paragraph 16.2 of Part XIX (*Additional Information*).

It is expected that dealings in the Rights Issue Shares, nil paid, will commence on the London Stock Exchange at 8.00 a.m. (London time) on 8 June 2010, on the Hong Kong Stock Exchange at 9.30 a.m. (Hong Kong time) on 10 June 2010 and on the SGX-ST at 9.00 a.m. (Singapore time) on 9 June 2010.

The latest time and date for acceptance and payment in full under the Rights Issue is expected to be:

- for UK Shareholders, 11.00 a.m. (London time) on 23 June 2010;
- for HK Shareholders, 4.00 p.m. (Hong Kong time) on 23 June 2010; and
- for Singapore Shareholders, 5.00 p.m. and 9.30 p.m. (Singapore time) on 17 June 2010 for acceptances by Singapore Application Forms and ATM, respectively.

The Rights Issue is not conditional upon completion of the Acquisition or the Scheme. If completion of the Acquisition does not occur, which Prudential believes is unlikely, Prudential's current intention is that the net proceeds of the Rights Issue will be invested on a short-term basis while Prudential considers how the net proceeds of the Rights Issue (after deduction of Rights Issue and Transaction related expenses and hedging costs) will be returned to Prudential's shareholders (taking into account, amongst others, the tax implications for Prudential's shareholders).

## 9. Risk factors

Investors should consider carefully the following risks, amongst others:

### *Risks relating to the Prudential Group and the Enlarged Group*

- The Prudential Group's businesses are, and the Enlarged Group's businesses will be, inherently subject to market fluctuations and general economic conditions.
- Interest rate fluctuations may materially and adversely affect the Enlarged Group's profitability.
- The Enlarged Group will be subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio.
- The Prudential Group is, and the Enlarged Group will be, subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses.
- The Prudential Group conducts, and the Enlarged Group will conduct, their 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 they operate.

- The resolution of several issues affecting the financial services industry could have a negative impact on the Prudential Group's and the Enlarged Group's reported results or on their relations with current and potential customers.
- Litigation, disputes and regulatory investigations may adversely affect the Prudential Group's and the Enlarged Group's profitability and financial condition.
- The Prudential Group's businesses are conducted, and the Enlarged Group's businesses will be conducted, in highly competitive environments with developing demographic trends and continued profitability depends on management's ability to respond to these pressures and trends.
- Downgrades in the Prudential Group's and, following the Acquisition, the Enlarged Group's, financial strength and credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties.
- Adverse experience in the operational risks inherent in the Prudential Group's and Enlarged Group's businesses could have a negative impact on their results of operations.
- Adverse experience against the assumptions used in pricing products and reporting business results could significantly affect the Prudential Group's and Enlarged Group's results of operations.
- The business and prospects of the Enlarged Group may be materially and adversely affected if it is not able to manage the growth of the Enlarged Group's operations successfully.
- As holding companies, Prudential and AIA are each dependent upon their respective subsidiaries to cover operating expenses and dividend payments and, following the Acquisition, New Prudential will in turn depend on dividend payments from Prudential and AIA.
- The Prudential Group operates, and the Enlarged Group will operate, in a number of markets through joint ventures and other arrangements with third parties (including in China and India), involving certain risks that the Prudential Group does not, and the Enlarged Group will not, face with respect to its consolidated subsidiaries.
- Prudential's Articles of Association contain an exclusive jurisdiction provision.
- Events relating to the AIG Group could continue to harm the AIA Group's business and reputation and could also harm the Prudential Group's business and reputation.
- Agent, employee and distribution partner misconduct is difficult to detect and deter and could harm the Enlarged Group's reputation or lead to regulatory sanctions or litigation.
- Changes in tax legislation may result in adverse tax consequences.

#### ***Risks relating to the Transactions***

- The Acquisition and the Scheme may each not complete.
- The integration of the Prudential Group and the AIA Group may be more difficult than anticipated.
- The Enlarged Group may fail to realise the anticipated benefits, including estimated synergies, and may fail to achieve its targets, in relation to the Acquisition.
- Change of control provisions in the AIA Group's and Prudential Group's agreements may be triggered upon the completion of the Acquisition and may lead to adverse consequences.
- The Acquisition and the Scheme may negatively impact the Prudential Group's or the AIA Group's tax position.
- Share prices may fluctuate.
- Shareholders who do not take up their rights in full will experience significant dilution in their ownership.
- The trading market for Nil Paid Rights may not develop.
- The period required for Prudential Shares and New Prudential Shares to be transferred between the UK and Hong Kong markets and between the Hong Kong and Singapore markets may be longer than expected.
- An active trading market for Prudential Shares on the Hong Kong Stock Exchange may not develop or be sustained, their trading prices may fluctuate significantly and the effectiveness of the liquidity arrangements by Designated Dealers may be limited.

## PART II

### RISK FACTORS

Investing in and holding the Prudential Shares is subject to a number of risks. Accordingly, investors in the Prudential Shares should carefully consider the risks described below, together with all of the information set out in this prospectus, prior to making any investment decision. If one or more of the following risks were to arise, the Prudential Group's and Enlarged Group's business, results of operations, financial condition and/or prospects and/or the Prudential share price could be materially and adversely affected to the detriment of Prudential and its shareholders, and investors could lose all or part of their investment. The risks set out below may not be exhaustive and do not necessarily comprise all of the risks associated with an investment in Prudential and the Prudential Shares. Additional risks and uncertainties not presently known to Prudential or which Prudential currently deems immaterial may arise or become material in the future and may have a material adverse effect on Prudential.

#### **1. Risks relating to the Prudential Group and Enlarged Group**

##### ***The Prudential Group's businesses are, and the Enlarged Group's businesses will be, inherently subject to market fluctuations and general economic conditions***

The Prudential Group's businesses are, and the Enlarged Group's businesses will be, inherently subject to market fluctuations and general economic conditions. Uncertain or negative trends in international economic and investment climates which have adversely affected their business and profitability could be repeated, or prolonged, or could worsen.

The adverse effects of such trends, including the unprecedented market dislocation across asset classes and geographical markets witnessed in 2008 and in the first half of 2009, have been and would be felt principally through the following:

- investment impairments or reduced investment returns, as a result of market volatility, could impair the Prudential Group's and the Enlarged Group's ability to write significant volumes of new business which would have a negative impact on their assets under management and profit;
- higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses, as experienced during 2008 and 2009, when illiquidity and credit spreads reached all-time highs;
- the Prudential Group in the normal course of business enters (and the Enlarged Group will enter) into a variety of transactions with counterparties, including derivative transactions. Failure of any of these counterparties to discharge their obligations, or where adequate collateral is not in place, could have an adverse impact on the Prudential Group's and the Enlarged Group's results; and
- estimates of the value of financial instruments are difficult because in certain illiquid or closed markets, determining the value at which financial instruments can be realised is highly subjective. Processes to ascertain value and estimates of value require substantial elements of judgement, assumptions and estimates (which may change over time). Increased illiquidity also adds to uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline.

Although global markets have begun to stabilise beginning in 2009, interest rates remain low, and many of the challenges of 2008 persist in the credit markets. New challenges may continue to emerge.

A significant part of Prudential's shareholders' profit is related to bonuses for policyholders declared on its 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 the Prudential Group's expectations of future investment returns. During 2008 and for the first half of 2009, the Prudential Group had to operate in the UK against a challenging background of unprecedented volatility in capital and equity markets, interest rates and widespread economic uncertainty. This has led, among other things, to reduced consumer spending, an increase in unemployment, and consequently reduced liquidity, requiring the intervention of the Bank of England via a quantitative easing programme to restore credit liquidity in the market.

For some non-unit-linked investment products, in particular those written in some of the Enlarged Group's Asian operations, it may not be possible to hold assets which will provide cash flows to match exactly those relating to policyholder liabilities. This is particularly true in those countries where bond markets are not developed and in certain markets where regulated surrender 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 interest rates used to calculate surrender values over a sustained period, this could have an adverse impact on the Enlarged Group's reported profit.

In the US, fluctuations in prevailing interest rates can affect results from Jackson which has a significant spread-based business, with the majority of its assets invested in fixed income securities. In particular, fixed annuities and stable value products written by Jackson expose the Prudential Group 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. During 2008, the US financial services industry faced an unprecedented array of challenges: the S&P 500 index fell by 38.5%, government interest rates fell to historic lows, and global markets experienced a significant increase in volatility. In addition, credit markets seized up and global credit spreads widened to historic levels. These factors contributed to substantial increases in Jackson's unrealised losses. Declines in spread from these products or other spread businesses that Jackson conducts could have a material impact on its businesses or results of operations. Jackson also writes a significant amount of variable annuities that offer capital or income protection guarantees. There could be unforeseen market circumstances where the derivatives that it enters into to hedge its market risks may not fully offset its losses, and any cost of the guarantees that remain unhedged will also affect the Prudential Group's and the Enlarged Group's results.

### ***Interest rate fluctuations may materially and adversely affect the Enlarged Group's profitability***

A substantial portion of the Enlarged Group's investment assets will be in interest-bearing investments. For example, for the AIA Group alone, fixed income securities represented 89% of the carrying value of total policyholder and shareholder investments as of 30 November 2009. During periods of declining interest rates the Enlarged Group's average investment yield will decline as maturing investments, as well as bonds and loans that are redeemed or repaid in order to take advantage of the lower interest rate environment, are replaced with new investments with lower yields and coupon payments. As a result, the decline in interest rates would reduce the Enlarged Group's return on investments, which could materially reduce its profitability, regardless of whether such investments are used to support particular insurance policy obligations.

Certain of the Enlarged Group's insurance obligations will have a longer duration than its investment assets. In addition, some of the Enlarged Group's premiums will be calculated based on an assumed investment yield. As such, lower interest rates may reduce the Enlarged Group's average investment yield, while premiums from certain outstanding products remain unchanged thereby reducing profitability. Falling interest rates or a prolonged period of low interest rates may make it difficult for the Enlarged Group to match effectively its assets to its liabilities. If the current low interest rate environment continues, these negative effects on profitability will persist or possibly increase as average investment yield decreases. In addition, if a decrease in the profitability of the Enlarged Group's products reduces the policyholder surplus relating to participating products, some payments to policyholders, such as non-guaranteed dividends, may decrease or not be paid. In such circumstances, the Enlarged Group may experience an increase in customer dissatisfaction, complaints, potential litigation or surrenders relating to these products.

The process of pricing the Enlarged Group's products often entails making assumptions about interest rates. If actual interest rates are lower than the interest rates assumed during the product pricing process, this could have an adverse effect on the profitability of the products. For products with guaranteed interest rate benefits, declines in interest rates reduce the interest rate spread, or the difference between the amounts that are required to be paid under these products and the rate of return the Enlarged Group is able to earn on its investments intended to support its obligations under these products. The AIA Group has previously offered guaranteed interest products where the guaranteed rate of interest is in excess of current market interest rates. These products were sold primarily in China, the Philippines, Taiwan and Thailand at the then prevailing high market interest rates. As of 30 November 2009, the AIA Group's aggregate policy reserves for such products, calculated in accordance with IFRS, amounted to US\$3,504 million, or approximately 5.8% of total net reserves for all of its insurance policies.

During periods of rising interest rates, although the increased investment yield increases the returns on the investment portfolio, surrenders and withdrawals of policies may increase as policyholders seek investments with higher perceived returns. This process could lead to a cash outflow from the Enlarged Group's business. Such outflows could require investment assets to be sold at a time when the prices of those assets are lower because of the increase in market interest rates, which could in turn result in realised investment losses. In addition, unanticipated surrenders and withdrawals could require the Enlarged Group to accelerate the amortisation of deferred policy acquisition costs, which would materially and adversely affect the results of operations. Moreover, a rise in interest

rates would have a material adverse effect on shareholders' equity due to a decrease in the fair value of its fixed income investments.

***The Enlarged Group will be subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio***

The Enlarged Group will be subject to the risk of potential sovereign debt credit deterioration and default. Following the Acquisition, the Enlarged Group will hold significant amounts of local currency and foreign currency-denominated sovereign debt obligations in its investment portfolio. The AIA Group held government bonds, primarily issued by governments in Asia, with carrying value of US\$17,970 million as of 30 November 2009. In particular, it held Thai government bonds issued in Thai Baht with a carrying value of US\$7,374 million. As of 30 November 2009, the AIA Group's aggregate investment in government bonds represented approximately 28% of the carrying value of the AIA Group's total policyholder and shareholder investments. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. Investing in such instruments creates exposure to the direct or indirect consequences of political, social or economic changes (including changes in governments, heads of states or monarchs) in the countries in which the issuers are located and the creditworthiness of the sovereign. 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 the Enlarged Group 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. 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 issues. If a sovereign were to default on its obligations, this could have a material adverse effect on the Enlarged Group's financial condition and results of operations.

***The Prudential Group is, and the Enlarged Group will be, subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses***

Due to their geographical diversity, the Prudential Group's and the Enlarged Group's businesses are subject to the risk of exchange rate fluctuations (including the risk of the de-pegging of the HK dollar to the US dollar). The Prudential Group's and Enlarged Group's operations in the US and Asia, which represent a significant proportion of operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in the Prudential Group's and Enlarged Group's consolidated financial statements upon translation of results into pounds sterling. The currency exposure relating to the translation of reported earnings is not currently separately managed. The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within the statement of changes in equity. Consequently, this could impact on the Enlarged Group's gearing ratios (defined as debt over debt plus shareholders' funds).

***The Prudential Group conducts, and the Enlarged Group will conduct, their 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 they operate***

Changes in government policy (including through changes in governments, heads of state or monarchs), legislation (including tax) or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which the Prudential Group operates (or in which the Enlarged Group will operate), which in some circumstances may be applied retrospectively, may adversely affect the Prudential Group's (and the Enlarged Group's) product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. For example, the AIA Group's businesses in China, Malaysia and Thailand were established prior to the implementation of increased restrictions on foreign ownership, and if any of these were to become subject to more stringent ownership restrictions, this could have an adverse effect on the AIA Group's business. Also, regulators in jurisdictions in which the Prudential Group operates (or in which the Enlarged Group will operate) 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 the recent interventions by governments in response to global economic conditions, it is widely expected that there will be a substantial increase in government regulation and

supervision of the financial services industry, including the possibility of higher capital requirements, restrictions on certain types of transaction structure, and enhanced supervisory powers.

Current EU directives, including the EU Insurance Groups Directive (“IGD”) require European financial services groups to demonstrate net aggregate surplus capital in excess of solvency requirements at the group level in respect of shareholder-owned entities. The test is a continuous requirement, so that the Prudential Group needs (and the Enlarged Group will need) to maintain a somewhat higher amount of regulatory capital at the group level than otherwise necessary in respect of some of its individual businesses to accommodate, for example, short-term movements in global foreign exchange rates, interest rates, deterioration in credit quality and equity markets. The EU is also developing a new solvency framework for insurance companies, referred to as “Solvency II”. The new approach will be based on the concept of three pillars — minimum capital requirements, supervisory review of firms’ assessment of risk, and enhanced disclosure requirements — and will cover valuations, the treatment of insurance groups, the definition of capital and the overall level of capital requirements. A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies, and may allow the Prudential Group (and the Enlarged Group) to make use of its internal economic capital models, if approved by the FSA. The Solvency II Directive was formally approved by a meeting of the EU’s Economic and Financial Affairs Council on 10 November 2009. The European Commission has already initiated the process of developing the detailed rules that will complement the high-level Principles of the Directive, referred to as “implementing measures”, which are subject to a consultation process and are not expected to be finalised until late 2011. There is a significant uncertainty regarding the final outcome of this process. As a result there is a risk that the effect of the measures finally adopted could be adverse for the Enlarged Group, including potentially a significant increase in capital required to support its business.

Various jurisdictions in which the Prudential Group operates (and in which the Enlarged Group will operate) 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 where the Prudential Group (and the Enlarged Group), along with other companies, may be required to make such contributions.

The Prudential Group’s accounts are prepared (and the Enlarged Group’s accounts will be prepared) in accordance with current IFRS applicable to the insurance industry. The International Accounting Standards Board (“IASB”) introduced a framework that it described as Phase I, which 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. The IASB has published proposals in its Phase II discussion paper, which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts according to IFRS and has stated its intention to publish an Exposure Draft in 2010. It is uncertain whether and how the proposals in the discussion paper will become definitive IFRS and when such changes might take effect.

Any changes or modification of IFRS accounting policies may require a change in the future results or a restatement of reported results.

European Embedded Value (“EEV”) basis results are published as supplementary information by Prudential using principles issued by the European CFO (Chief Financial Officers) Forum. The EEV basis is a value-based reporting method for Prudential’s long-term business which is used by market analysts and which underpins a significant part of the key performance indicators used by Prudential’s management for both internal and external reporting purposes. In June 2008, in an effort to improve the consistency and transparency of embedded value reporting, the CFO Forum published the Market Consistent Embedded Value (MCEV) Principles. Following a review of the impact of turbulent market conditions on the MCEV Principles, the CFO Forum announced in May 2009 the postponement of the mandatory reporting on MCEV basis until 2011 and subsequently, in October 2009, changes in the principles to allow for the inclusion of a liquidity premium, which is the additional return investors require for investing in less liquid assets and is a key component in the calculation of the profitability of UK annuity business. It also announced that it was performing further work to develop more detailed application guidance to increase consistency going forward. When the work has been completed, Prudential (and the Enlarged Group) will consider its approach to the new Principles. The adoption of the new Principles would give rise to different embedded value results from those prepared under the application of European Embedded Value Principles.

***The resolution of several issues affecting the financial services industry could have a negative impact on the Prudential Group’s and the Enlarged Group’s reported results or on their relations with current and potential customers***

The Prudential Group is, and the Enlarged Group will be, and both in the future may be, subject to legal and regulatory actions in the ordinary course of their business, both in the UK and internationally. This could be a review

of business sold in the past under previously acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of pension and mortgage endowment policies, changes to the tax regime affecting products and regulatory reviews on products sold and industry practices, including, in the latter case, businesses it has closed.

Regulators particularly, but not exclusively, in the US and the UK are moving towards a regime based on principles-based regulation which brings an element of uncertainty. These regulators are increasingly interested in 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, federal and state regulators have focused on, and continue to devote substantial attention to, the mutual fund, fixed index variable annuity and insurance product industries. This includes new regulations in respect of the suitability of broker-dealers' sales of certain products. As a result of publicity relating to widespread perceptions of industry abuses, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms.

In Asia, regulatory regimes are developing at different speeds, driven by a combination of global factors and local considerations. There is a risk that new requirements are introduced that are retrospectively applied to sales made prior to their introduction.

***Litigation, disputes and regulatory investigations may adversely affect the Prudential Group's and the Enlarged Group's profitability and financial condition***

The Prudential Group is, and may be in the future, and the Enlarged Group may be, subject to legal actions, disputes and regulatory investigations in the ordinary course of their insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of the Prudential Group's or the Enlarged Group's businesses and operations that are specific to the Prudential Group or the Enlarged Group, or that are common to companies that operate in the Prudential Group's or the Enlarged Group's markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by the Prudential Group or the Enlarged Group, and may be class actions. Although the Prudential Group believes that it has adequately provided in all material aspects 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, and the inherent unpredictability of litigation and disputes, it is possible that an adverse outcome could, from time to time, have an adverse effect on the Prudential Group's and the Enlarged Group's results of operations or cash flows.

***The Prudential Group's businesses are conducted, and the Enlarged Group's businesses will be conducted, in highly competitive environments with developing demographic trends and continued profitability depends on 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 the Prudential Group's and Enlarged Group's ability to sell their 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, developing demographic trends and customer appetite for certain savings products. In some of its markets, the Prudential Group faces, and the Enlarged Group may face, competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates or claims-paying ratios. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit the Prudential Group's and the Enlarged Group's potential to grow their business as quickly as planned.

In Asia, the Prudential Group's and Enlarged Group's principal regional competitors are international financial companies, including Allianz, AXA, ING, and Manulife. In a number of markets, local companies have a very significant market presence.

Within the UK, the Prudential Group's principal competitors in the life market include many of the major retail financial services companies including, in particular, Aviva, Legal & General, Lloyds Banking Group and Standard Life.

Jackson's competitors in the US include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies such as AIG, AXA Financial Inc., Hartford Life Inc., Lincoln National, MetLife and TIAA-CREF.

The Prudential Group believes competition will intensify across all regions in response to consumer demand, technological advances, the impact of consolidation, regulatory actions and other factors. The Prudential Group's and the Enlarged Group's ability to generate an appropriate return depends significantly upon its capacity to anticipate and respond appropriately to these competitive pressures.

***Downgrades in the Prudential Group's, and following the Acquisition, the Enlarged Group's, financial strength and credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties***

The Prudential Group'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 most of the Prudential Group's products, and as a result its competitiveness. Downgrades in the Prudential Group's, AIA Group's and/or the Enlarged Group'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 and retain current policyholders. In addition, the interest rates the Prudential Group pays on its borrowings are affected by its debt credit ratings, which are in place to measure the Prudential Group's ability to meet its contractual obligations.

As at 31 March 2010:

Prudential's long-term senior debt is rated as A2 (negative outlook) by Moody's, A+ (negative watch) by Standard & Poor's and A+ (negative watch) by Fitch;

Prudential's short-term debt is rated as P-1 by Moody's, A-1 by Standard & Poor's and F1+ (negative watch) by Fitch;

The Prudential Assurance Company Limited long-term fund is rated Aa2 (negative outlook) by Moody's, AA (negative watch) by Standard & Poor's and AA+ (negative watch) by Fitch;

Jackson's financial strength is rated AA (negative watch) by Standard & Poor's and Fitch, A1 (negative outlook) by Moody's, and A+ (under review- negative) by AM Best; and

American International Assurance Company Limited's financial strength is rated A+ (developing) by Standard & Poor's.

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 the Prudential Group's financial condition or, following the Acquisition, the Enlarged Group's financial condition.

The Enlarged Group has not yet been rated. There can be no assurance that the Enlarged Group will be rated the same or higher than the current rating of Prudential, its subsidiaries or AIA Co.

***Adverse experience in the operational risks inherent in the Prudential Group's and the Enlarged Group's businesses could have a negative impact on their results of operations***

Operational risks are present in all of the Prudential Group's businesses and will be present in all of the Enlarged Group's businesses, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. The Prudential Group's business is, and the Enlarged Group's business will be, dependent on processing a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. In addition, the Prudential Group outsources and the Enlarged Group will outsource, several operations, including a significant part of its UK back office and customer-facing functions as well as a number of IT functions, resulting in reliance upon the operational processing performance of its outsourcing partners.

Further, because of the long-term nature of much of the Prudential Group's business, accurate records have to be maintained for significant periods. The Prudential Group's systems and processes incorporate controls which are designed to manage and mitigate the operational risks associated with its activities. For example, any weakness in the administration systems or actuarial reserving processes could have an impact on its results of operations during the effective period. The Prudential Group has not experienced or identified any operational risks in its systems or processes during 2009, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

In addition, the AIA Group has been gradually implementing certain corporate initiatives to update and improve its financial reporting, actuarial and information systems. Key aspects of these initiatives include the introduction of new automated systems to track and analyse investments and the migration to a uniform actuarial platform. Significant time, investments and management resources will be required for these financial reporting systems to be

fully updated and optimised. While the Prudential Group has, and the Enlarged Group will have, the IT, management and other reporting systems required for Prudential and New Prudential each to comply with its obligations as a company with securities admitted to the Official List and as a supervised firm regulated by the FSA, as a result of the AIA Group's recent corporate initiatives, the Enlarged Group may experience difficulties that could adversely affect the ability of the Enlarged Group to run its business.

***Adverse experience against the assumptions used in pricing products and reporting business results could significantly affect the Prudential Group's and the Enlarged Group's results of operations***

The Prudential Group needs, and the Enlarged Group will need, to make assumptions about a number of factors in determining the pricing of its products and setting reserves and for reporting its capital levels and the results of its long-term business operations. For example, the assumption that the Prudential Group makes about future expected levels of mortality is particularly relevant for its UK annuity business. In exchange for a premium equal to the capital value of their accumulated pension fund, pension annuity policyholders receive a guaranteed payment, usually monthly, for as long as they are alive. The Prudential Group conducts rigorous research into longevity risk, using data from its substantial annuitant portfolio. As part of its pension annuity pricing and reserving policy, the Prudential Group's UK business assumes that current rates of mortality continuously improve over time at levels based on adjusted data from the Continuous Mortality Investigations (CMI) as published by the Institute and Faculty of Actuaries. If mortality improvement rates significantly exceed the improvement assumed, the Prudential Group's and Enlarged Group's results of operations could be adversely affected.

A further example is the assumption that the Prudential Group makes about future expected levels of the rates of early termination of products by its customers (persistence). This is particularly relevant to its lines of business other than its UK annuity business. The Prudential Group's persistence assumptions reflect recent past experience for each relevant line of business. Any expected deterioration in future persistence is also reflected in the assumption. If actual levels of future persistence are significantly lower than assumed (that is, policy termination rates are significantly higher than assumed), the Prudential Group's and the Enlarged Group's results of operations could be adversely affected.

Another example is the impact of epidemics and other effects that cause a large number of deaths. Significant influenza epidemics have occurred three times in the last century, but the likelihood, timing, or the severity of future epidemics can not 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 Prudential Group's and Enlarged Group's loss experience.

In common with other industry participants, the profitability of the Prudential Group's and the Enlarged Group's businesses depends on a mix of factors including mortality and morbidity trends, policy surrender rates, investment performance and impairments, unit cost of administration and new business acquisition expense.

***The business and prospects of the Enlarged Group may be materially and adversely affected if it is not able to manage the growth of the Enlarged Group's operations successfully***

The life insurance market in the Asia region has experienced significant growth in recent years. Management of the AIA Group's growth to date has required significant management and operational resources and is likely to continue to do so. Future growth of the Enlarged Group will require, among other things: the continued development of adequate underwriting and claim handling capabilities and skills, sufficient capital base, increased marketing and sales activities and the hiring and training of new personnel.

There is no assurance that the Enlarged Group will be successful in managing future growth. In particular, there may be difficulties in hiring and training sufficient numbers of customer service personnel and agents to keep pace with any future growth in the number of customers in the Asia region. In addition, the Enlarged Group may experience difficulties in upgrading, developing and expanding information technology systems quickly enough to accommodate any future growth. If it is unable to manage future growth successfully, the Enlarged Group's business and prospects may be materially and adversely affected.

***As holding companies, Prudential and AIA are each dependent upon their respective subsidiaries to cover operating expenses and dividend payments and, following the Acquisition, New Prudential will in turn depend on dividend payments from Prudential and AIA***

The Prudential Group's and AIA Group's insurance and investment management operations are generally conducted through direct and indirect subsidiaries.

As holding companies, Prudential's and AIA'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 the subsidiaries of each of Prudential and AIA are restricted by applicable insurance, foreign exchange and tax laws, rules and regulations that can limit the payment of dividends, which in some circumstances could limit the ability to pay dividends to shareholders or to make available funds held in certain subsidiaries to cover operating expenses of other members of the Enlarged Group. In particular, AIA has historically been limited by regulators in Thailand on the extent to which it can distribute surplus capital from AIA Thailand to any other subsidiary or branch of the AIA Group. In addition, AIA Co and AIA-B will be required to maintain certain solvency ratios pursuant to an undertaking given by Prudential to the OCI in connection with the Transactions.

Following the Acquisition, New Prudential will be dependent on dividend payments from Prudential and AIA.

***The Prudential Group operates, and the Enlarged Group will operate, in a number of markets through joint ventures and other arrangements with third parties (including in China and India), involving certain risks that the Prudential Group does not, and the Enlarged Group will not, face with respect to its consolidated subsidiaries***

The Prudential Group operates, and the Enlarged Group will operate, and in certain markets is required by local regulation to operate, through joint ventures (including in China and India). The Prudential Group's and Enlarged Group's ability to exercise management control over their joint venture operations and their investment in them depends on the terms of the joint venture agreements, in particular, the allocation of control among, and continued co-operation between, the joint venture participants. The Prudential Group and the Enlarged Group may also face financial or other exposure in the event that any of their joint venture partners fails to meet their obligations under the joint venture or encounters financial difficulty. In addition, a significant proportion of the Prudential Group's and the Enlarged Group's product distribution is and will be carried out through arrangements with third parties not controlled by the Prudential Group and Enlarged Group respectively and is dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements could adversely affect the results of operations of the Prudential Group and the Enlarged Group.

***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. It is expected that the articles of association of New Prudential will also include a similar provision.

***Events relating to the AIG Group could continue to harm the AIA Group's business and reputation and could also harm the Prudential Group's business and reputation***

Following the AIG Events, the AIA Group's customers, agents and employees, regulators and business counterparties expressed concerns about the business and financial condition of the AIG Group and the AIA Group. As a result, the AIA Group experienced a temporary increase in policy surrenders and withdrawals and a reduction in new business, primarily attributable to a perceived reduction in the AIA Group's financial strength. Following completion of the Acquisition, the AIA Group will continue to have relationships with the AIG Group, including the provision of services. In addition, although the AIA Group has re-branded a number of its products and businesses to more closely associate them with AIA, in part to overcome any perception of instability surrounding the AIG Group, the re-branding efforts may not be successful or events related or relating to the AIG Group may still adversely impact the AIA Group's reputation. There is also the risk that the Prudential Group's business may suffer due to the association with the AIA Group (including as a result of AIA Aurora's (a subsidiary of AIG) holdings in New Prudential to be issued as part of the consideration for the Acquisition) following the Acquisition, which may lead to, for example, higher withdrawals, lower new business sales, a negative impact on relations with creditors, or a negative impact on the Prudential Group's credit ratings.

***Agent, employee and distribution partner misconduct is difficult to detect and deter and could harm the Enlarged Group's reputation or lead to regulatory sanctions or litigation***

Agent, employee or distribution partner misconduct could result in violations of law, regulatory sanctions, litigation or serious reputational or financial harm. Such misconduct could include: binding the Enlarged Group to transactions that exceed authorised limits; hiding unauthorised or unsuccessful activities resulting in unknown and unmanaged risks or losses; improperly using or disclosing confidential information, illegal or improper payments; recommending products, services or transactions that are not suitable for customers; misappropriation of funds; engaging in misrepresentation or fraudulent, deceptive or otherwise improper activities when marketing or selling products to customers; engaging in unauthorised or excessive transactions to the detriment of customers; or otherwise not complying with applicable laws or internal policies and procedures.

The measures that the Enlarged Group takes to detect and deter misconduct by agents, employees and distribution partners may not be effective in all cases and may therefore not always be successful in detecting or deterring such misconduct. There is no assurance that any such misconduct would not have a material adverse effect on the Enlarged Group's reputation, business, financial condition, results of operation or prospects.

***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 the Enlarged Group operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Prudential Group or the Enlarged Group or in taxation legislation or its interpretation could affect the Prudential Group's and the Enlarged Group's profitability and ability to provide returns to shareholders or alter the post-tax returns to shareholders.

**2. Risks relating to the Transactions**

***The Acquisition and the Scheme may each not complete***

Completion of the Acquisition is subject to the satisfaction (or waiver) of a number of conditions precedent (including the approval of the holders of Prudential Shares, the approval of the Scheme by the Court and relevant competition and regulatory clearances). Any relevant body may refuse its approval or, in the case of competition or regulatory authorities, may seek to make their approval subject to compliance by Prudential with unanticipated or onerous conditions. In certain jurisdictions, although consent may not be required from the relevant regulator, there may be the risk of that regulator imposing onerous requirements on the Enlarged Group because of the Acquisition. These conditions, if accepted, could have the effect, among other things, of imposing significant additional costs on the Enlarged Group, limiting the Enlarged Group's revenues, requiring divestitures of certain assets, reducing the anticipated benefits of the Acquisition or imposing other operating restrictions upon the business of the Enlarged Group.

The Rights Issue is not conditional upon completion of the Acquisition. If completion of the Acquisition does not occur, which Prudential believes is unlikely, Prudential's current intention is that the net proceeds of the Rights Issue will be invested on a short-term basis while Prudential considers how the net proceeds of the Rights Issue (after deduction of Rights Issue and Transaction related expenses and hedging costs) will be returned to Prudential's shareholders. In considering how any such proceeds might be returned to Prudential's shareholders, Prudential will take into account, amongst other things, the tax implications for Prudential's shareholders.

In addition, if completion of the Acquisition does not occur, which Prudential believes is unlikely, a termination fee of £153 million (including any VAT due in respect thereof) is, in certain circumstances, payable by Prudential to AIA Aurora.

***The integration of the Prudential Group and AIA Group may be more difficult than anticipated***

The integration process following the completion of the Acquisition may prove more difficult than anticipated. In addition, if the focus on this process impacts on the performance of its business, the results and operations of the Enlarged Group are also at risk. The integration may take longer than expected, or difficulties relating to the integration may arise or may cost more than estimated. The integration could fail to achieve the increased revenues, earnings, cost savings and operational benefits that are expected to result from the Acquisition and could even incur substantial costs as a result of, for example, inconsistencies in standards, controls, procedures and policies and business cultures between the Prudential Group and the AIA Group and the diversion of management's attention from their responsibilities as a result of the need to deal with integration issues. The success of the integration could also be adversely affected by the occurrence of external factors that are outside the control of the Enlarged Group, such as the adoption of aggressive pricing strategies or other competitive initiatives by the Enlarged Group's

competitors at a time when the Prudential Group and AIA Group are focused on implementing the integration. Any difficulties in the integration of internal policies, procedures and controls, for example in relation to risk management, could correspondingly increase the risk exposure and losses may be experienced as a direct or indirect result of failures of the Enlarged Group's policies and controls.

In addition, the Enlarged Group will rely to a large extent on its ability to attract and retain key personnel, including agents, who have in-depth knowledge and understanding of the life insurance market in the geographical markets in which it operates. Key personnel may depart because of issues relating to the uncertainty or difficulty of integration or a desire not to remain with the Enlarged Group. The loss of the services of these personnel may cause the Enlarged Group's business to suffer.

***The Enlarged Group may fail to realise the anticipated benefits, including estimated synergies, and may fail to achieve its targets, in relation to the Acquisition***

Prudential anticipates that it can realise material synergies and growth opportunities from, and achieve certain financial targets following, the combination of the Prudential Group and the AIA Group. To realise the anticipated benefits of this combination, the Enlarged Group will need to, amongst other things, develop strategies and implement a business plan to achieve higher growth through improved sales productivity, higher efficiency, cost savings, complementary distribution channels and broader product offering. The ability of the Enlarged Group to achieve the expected synergies and other benefits of the Acquisition, including in particular the expected revenue and cost synergies and the financial targets described in section 4 of Part VI (*Information about the Enlarged Group*), is subject to the occurrence or non-occurrence of a number of assumptions, including, but not limited to, those set out in that section, and other factors set out in this Part II (*Risk Factors*). If, the Enlarged Group's strategies and business plan following the Acquisition fail to achieve these anticipated benefits, if the value of these anticipated benefits is lower than expected, or if these anticipated benefits take longer or cost more to achieve, the targets and estimated synergies may not be achieved or the profitability of the Enlarged Group going forward could be significantly impacted.

***Change of control provisions in the AIA Group's and Prudential Group's agreements may be triggered upon the completion of the Acquisition and may lead to adverse consequences***

Each of the AIA Group and the Prudential Group may be party to contracts, agreements and instruments that contain change of control provisions that may be triggered upon the completion of the Acquisition. Agreements with change of control provisions typically provide for, or permit the termination of, the agreement upon the occurrence of a change of control of one of the parties. Usually these provisions, if any, may be waived with the consent of the other party, and Prudential will consider whether it will seek these waivers. In the absence of these waivers, the operation of the change of control provisions, if any, could result in the loss of significant contractual rights and benefits, the termination of significant agreements or the payment of a termination fee. In addition, employment agreements or other employee benefit arrangements with members of each of the AIA Group's and the Prudential Group's employees may contain change of control provisions providing for additional payments following a change of control.

***The Acquisition and the Scheme may negatively impact the Prudential Group's or the AIA Group's tax position***

The Acquisition and the Scheme in certain jurisdictions are likely to constitute a change of ownership of the AIA Group and the Prudential Group respectively, which may have a negative impact on their respective tax positions. The tax consequences of a change of ownership of a company can include the loss or restriction of certain tax attributes arising before the change of ownership, including, but not limited to, tax losses, tax credits and/or tax basis in assets. The consequences of a change of ownership on the tax position of the Prudential Group or the AIA Group are not expected to be material in the context of the Enlarged Group. In addition, the change of ownership may result in other tax costs not normally associated with the ordinary course of business.

***Share prices may fluctuate***

The market price of Prudential Shares and Rights Issue Shares (including Nil Paid Rights and Fully Paid Rights) could be subject to significant fluctuations due to changes in sentiment in the market. Such risks depend on the market's perception of the likelihood of completion of the Rights Issue and of the Acquisition, and/or in response to various facts and events, including variations in the Prudential Group's operating results and business developments of Prudential Group and/or its competitors. Stock markets have from time to time experienced significant price and volume fluctuations that have affected the market prices for securities and which may be unrelated to the Prudential

Group's operating performance or prospects. Furthermore, the Prudential Group's operating results and prospects from time to time may be below the expectations of market analysts and investors. Any of these events could result in a decline in the market price of Prudential Shares and Rights Issues Shares (including Nil Paid Rights and Fully Paid Rights).

In addition, Prudential has a number of significant shareholders, including, upon completion of the Transactions, AIA Aurora (a subsidiary of AIG), which will hold approximately 10.9% of the issued ordinary share capital of New Prudential (subject to adjustments for, inter alia, further issues of Prudential Shares or New Prudential Shares in the period prior to completion of the Acquisition). A sale or sales of a substantial number of Prudential Shares by any of these significant shareholders, either in the public market or in private transactions, or perception that such a sale or sales may occur, could adversely affect the market price of Prudential Shares.

***Shareholders who do not take up their rights in full will experience significant dilution in their ownership***

Those holders of Existing Shares who do not participate in the Rights Issue will suffer a significant reduction in their proportionate ownership and voting interest in the Prudential Shares as represented by their holding of Prudential Shares immediately following Admission. Even if a holder of Existing Shares elects to sell his unexercised Nil Paid Rights, or such Nil Paid Rights are sold on his behalf, the consideration he receives may not be sufficient to compensate such a holder fully for the dilution of his percentage ownership of Prudential that may be caused as a result of the Rights Issue.

Following completion of the Transactions, shareholders will also experience dilution in their proportionate ownership and voting interest in New Prudential as compared to their proportionate ownership and voting interest in Prudential because of the issue by New Prudential of ordinary shares to AIA Aurora as part of the consideration for the Acquisition.

***The trading market for Nil Paid Rights may not develop***

An active trading market in the Nil Paid Rights may not develop on the London Stock Exchange, the Hong Kong Stock Exchange and/or the SGX-ST during the trading period. In addition, because the trading price of the Nil Paid Rights depends on the trading price of the Prudential Shares, the Nil Paid Rights price may be volatile.

***The period required for Prudential Shares and New Prudential Shares to be transferred between the UK and Hong Kong markets and between the Hong Kong and Singapore markets may be longer than expected, and shareholders may not be able to settle or effect any sales of their shares during this period***

There is no direct trading or settlement between the stock exchanges of London and Hong Kong nor between the stock exchanges of Hong Kong and Singapore. To enable the migration of Prudential Shares and New Prudential Shares between the relevant stock exchanges, shareholders are required to comply with specific procedures and bear necessary costs. Details of the share transfer procedures under normal circumstances are set out in sections 28 and 30 of Part XIX of this prospectus. However, there is no assurance that the transfer of Prudential Shares or New Prudential Shares will complete in accordance with the timelines set out in sections 28 and 30 of Part XIX of this prospectus. There may be unforeseen market circumstances or other factors which delay the transfer, thereby preventing shareholders from settling or effecting the sale of their Prudential Shares or New Prudential Shares.

***An active trading market for Prudential Shares on the Hong Kong Stock Exchange may not develop or be sustained, their trading prices may fluctuate significantly and the effectiveness of the liquidity arrangements by Designated Dealers may be limited***

Following the completion of the introduction of the Prudential Shares on the Hong Kong Stock Exchange (the "Introduction"), Prudential cannot assure that an active trading market for Prudential Shares on the Hong Kong Stock Exchange will develop or be sustained. In addition, the expected market price for Prudential Shares in Hong Kong following the Introduction may not be indicative of the trading prices of the Prudential Shares on the London Stock Exchange and Prudential ADRs on the New York Stock Exchange. If an active trading market of Prudential Shares in Hong Kong does not develop or is not sustained after the Introduction, the market price and liquidity of the Prudential Shares on the Hong Kong Stock Exchange could be materially and adversely affected.

Throughout the Designated Period, the Designated Dealers intend to carry out liquidity activities (see section 29 of Part XIX of this prospectus). Whilst such stock borrowing and trading activities are expected to contribute towards liquidity to meet demand for Prudential Shares to avoid a disorderly market in the Prudential Shares arising from excess demand for Prudential Shares not fulfilled in Hong Kong upon and during the initial period following the Introduction, investors should be aware that such liquidity arrangements are subject to the Designated Dealers'

ability to obtain sufficient numbers of Prudential Shares for settlement on the Hong Kong market to meet demand. There is no guarantee that such liquidity arrangements will attain and/or maintain liquidity in the Prudential Shares at any particular level on the Hong Kong Stock Exchange, nor is there any assurance that the price of Prudential Shares in Hong Kong will not exhibit significant volatility.

The liquidity arrangements do not create any obligation on the Designated Dealers to undertake any stock borrowing, trades or other transactions in the Prudential Shares. Accordingly, there is no guarantee that during the Designated Period, the price at which the Shares are traded on the Hong Kong Stock Exchange will be substantially the same as or similar to the price at which Prudential Shares are traded on the London Stock Exchange or that any particular volume of Prudential Shares will trade on the Hong Kong Stock Exchange. The liquidity arrangements being implemented in connection with the Introduction are not equivalent to the price stabilisation activities which may be undertaken in connection with an initial public offering. In addition, the Designated Dealers are not acting as market makers and do not undertake to create or make a market in Prudential Shares on the Hong Kong Stock Exchange. In particular, the Designated Dealers do not intend to seek to use buying of Prudential Shares in Hong Kong to meet excess supply in the market.

The liquidity arrangements will also terminate and cease to continue beyond the Designated Period. Accordingly, there may be volatility in the Hong Kong market after the Designated Period and in particular during the period when movements of Prudential Shares between the UK Register and the HK Register are suspended in connection with the Rights Issue when the availability of Prudential Shares in Hong Kong may be limited. Upon expiry of the Designated Period, the Designated Dealers will be obliged to return the Prudential Shares they have borrowed pursuant to the liquidity arrangements. If this is effected by purchasing Prudential Shares in the UK market and transferring such Prudential Shares to the lenders, such activity may create volatility in the UK market which may, in turn, lead to volatility in the Hong Kong market. If this is effected by returning unutilised Prudential Shares borrowed in the UK and moved to Hong Kong back to the UK, such Prudential Shares would no longer be available to contribute to liquidity in the Hong Kong market.

## PART III

### DIRECTORS, COMPANY SECRETARY AND ADVISERS

<b>Directors:</b>	Harvey Andrew McGrath (Chairman) Cheick Tidjane Thiam (Group Chief Executive) Nicolaos Andreas Nicandrou (Chief Financial Officer) Robert Alan Devey (Executive Director) Clark Preston Manning Jr. (Executive Director) Michael George Alexander McLintock (Executive Director) Barry Lee Stowe (Executive Director) Keki Bomi Dadiseth (Independent non-executive Director) Michael William Oliver Garrett (Independent non-executive Director) Ann Frances Godbehere (Independent non-executive Director) Bridget Ann Macaskill (Independent non-executive Director) Kathleen Anne O'Donovan (Independent non-executive Director) James Hood Ross (Senior Independent Director) Lord Andrew Turnbull (Independent non-executive Director)
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Each of the Directors' business address is Laurence Pountney Hill, London EC4R 0HH, United Kingdom.

**Company Secretary:** Margaret Ann Coltman

**Assistant Company Secretary and alternative authorised representative to Nicolaos Andreas Nicandrou:** Chan Ya Lai, Alice

**Authorised Representatives:** Nicolaos Andreas Nicandrou  
Barry Lee Stowe

**Joint Sponsors, Joint Global Co-ordinators and Joint Bookrunners:** Credit Suisse Securities (Europe) Limited  
One Cabot Square  
London E14 4QJ  
United Kingdom

HSBC Bank plc  
8 Canada Square  
London E14 5HQ  
United Kingdom

J.P. Morgan Securities Ltd.  
125 London Wall  
London EC2Y 5AJ  
United Kingdom

**Financial Advisers to Prudential in respect of the Rights Issue, the Acquisition and the Scheme:** Ondra LLP (trading as Ondra Partners)  
23<sup>rd</sup> Floor  
125 Old Broad Street  
London EC2N 1AR  
United Kingdom

**Financial Advisers to Prudential in respect of the Acquisition and the Scheme:** Credit Suisse Securities (Europe) Limited  
One Cabot Square  
London E14 4QJ  
United Kingdom

HSBC Bank plc  
8 Canada Square  
London E14 5HQ  
United Kingdom

J.P. Morgan plc  
125 London Wall  
London EC2Y 5AJ  
United Kingdom

<b>Financial Advisers to Prudential in respect of the Acquisition:</b>	Lazard Frères & Co LLC 30 Rockefeller Plaza New York NY 10020 United States
<b>Auditors to Prudential:</b>	KPMG Audit Plc Chartered Accountants 8 Salisbury Square London EC4Y 8BB United Kingdom
<b>Reporting Accountants to Prudential:</b>	KPMG Audit Plc Chartered Accountants 8 Salisbury Square London EC4Y 8BB United Kingdom
	KPMG Certified Public Accountants Prince's Building 10 Chater Road Central, Hong Kong
<b>Auditor and Reporting Accountant to AIA:</b>	PricewaterhouseCoopers Certified Public Accountants 22 <sup>nd</sup> Floor, Prince's Building Central, Hong Kong
<b>Legal Advisers to Prudential as to English and Hong Kong law:</b>	Slaughter and May One Bunhill Row London EC1Y 8YY United Kingdom  Slaughter and May 47th Floor, Jardine House One Connaught Place Central, Hong Kong
<b>Legal Advisers to Prudential as to Singapore law:</b>	Allen & Gledhill LLP One Marina Boulevard #28-00 Singapore 018989
<b>Legal Advisers to Prudential as to US law:</b>	Cleary Gottlieb Steen & Hamilton LLP City Place House 55 Basinghall Street London EC2V 5EH United Kingdom
<b>Legal Advisers to the Joint Sponsors, Joint Global Co-ordinators, Joint Bookrunners, J.P. Morgan plc and Underwriters as to English, Hong Kong, Singapore and US law:</b>	Herbert Smith LLP Exchange House Primrose Street London EC2A 2HS United Kingdom  Herbert Smith 23 <sup>rd</sup> floor, Gloucester Tower 15 Queen's Road Central, Hong Kong  Herbert Smith LLP 50 Raffles Place #24-01 Singapore Land Tower Singapore 048623

**Registrar and Receiving Agent:**

Equiniti Limited  
Aspect House  
Spencer Road  
Lancing  
West Sussex BN99 6DA  
United Kingdom

**HK Registrar and transfer office:**

Computershare Hong Kong Investor Services Limited  
Shops 1712-1716  
17th Floor, Hopewell Centre  
183 Queen's Road East  
Wanchai  
Hong Kong

**PART IV**  
**IMPORTANT NOTICES**

**ENFORCEABILITY OF JUDGEMENTS**

Prudential is a public limited company incorporated under the laws of England and Wales. Most of the Directors are citizens or residents of countries other than the United States, and a substantial portion of the assets of such persons and a substantial portion of the assets of the Prudential Group are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon Prudential or New Prudential or such persons or to enforce outside the United States judgements obtained against Prudential or New Prudential or such persons in the United States courts, including, without limitation, judgements based upon the civil liability provisions of the United States federal securities laws or the laws of any state or territory within the United States. In addition, awards of punitive damages in actions brought in the United States or elsewhere may be unenforceable in the United Kingdom. Investors may also have difficulties enforcing, in original actions brought in courts in jurisdictions outside the United States, liabilities under US securities laws.

**RESTRICTION ON MOVEMENTS BETWEEN THE HONG KONG REGISTER AND THE UK REGISTER**

Since the UK Ex-Rights Date and the HK Ex-Rights Date are each fixed for different dates to cater for different regulations and market practices for rights issues in the UK and Hong Kong and because the Issue Price in Hong Kong dollars has been fixed by reference to the relevant exchange rate on 14 May 2010 (being the last HK Business Day prior to the announcement of the Rights Issue), Prudential has instructed the Registrar and HK Registrar not to process removals of Prudential Shares (i) from the HK Register to the UK Register from 4.30 p.m. (Hong Kong time) on 1 June 2010 until 9.30 a.m. (Hong Kong time) on 8 June 2010; and (ii) from the UK Register to the HK Register from 3.00 p.m. (London time) on 1 June 2010 until 8.00 a.m. (London time) on 8 June 2010. Accordingly, shareholders will not be able to move their Prudential Shares between the two Registers during these times.

In addition, because the Issue Price for HK Shareholders is in Hong Kong dollars whereas the Issue Price for UK Shareholders is in pounds sterling, it will not be possible to move Nil Paid Rights arising from the provisional allotment of Rights Issue Shares to HK Shareholders (which are rights to acquire Rights Issue Shares to be registered on the HK Register) into rights to acquire Rights Issue Shares to be registered on the UK Register or vice versa. Similarly, it will not be possible to move Nil Paid Rights held in CCASS into CDP or vice versa.

**FORWARD-LOOKING STATEMENTS**

This prospectus includes ‘forward-looking statements’, with respect to certain of the Prudential Group’s and the Enlarged Group’s plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Forward-looking statements include, without limitation, statements that typically contain words such as ‘will’, ‘may’, ‘should’, ‘continue’, ‘aims’, ‘believes’, ‘expects’, ‘estimates’, ‘intends’, ‘anticipates’, ‘projects’, ‘plans’ or similar expressions. By their nature, forward-looking statements involve material risks and uncertainties because they relate to events and depend on circumstances that all occur in the future. Many of these risks and uncertainties relate to factors that are beyond the Prudential Group’s and/or the Enlarged Group’s abilities to control or estimate precisely, such as future market conditions, fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, the impact of competition, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; and the impact of changes in capital standards, solvency standards or accounting standards, and tax and other legislation and regulations in the jurisdictions in which the Prudential Group and the Enlarged Group operate, together with material risks and uncertainties in relation to the Transactions including the possibility that the Transactions may not be consummated, the ability to achieve expected synergies, including in particular the expected revenue and cost synergies, and the financial targets described in section 4 of Part VI (*Information about the Enlarged Group*), improved productivity and opportunities for growth from the Transactions; and also all the other factors discussed in Part II (*Risk Factors*). This may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. As a result, the Prudential Group’s and/or Enlarged Group’s actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in the forward-looking statements.

The forward-looking statements contained in this prospectus are made as of the date hereof. Prudential and New Prudential may also make or disclose written and/or oral forward-looking statements in reports filed or furnished to

the UKLA, the FSA, the London Stock Exchange, the Hong Kong Stock Exchange, the SFC, the SGX-ST, the MAS or the US Securities and Exchange Commission, as well as in their annual report and accounts to shareholders, proxy statements, offering circulars, registration statements and prospectuses, press releases and other written materials and in oral statements made by directors, officers or employees to third parties, including financial analysts. Neither Prudential, New Prudential, any member of the Prudential Group, nor the Enlarged Group assumes any obligation or has any intention to publicly update or revise these forward-looking statements, whether as a result of future events, new information or otherwise except as required pursuant to the Prospectus Rules, the Listing Rules, the Disclosure and Transparency Rules, the Hong Kong Listing Rules or the SGX-ST listing rules. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed in Part II (*Risk Factors*) of this prospectus. These risk factors are not exhaustive as the Prudential Group operates, and the Enlarged Group will operate, in a continually changing business environment with new risks emerging from time to time that it may be unable to predict or that it currently does not expect to have a material adverse effect on its business. Investors should carefully read this prospectus in its entirety as it contains important information about the business of the Prudential Group and the Enlarged Group and the risks it faces and management plans and objectives.

## **PRESENTATION OF PRUDENTIAL GROUP FINANCIAL INFORMATION**

### **IFRS basis financial information**

Part XIV of this prospectus contains consolidated historical financial information for the Prudential Group as of and for the years ended 31 December 2007, 2008 and 2009. The consolidated financial information of Prudential and the parent company financial information has been prepared and approved by the directors in accordance with IFRS as issued by the IASB and as endorsed by the EU. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRS have not been endorsed by the EU. At 31 December 2009, there were no unendorsed standards effective for the three years ended 31 December 2009 affecting the consolidated or the parent company financial information, and there was no difference between IFRSs endorsed by the EU and IFRS issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the three years ended 31 December 2009 is prepared in accordance with IFRS as issued by the IASB. This consolidated financial information has been reported on by KPMG Audit Plc, London, as stated in their report appearing in Part XIV of this prospectus. The financial information relating to the Prudential Group comprises the consolidated income statement, consolidated statement of comprehensive income, the consolidated statement of changes in equity, consolidated statement of financial position and the consolidated statement of cash flows of the Prudential Group and disclosure notes. The Prudential Group's consolidated financial information is presented in pounds sterling, the Prudential Group's presentation currency. Accordingly, the results and financial position of foreign subsidiaries must be translated into the presentation currency of the Prudential Group from their functional currencies, i.e. the currency of the primary economic environment in which the entity operates.

### ***Operating profit based on longer-term investment results***

Note B1 to the historical financial information for the Prudential Group in Part XIV of this prospectus provides segment results for Prudential by reference to a performance measure of "operating profit based on longer-term investment returns". This measure is part of the total profit from continuing operations before tax attributable to shareholders. Note B1 also provides a supplementary analysis of profit from continuing operations before tax attributable to shareholders which includes the segmental performance reporting measure. The measure of "operating profit based on longer-term investment returns" is the basis on which management regularly reviews the performance of the Prudential Group's segments as defined by IFRS 8.

For the purposes of measuring operating profit, investment returns on shareholder-financed business are based on expected long-term rates of return. The expected long-term rates of return are intended to reflect historical real rates of return and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The most significant operation that requires adjustment for the difference between actual and long-term investment returns is Jackson. The amounts included in operating results for long-term capital returns for Jackson's debt securities comprise two components. These are a risk margin reserve-based charge for long-term expected defaults, which is determined by reference to the credit quality of the portfolio, and amortisation of interest-related realised gains and losses to operating results based on longer-term results to the date when sold bonds would otherwise have matured. Consistent with the policy of including longer-term investment returns in the measure of operating profit, movements in policyholder liabilities are also, where appropriate, delineated between amounts included in operating profits and movements arising from short-term market conditions, which are recorded in short-term fluctuations in investment returns.

For the basis of calculation of operating profit, together with other information that is important to understanding the Prudential Group's financial condition and results of operation, see Part XII (*Operating and Financial Review of the Prudential Group*) of this document.

## **EEV basis supplementary information**

### ***Overview***

This prospectus also contains European Embedded Value ("EEV") basis supplementary information for the Prudential Group as of and for the years ended 31 December 2008 and 2009. The EEV basis supplementary information has been prepared in accordance with the EEV Principles and Guidance issued by the Chief Financial Officers' Forum of European Insurance Companies. The EEV basis supplementary information as of and for the years ended 31 December 2008 and 2009, together with the related notes to the Prudential Group's EEV basis supplementary information and the independent auditor's report from KPMG Audit Plc, has been extracted without any modification from the Prudential 2009 Annual Report and Accounts, and is set forth in Part XIV (*Historical Financial Information for Prudential*) to this prospectus. Where appropriate, the EEV basis supplementary information includes the effects of adoption of IFRS. The EEV basis results are not determined in accordance with IFRS or any other generally accepted accounting principles, and should not be considered as alternatives to performance measures derived in accordance with IFRS. Other insurance companies may calculate EEV basis or similar results differently, and consequently, the Prudential Group's presentation of these results may not be readily comparable to other companies' figures.

### ***EV and EEV***

Embedded value ("EV") is the present value of the shareholders' interest in the earnings distributable from assets allocated to the life businesses after allowing for the aggregate risks in that business. This includes the present value of future cash flows from in-force business and capital tied-up in the life funds, the cost of holding additional capital, and shareholders' free surplus. EV is a broadly defined concept and different applications of the principle can lead to very different financial results. This has led to attempts to standardise the application of EV in order to improve the rigour of, and comparability between, companies' EV results. EEV results are prepared in accordance with Principles issued by the CFO Forum of European Insurance Companies in May 2004 (and expanded by the Additional Guidance on EEV Disclosures published in October 2005), and are a standardised calculation of EV that has been adopted by many European life insurance companies to improve credibility and comparability of EV results.

A common set of principles are used under EEV that provide consistent definitions, a framework for setting actuarial assumptions, and a more explicit approach to the underlying methodology and disclosures. For example:

- The allowance for risk is explicit for EEV through: (i) an allowance for the cost of capital (at the higher of internal target for economic capital and the local statutory minimum), (ii) stochastic and other appropriate modelling of financial options and guarantees to ensure that an allowance for their cost is provided irrespective of their value at the balance sheet date, and (iii) an explicit allowance in the risk discount rate for financial and non-financial risks. EV has no prescribed way for allowing for the risk and uncertainty that is inherent in forecasting future cash flows (typically this has been achieved by including an implicit allowance for risk in the risk discount rate);
- EEV specifically allows for the look-through into profits arising in shareholder service companies, most notably the profit arising in investment management companies from managing the insurance companies' funds for covered business;
- There are extensive disclosures required for EEV on all aspects of the calculations, including the methodology adopted and the analysis of return.

In summary, the EEV basis is a value-based method of reporting in that it reflects the change in value of the business over the accounting period. This value is called the shareholders' funds on the EEV basis which, at a given point in time, is the value of future profits expected to arise from the current book of long-term insurance business plus the net worth of the company. In determining these expected profits, full allowance is made for the risks attached to their emergence and the associated cost of capital, and takes into account recent experience in assessing likely future persistency, mortality and expenses is taken into account.

## **PRESENTATION OF AIA GROUP FINANCIAL INFORMATION**

### ***IFRS basis financial information***

The AIA Group was formed following the combination of the branches and subsidiaries of AIA Co, its chief operating subsidiary, with certain of the Asia Pacific life insurance operations of the AIG Group. The AIA Group

reorganisation and business combinations arising from transfers of interests in entities that are under the common control of AIG throughout all periods presented in the historical financial information at Part XV of this prospectus have been accounted for as if they had occurred at the beginning of the earliest period presented. Accordingly, the AIA Group historical financial information included in Part XV of this prospectus presents the results of operations of the AIA Group as if it had been in existence throughout the period from 1 December 2006 to 30 November 2009.

Part XV of this prospectus contains the historical financial information as of and for the years ended 30 November 2007, 2008 and 2009, which has been prepared in accordance with IFRS, as adopted by the European Union. This consolidated financial information has been reported on by PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, as stated in their report appearing in Part XV of this prospectus. The financial information relating to the AIA Group comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of financial position, and the consolidated statement of cash flows of the AIA Group, and disclosure notes. The AIA Group's consolidated financial information is presented in US dollars, the AIA Group's presentation currency. Accordingly, the results and financial position of the AIA Group's subsidiaries must be translated into the presentation currency of the AIA Group from their functional currencies, i.e. the currency of the primary economic environment in which the entity operates.

#### *Operating profit*

Note 7 to the historical financial information for the AIA Group contained in Part XV of this prospectus provides segment results for the AIA Group by reference to a performance measure of "operating profit". This measure is part of the total profit before tax attributable to policyholder returns and shareholders. Note 5 to the AIA Group historical financial information provides a reconciliation of the operating profit to profit before tax. The "operating profit" measure is the basis on which management regularly reviews the performance of the AIA Group segments as defined by IFRS 8.

The AIA Group defines operating profit before and after tax respectively as profit excluding the following non-operating items:

- investment experience (which consists of realised gains and losses, foreign exchange gains and losses, impairments and unrealised gains and losses on investments held at fair value through profit or loss);
- investment income related to investment-linked contracts (consisting of dividends, interest income and rent income);
- investment management expenses related to investment-linked contracts;
- corresponding changes in insurance and investment contract liabilities in respect of investment-linked contracts and participating funds and changes in third party interests in consolidated investment funds resulting from the above; and
- other significant items that management considers to be non-operating income and expenses

For this and additional information that is important to understanding the AIA Group's financial condition and results of operation, see Part XIII (*Operating and Financial Review of the AIA Group*) of this prospectus.

#### *EEV basis supplementary information*

This prospectus also contains EEV basis supplementary information for the AIA Group as at 30 November 2009 as prepared by Prudential. The information also sets out the contribution to the EEV of new covered business written in the twelve months prior. Prudential has prepared these EEV results with the intention of complying with the EEV Principles and Guidance, with the exception of certain disclosure requirements. This information is set forth in Part XV (*Historical Financial Information for AIA*) of this prospectus.

### **COMPARABILITY OF IFRS BASIS FINANCIAL INFORMATION AND EEV BASIS SUPPLEMENTARY INFORMATION FOR PRUDENTIAL GROUP AND AIA GROUP**

#### *IFRS basis financial information*

The IFRS basis information included in Parts XIV and XV of this prospectus for Prudential and AIA respectively has been prepared applying consistent IFRS accounting policies. Whilst consistent IFRS accounting policies have been

applied the practical application of certain of these policies varies between the companies. These differences of application are particularly of note in the following two areas:

- a) The application of previous GAAP under the IASB standard IFRS 4 (“Insurance Contracts”) for the measurement of assets and liabilities of insurance contracts and the presentation of deposits and withdrawals for insurance contracts with investment features. Under IFRS 4 insurers are permitted to apply different measurement bases pending development by the IASB of a comprehensive phase II standard. In addition to differences of measurement, under IFRS 4 Prudential accounts for all premium and benefit flows within the income statement. AIA accounts for the investment components directly as movements in the balance sheet.
- b) The application of segment basis reporting of a supplementary reporting measure for operating profits. The operating profit measures for Prudential and AIA are different, in particular in terms of the measurement of profits for with-profits funds and the differing approaches to allocation of investment return between operating and non-operating profit. Prudential’s approach to with-profit accounting is to recognise profits on a distribution basis rather than, as for AIA, as a share of the earnings of the funds. The Prudential basis of operating profit includes longer-term capital returns for assets backing non-participating business whereas AIA’s operating profit does not. The unaudited pro forma financial information set out in Part XVI of this prospectus includes footnote disclosure of the 2009 profit before shareholder tax for the Enlarged Group by the supplementary analysis applied by Prudential. This analysis includes its measure of “operating profit based on longer-term investment returns” and the disclosure is accompanied by an explanation of the adjustments made to the 2009 AIA basis operating profit to derive the Prudential basis “Operating profit based on longer-term investment returns” for AIA.

### ***EEV basis supplementary information***

The EEV methodology adopted by Prudential is in accordance with the EEV principles and guidance issued in May 2004 by the European Insurers’ CFO forum and expanded by the additional guidance on EEV disclosures issued in October 2005. The EEV methodology used for AIA Group, as shown in the unaudited pro forma financial information set out in Part XVI of this prospectus is also in accordance with the same EEV principles and guidance except for certain disclosure points referred to in the Consulting Actuaries’ Report set out in Part XV of this document.

As such, the EEV methodologies used for both companies are in accordance with the EEV principles; however the principles do allow for different approaches to be taken by companies. There are two principal differences between the EEV methodology adopted by Prudential and that used for AIA Group. The first is in relation to the way that risk is allowed for in the embedded value calculations and the second is in relation to the way that long term economic assumptions are set. Both approaches are acceptable under the EEV principles. It is important to note that each of these differences should not be considered in isolation, but together with the other differences as part of the entire EEV basis, i.e. the risk discount rates should be considered in conjunction with the long term economic assumptions rather than separately and vice versa.

In setting risk discount rates Prudential Group has based these on risk free rates plus a risk margin. The risk margin reflects an allowance for non diversifiable risk associated with the emergence of distributable earnings not allowed for elsewhere in the valuation. Prudential Group has selected a granular approach that reflects differences in market risks inherent in product groups. The risk discount rate so derived does not reflect a market beta but instead reflects the expected volatility associated with cash flows in the embedded value model. Since financial options and guarantees are explicitly valued using stochastic techniques, discount rates under EEV are set excluding the effect of these product features. The approach to setting risk discount rates for AIA Group is a top down approach using weighted industry specific equity capital costs. The cost of equity capital is derived using estimated long term risk free rates, an equity risk premium and industry specific beta for each country where business is sold. No explicit valuation of options and guarantees is set out and as such the discount rates set for AIA Group include an allowance for financial options and guarantees. Both approaches are acceptable under the EEV principles.

For Prudential Group at 31 December 2009 — in-force business

	<u>China</u>	<u>Hong Kong<sup>1</sup></u>	<u>India</u>	<u>Indonesia</u>	<u>Japan</u>	<u>Korea</u>
Risk discount rate . . . . .	11.75%	5.7%	14.25%	13.8%	5.1%	8.4%
	<u>Malaysia</u>	<u>Philippines</u>	<u>Singapore</u>	<u>Taiwan</u>	<u>Thailand</u>	<u>Vietnam</u>
Risk discount rate . . . . .	9.5%	15.75%	6.8%	7.5%	13.0%	16.75%

1 The assumption shown for Hong Kong is for US dollar denominated business which comprises the largest proportion of the in-force Hong Kong business

For AIA Group at 30 November 2009 — in-force business

	<u>Australia</u>	<u>China</u>	<u>Hong Kong</u>	<u>Indonesia (USD denominated)</u>	<u>Indonesia (Rupiah denominated)</u>	<u>Korea</u>	<u>Malaysia</u>
Risk discount rate . . . . .	9.00%	10.00%	8.00%	12.50%	17.00%	10.00%	9.00%
	<u>New Zealand</u>	<u>Philippines</u>	<u>Singapore &amp; Brunei</u>	<u>Taiwan</u>	<u>Thailand</u>	<u>Vietnam</u>	
Risk discount rate . . . . .	9.00%	14.00%	7.50%	8.00%	10.00%	16.00%	

In setting economic assumptions an active basis is used for Prudential Group's Asian operations in Japan, Korea and for the US dollar denominated business written in Hong Kong. For Asian operations where the long-term fixed interest markets are less established, economic assumptions are based on an assessment of longer term economic conditions. For AIA Group long term economic assumptions are based on an active basis but where current returns differ markedly from long term returns the returns are assumed to grade to the long term returns linearly over the estimated mean term of the existing fixed income assets. Both approaches are acceptable under the EEV principles.

For Prudential Group at 31 December 2009

	<u>China</u>	<u>Hong Kong<sup>1</sup></u>	<u>India</u>	<u>Indonesia</u>	<u>Japan</u>	<u>Korea</u>
Government bond yield . . . . .	8.25%	3.9%	9.25%	10.25%	1.9%	5.5%
	<u>Malaysia</u>	<u>Philippines</u>	<u>Singapore</u>	<u>Taiwan</u>	<u>Thailand</u>	<u>Vietnam</u>
Government bond yield. . . . .	6.5%	9.25%	4.25%	5.5%	6.75%	10.25%

1 The assumption shown for Hong Kong is for US dollar denominated business which comprises the largest proportion of the in-force Hong Kong business

For AIA Group at 30 November 2009

	<u>Australia</u>	<u>China</u>	<u>Hong Kong</u>	<u>Indonesia (USD denominated)</u>	<u>Indonesia (Rupiah denominated)</u>	<u>Korea</u>	<u>Malaysia</u>
10 year Government bond yield . . . . .	5.75%	3.74%	3.83%	6.92%	11.00%	5.16%	4.46%
	<u>New Zealand</u>	<u>Philippines</u>	<u>Singapore &amp; Brunei</u>	<u>Taiwan</u>	<u>Thailand</u>	<u>Vietnam</u>	
10 year Government bond yield . . . . .	6.30%	7.47%	2.93%	1.73%	4.16%	9.25%	

Note that for AIA Group, the assessed long term returns are shown in the table where these differ markedly to current returns.

## UNAUDITED PRO FORMA FINANCIAL INFORMATION

Also included in this prospectus is unaudited pro forma financial information. The unaudited pro forma net asset statement has been prepared to illustrate the effect on the net assets of the Prudential Group as if the proposed Transactions had taken place on 31 December 2009. The unaudited pro forma income statement has been prepared to illustrate the effect on the Prudential Group as if the proposed Transactions had taken place on 1 January 2009. The statement of unaudited pro forma net worth and value-in-force on a European Embedded Value Basis has been prepared to illustrate the effect on the Prudential Group as if the proposed Transactions had taken place on 31 December 2009. The unaudited pro forma financial information has been prepared for illustrative purposes only and because of its nature addresses a hypothetical situation and, therefore, does not represent the Enlarged Group's actual financial results or financial position following the proposed Transactions.

As a result of the above, the unaudited pro forma financial information presented in this prospectus should not be relied on as indicative of future results of operations for the Enlarged Group and investors are cautioned against placing undue reliance on the unaudited pro forma financial information.

## ACCOUNTING STANDARDS

Certain of the financial information included in this prospectus has been prepared in accordance with IFRS and may not be comparable to the financial statements of US companies. US generally accepted accounting principles differ in certain significant respects from IFRS. The financial information in respect of FY 2007, FY 2008 and FY 2009 have not been reported on in accordance with auditing standards generally accepted in the United States or the auditing standards of the Public Company Accounting Oversight Board (United States).

## ROUNDING AND CURRENCY

For convenience, certain financial data in this prospectus has been subject to rounding and, as a result, the totals of the data presented herein and therein may vary slightly from the actual arithmetic totals of such data. In this

prospectus, references to “\$”, “US\$”, “US dollars”, “¢” or “cents” are to United States dollars and cents, the lawful currency of the United States, references to “£”, “pounds sterling”, “pounds”, “sterling”, “p” or “pence” are to pounds sterling and pence, the lawful currency of the United Kingdom, references to “HK\$” “HK dollars” and “Hong Kong dollars” are to Hong Kong dollars, the lawful currency of Hong Kong, references to “SGD” or “S\$” are to Singapore dollars, the lawful currency of Singapore, and references to “€”, “EUR”, “Euro” and “euro” are to the single currency introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European Communities, as amended by the Treaty on European Union.

In this prospectus, certain amounts denominated in HK dollars or US dollars have been translated into pounds sterling at the exchange rate stated. Such conversions shall not be construed as representations that amounts in pounds sterling were or could have been or could be converted into HK dollars or US dollars at such rates or any other exchange rates on such date or any other date. Prudential publishes its consolidated financial statements in pounds sterling. The following tables show the period-end, average, high and low noon buying rates in New York City for cable transfers in foreign currencies as certified by the Federal Reserve Bank of New York (the “Noon Buying Rate”) for the US dollar, expressed in US dollars per one pound, and the Hong Kong dollar, expressed in Hong Kong dollars per one pound, for the periods and dates indicated.

<u>Month</u>	<u>US dollar/pound</u>			
	<u>Period end</u>	<u>Average</u>	<u>High</u>	<u>Low</u>
November 2009 . . . . .	1.64	1.66	1.68	1.64
December 2009 . . . . .	1.62	1.62	1.66	1.59
January 2010 . . . . .	1.60	1.62	1.64	1.59
February 2010 . . . . .	1.52	1.56	1.60	1.52
March 2010 . . . . .	1.52	1.51	1.53	1.49
April 2010 . . . . .	1.53	1.53	1.55	1.52
May 2010 (through to 14 May 2010) . . . . .	1.46	1.49	1.52	1.46

<u>Month</u>	<u>HK dollar/pound</u>			
	<u>Period end</u>	<u>Average</u>	<u>High</u>	<u>Low</u>
November 2009 . . . . .	12.72	12.86	13.02	12.70
December 2009 . . . . .	12.53	12.58	12.90	12.32
January 2010 . . . . .	12.43	12.55	12.71	12.34
February 2010 . . . . .	11.83	12.13	12.40	11.80
March 2010 . . . . .	11.79	11.69	11.87	11.55
April 2010 . . . . .	11.88	11.90	12.02	11.78
May 2010 (through to 14 May 2010) . . . . .	11.33	11.59	11.83	11.33

<u>Year</u>	<u>US dollar/pound</u>			
	<u>Period end</u>	<u>Average rate</u>	<u>High</u>	<u>Low</u>
2005 . . . . .	1.72	1.82	1.93	1.71
2006 . . . . .	1.96	1.84	1.98	1.73
2007 . . . . .	1.98	2.00	2.11	1.92
2008 . . . . .	1.46	1.85	2.03	1.44
2009 . . . . .	1.62	1.57	1.70	1.37

<u>Year</u>	<u>HK dollar/pound</u>			
	<u>Period end</u>	<u>Average rate</u>	<u>High</u>	<u>Low</u>
2005 . . . . .	13.33	14.16	15.05	13.29
2006 . . . . .	15.23	14.32	15.39	13.39
2007 . . . . .	15.47	15.62	16.39	15.03
2008 . . . . .	11.33	14.44	15.81	11.16
2009 . . . . .	12.54	12.14	13.16	10.59

On 14 May 2010, the noon buying rate was £1.00 = HK\$11.33 and £1.00 = US\$1.46.

Certain amounts and percentage figures included in this prospectus have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures preceding them.

## PART V

### INFORMATION ABOUT THE TRANSACTIONS

#### 1. Background and reasons for the Transactions

Prudential believes that the Transactions are a compelling and rare opportunity with strong strategic, operational and financial rationale that will contribute significantly to the achievement of Prudential's strategic objective to focus on its Asian growth. The Transactions are expected to create a leading Asian life insurer and to yield significant value for Prudential shareholders, its other stakeholders and AIG.

The Transactions will provide the Enlarged Group with a greater presence in Asia and in particular, high growth South East Asian economies. Life insurance premiums in the Asia Pacific region grew at a compound annual growth rate of 17.5% from 2003 to 2008, primarily driven by strong regional economic growth, favourable demographic changes, social welfare reforms, healthcare demand and insurance market reforms.

The Transactions provide the Enlarged Group with the opportunity to:

- create a leading life insurer with Asia at its core and strong operations in the US and the UK;
- establish the leading position in the high growth South East Asian markets of Hong Kong, Singapore, Malaysia, Thailand, Indonesia, the Philippines and Vietnam, and the leading foreign life insurance business in China and India;<sup>(33)</sup>
- allow Prudential shareholders to benefit from a compelling Acquisition valuation to yield attractive returns for its shareholders;
- deliver sustainable revenue and earnings growth;
- achieve significant cost and revenue synergies;
- benefit from improved productivity across distribution channels, enhanced customer insights and broader product offering; and
- create a platform for further opportunities for growth in Asia.

The key growth opportunities include:

- *Products*: Significant opportunities to narrow the margin gap between AIA and Prudential by managing the AIA product mix in line with Prudential's;
- *Agency distribution*: Improvements in AIA sales force productivity based upon Prudential's agency management capabilities;
- *Bancassurance*: Increase effectiveness of AIA's current relationships by leveraging Prudential's capabilities in Asia, with banks such as Standard Chartered Bank ("SCB"), ICICI Bank Limited ("ICICI") and United Overseas Bank Limited ("UOB") and
- *Customers*: Increasing utilisation of customer management and data mining tools applied to the Enlarged Group's customers.

The combination of the Prudential Group and the AIA Group is expected to generate significant synergy benefits. Prudential is seeking to achieve US\$800 million pre-tax (US\$650 million post tax) of annualised run-rate revenue synergies (on a value of new business basis) and US\$370 million of annualised run-rate pre-tax cost synergies during 2013. These savings are expected to arise from actions planned to be taken by Prudential including: increasing AIA agent productivity, managing AIA's product mix, growing the bancassurance business by replicating Prudential's bancassurance skills to AIA's bancassurance partnerships, increasing utilisation of customer management and data mining tools; and increasing efficiency and reducing costs across regional offices and local business units.

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(33) As set out in Part VI of this prospectus, (a) Prudential is ranked as the leading life insurer in Singapore, Malaysia, Indonesia and Vietnam, (b) AIA is ranked as the leading life insurer in the Philippines and Thailand, (c) ICICI Prudential is ranked as the leading private life insurer in India and (d) AIA is ranked as the leading foreign life insurer in China. According to the OCI, the combined market share of Prudential and AIA is greater than the market share of any other company in the Hong Kong life insurance market.

## 2. Acquisition Agreement

Under the Acquisition Agreement, AIA Aurora (a subsidiary of AIG) has agreed to sell, and New Prudential has agreed to purchase, the entire issued share capital of AIA for consideration with a notional value of US\$35.5 billion, comprising:

- (i) US\$25.0 billion in cash payable at completion of the Acquisition, subject to reduction in an amount equal to the aggregate nominal value of any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter;
- (ii) a number of New Prudential Shares having a notional value of £3.613 billion (approximately US\$5.5 billion) to be allotted and issued to AIA Aurora at completion of the Acquisition;
- (iii) US\$3.0 billion in aggregate principal amount of mandatory convertible notes due 2013 (convertible into New Prudential Shares) to be allotted and issued by New Prudential to AIA Aurora at completion of the Acquisition (the "MCNs");
- (iv) US\$2.0 billion in aggregate principal amount of perpetual tier one notes to be issued by Prudential (the "Tier 1 Notes"); and
- (v) any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter.

The number of New Prudential Shares to be issued to AIA Aurora is expected to represent approximately 10.9% of the issued ordinary share capital of New Prudential immediately following completion of the Acquisition (subject to adjustments for, *inter alia*, further issues of New Prudential Shares in the period prior to completion of the Acquisition).

The material conditions to completion of the Acquisition Agreement are:

- the passing of the requisite resolutions by Prudential shareholders at the General Meeting;
- obtaining the requisite regulatory and antitrust approvals;
- there having been no material adverse change in AIA between the date of the Acquisition Agreement and commencement of the Rights Issue;
- there having been no breach of warranty by AIA Aurora giving rise to a material adverse change;
- there having been no breach by AIG of the covenants relating to the conduct of the business of the AIA Group which is material in the context of the AIA Group taken as a whole;
- there having been no breach of the warranty by New Prudential giving rise to a material adverse effect on the ability of it or Prudential to complete the Acquisition;
- the Scheme being approved by Prudential shareholders, sanctioned by the court and becoming effective; and
- admission of the Rights Issue Shares, the New Prudential Shares, the MCNs and the Tier 1 Notes to listing on the Official List and to trading on the London Stock Exchange.

The parties to the Acquisition Agreement have agreed to use their best endeavours to co-operate to satisfy the conditions (which may include Prudential agreeing to divest AIA Group or Prudential Group assets or businesses) and, in particular, Prudential has agreed that the Board will recommend that shareholders vote in favour of the requisite resolutions at the General Meeting (the "Board Recommendation"), subject always to the Directors' fiduciary duties.

In the event that completion of the Acquisition has not occurred and the Acquisition Agreement has not been terminated by 31 August 2010, New Prudential has agreed to pay to AIA Aurora an additional amount of consideration equal to 5/1200ths of the cash consideration outstanding per month from 1 September 2010 to the completion date.

The material termination provisions under the Acquisition Agreement allow termination:

- by AIG or AIA Aurora in the event that the Directors adversely withdraw, modify or qualify the Board Recommendation;
- by any party in the event that Prudential shareholders have not passed the requisite resolutions by 1 August 2010;
- by any party in the event that completion does not occur by 1 March 2011 (the "Long Stop Date"), subject to options for either party to extend in limited circumstances;
- by New Prudential in the event of a breach of warranty by AIA Aurora giving rise to a material adverse change, subject to cure;

- by New Prudential in the event of a material adverse change in AIA between the date of the Acquisition Agreement and commencement of the Rights Issue;
- by New Prudential in the event of a breach of covenant relating to the conduct of the business of the AIA Group prior to completion which is material in the context of the AIA Group taken as a whole, subject to cure; and
- by AIA Aurora or AIG in the event of a breach of warranty by New Prudential giving rise to a material adverse effect on the ability of it or Prudential to complete the Transactions subject to cure.

Prudential has agreed to pay to AIA Aurora a termination fee of £153 million (inclusive of any VAT due in respect thereof) if the Acquisition Agreement is terminated as a result of: (i) the requisite regulatory or antitrust approvals not having been obtained by the Long Stop Date; (ii) the Rights Issue not having been completed by the Long Stop Date; (iii) Prudential shareholders not having passed the requisite resolutions by 1 August 2010; (iv) the Board Recommendation having been adversely withdrawn, modified or qualified; or (v) if the Acquisition Agreement is terminated on or after the Long Stop Date and at the time of termination AIA Aurora would have had the right to terminate as described in (iii) and (iv) above (in each case, other than as a result of breach of warranty or covenant which was sufficiently serious to permit New Prudential to terminate the agreement).

The Acquisition Agreement also contains an undertaking by AIG to use best endeavours to ensure that the business of the AIA Group is run in the ordinary course up to completion and that specified actions are not taken without the consent of New Prudential.

New Prudential's liability to AIG and AIA Aurora for breach of warranty terminates at completion of the Acquisition, with the exception of warranties relating to capacity, title and the New Prudential Shares and other securities to be issued on completion. AIG and AIA Aurora's liability to New Prudential for breach of warranty terminates at completion, with the exception of the warranties relating to capacity and title and certain other matters related to the adequacy of the draft prospectus of AIA prepared in contemplation of the initial public offering of the AIA Group. AIA Aurora's liability under the prospectus warranty is capped at US\$7.5 billion and subject to a limitation period of 12 months.

AIA Aurora is subject to a lock-up:

- in respect of New Prudential Shares, 50% is eligible for sale after 12 months under orderly market conditions, which involves the sale taking place in consultation with New Prudential, and the other 50% eligible for sale after 24 months; and
- in respect of the MCNs, for a period of 24 months from the date of completion of the Acquisition,

in each case subject to customary exceptions. These exceptions include the ability for AIA Aurora to pledge New Prudential Shares or MCNs to a financing counterparty providing the financing counterparty accepts a lock-up obligation on the same terms as described above, subject to exceptions for unrelated ordinary course market activities and in circumstances where the financing counterparty is entitled to enforce its security (in which case any sale of the pledged New Prudential Shares or MCNs by the financing counterparty will be undertaken in consultation with New Prudential's nominated brokers).

Prudential and New Prudential are prohibited, from the date of the Acquisition Agreement until the date on which Prudential shareholders pass the requisite resolutions, from:

- entering into discussions regarding any transaction which would require the approval of Prudential shareholders if to do so would result in the Board Recommendation being adversely withdrawn, modified or qualified or assisting any person with, or providing information to any person for the purposes aforementioned; and
- soliciting, encouraging or assisting any person to acquire securities in Prudential such that an offer would have to be made for Prudential or New Prudential according to the City Code on Takeovers and Mergers, or assisting any person with, or providing information to any person for the purposes of, the aforementioned.

The Acquisition Agreement contains a prohibition on AIA Aurora soliciting the senior employees of the AIA Group for a period of 18 months from completion of the Transactions, other than by way of general advertisement.

New Prudential's obligations under the Acquisition Agreement are guaranteed by Prudential.

### 3. Consideration for the Acquisition

The Acquisition is to be financed through US\$25.0 billion in cash (subject to reduction in an amount equal to the aggregate nominal value of any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter) and through US\$10.5 billion in New Prudential Shares and other securities, which will be increased by an amount equal to the aggregate nominal amount of any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter. The cash component of the consideration will be financed through:

- Underwritten Rights Issue — Credit Suisse, HSBC and J.P. Morgan Cazenove as Joint Global Co-ordinators and Joint Bookrunners have undertaken to Prudential to underwrite the Rights Issue to raise an amount in sterling which is equivalent to US\$20.0 billion (net of costs, fees and expenses).
- Underwritten debt commitment — Prudential intends to raise an amount equivalent to approximately US\$5.3 billion (net of costs, fees and expenses which are expected to be up to US\$200 million) (US\$5.5 billion gross) by way of one or more offerings of subordinated debt securities to institutional investors (the “Bond Offerings”). In connection with the Bond Offerings, Prudential has entered into an agreement pursuant to which the Joint Lead Arrangers will provide a committed US\$5.4 billion hybrid capital facility (the “Hybrid Capital Facility”) and will, at the request of Prudential, subscribe for Lower Tier 2 capital notes and/or Upper Tier 2 capital notes and/or provide Lower Tier 2 capital loans and/or Upper Tier 2 capital loans in aggregate principal value of up to US\$5.4 billion to be issued by or advanced to Prudential. The Joint Lead Arrangers will subscribe for the Lower Tier 2 capital notes and Upper Tier 2 capital notes and/or provide Lower Tier 2 capital loans and/or Upper Tier 2 capital loans in the event that Prudential does not issue Lower Tier 2 capital and Upper Tier 2 capital notes in aggregate principal value of up to US\$5.4 billion pursuant to the Bond Offerings. Prudential intends to raise the balance of US\$100 million through its ordinary course capital markets debt issuance programmes. Prudential, AIG and AIA Aurora have also entered into an agreement (the “Subordinated Note Commitment Letter”) under which, to the extent that the Joint Lead Arrangers are unable to procure subscriptions in full for the Bond Offerings for an aggregate amount equal to US\$5.4 billion by the date on which the last of certain conditions in the Acquisition Agreement have been satisfied or waived, AIA Aurora has agreed to subscribe for subordinated debt securities on completion of the Acquisition in an aggregate amount equal to the lesser of: (i) US\$1.875 billion; and (ii) the amount required to make the aggregate amount of subordinated debt securities subscribed for under the Bond Offerings and pursuant to the Subordinated Note Commitment Letter equal to US\$5.4 billion. The effectiveness of the Subordinated Note Commitment Letter is conditional on the consent of the Joint Lead Arrangers being obtained; at the date of this prospectus such consent has not been obtained. Although Prudential intends to proceed with the Bond Offerings, and the Joint Lead Arrangers have committed to provide the same amount pursuant to the Hybrid Capital Facility, as described above, Credit Suisse, HSBC and J.P. Morgan plc and JPMorgan Chase Bank, N.A. remain committed to Prudential to provide the debt commitment in the form of a senior, unsubordinated US\$5.4 billion bridge facility. Prudential will not make any drawings under the bridge facility unless circumstances change such that it can do so and remain in compliance with its regulatory capital requirement, which is considered to be unlikely. The net proceeds of any notes issued pursuant to the Bond Offerings or any drawdown under the Hybrid Capital Facility or subscription under the Subordinated Note Commitment Letter will reduce the amount available for drawing under the US\$5.4 billion bridge facility commensurately.

AIA Aurora will receive up to US\$5 billion in cash consideration from the Bond Offerings at completion of the Acquisition. To the extent Prudential raises a net amount in excess of US\$5 billion from the Bond Offerings and/or the Hybrid Capital Facility and/or subscription under the Subordinated Note Commitment Letter, such excess will be applied by Prudential to meet, inter alia, costs, fees and expenses and other group liabilities.

If the Prudential Shares were listed on the Hong Kong Stock Exchange, the applicable percentage ratios for the Acquisition would have exceeded 100% and the Acquisition would have constituted a very substantial acquisition.

The consideration represents a multiple of 1.62x AIA’s Embedded Value as at 30 November 2009 and 22.2x AIA’s 30 November 2009 new business profit. However, Prudential believes the new business profit of the AIA Group in 2009 was significantly impaired due to the AIG Events, and the global economic crisis and not reflective of the potential of the business. Prudential is seeking to achieve US\$370 million of annualised cost savings during 2013. In addition, the combination provides an opportunity to achieve revenue synergies through enhanced agency productivity, increasing effectiveness of bancassurance relationships, and increasing utilisation of customer management and data mining tools.

Prudential has entered into foreign exchange hedging arrangements in respect of its requirement to convert the pounds sterling proceeds of the Rights Issue into US dollars, which is the currency in which New Prudential must pay the cash element of the consideration. Prudential has budgeted £500 million for hedging costs. The actual

impact of these hedging arrangements on the acquisition price and income statement will depend on the evolution of the sterling/dollar exchange rate through to completion of the Acquisition.

Details of the terms and conditions of the Rights Issue can be found at Part IX of this prospectus.

The US\$10.5 billion in New Prudential Shares and other securities will include:

- Equity consideration — AIA Aurora will receive equity consideration having a notional value of £3.613 billion (expected to represent, subject to adjustments for, *inter alia*, further issues of Prudential Shares or New Prudential Shares in the period prior to completion of the Acquisition, approximately 10.9% of the issued ordinary share capital of New Prudential immediately following completion of the Acquisition, and being 2,023,836,505 shares if calculated as at 14 May 2010, being the latest practicable date prior to publication of this prospectus). The equity consideration will be subject to a lock-up, with 50% eligible for sale after 12 months under orderly market conditions, which involves the sale taking place in consultation with New Prudential, and the other 50% eligible for sale after 24 months.
- MCNs — AIA Aurora will receive US\$3 billion in aggregate principal amount of MCNs to be issued by New Prudential to AIA Aurora on the date of completion of the Acquisition. The MCNs will automatically convert into New Prudential Shares on the third anniversary of the date of completion of the Acquisition (the “Mandatory Conversion Date”). The MCNs may also be converted into New Prudential Shares prior to the Mandatory Conversion Date at the option of the holders or at the option of New Prudential. The number of New Prudential Shares that each MCN converts into on conversion will be determined by the volume weighted average share price of the New Prudential Shares (converted into US dollars at the spot rate published by Bloomberg at 11:00 a.m. on the relevant trading day) on each of the 20 consecutive trading days ending on the third trading day prior to conversion as against a reference share price calculated on the basis of the share price of Prudential’s ordinary shares as at close of trading on 26 February 2010. The MCNs pay a semi-annual fixed coupon of 3.75% per annum and entitle holders to participate in any dividend declared or distribution made to shareholders by New Prudential above pre-determined levels. The MCNs have no fixed maturity date and will be eligible to count towards the New Prudential Group’s tier one capital resources. The MCNs will be subject to a lock-up limiting the sale of them by AIA Aurora for 24 months from the date of completion of the Acquisition.
- Tier 1 Notes — AIA Aurora will receive US\$2 billion in aggregate principal amount of Tier 1 Notes to be issued by Prudential. The Tier 1 Notes will pay a quarterly fixed coupon of 6.25% per annum until the date falling exactly ten years and one day after the date of completion of the Acquisition (the “First Call Date”). From and including the First Call Date, the Tier 1 Notes will pay a floating rate coupon equal to 3-month LIBOR plus 3.566%. The Tier 1 Notes will be perpetual and redeemable prior to the First Call Date only in very limited circumstances. Prudential may elect to defer payments of interest and any deferred interest may only be paid through an alternative coupon satisfaction mechanism. The Tier 1 Notes will be eligible to count towards the Enlarged Group’s tier one capital resources.

### *MCNs*

The MCNs will be issued by New Prudential in the form of registered securities having a denomination of US\$100,000 each. The MCNs automatically convert into New Prudential Shares on the Mandatory Conversion Date, unless previously purchased, cancelled or converted into New Prudential Shares. The MCNs are not redeemable at any time.

New Prudential will apply for the MCNs to be admitted to the Official List and to trading on the regulated market of the London Stock Exchange. New Prudential will apply for the New Prudential Shares, on the date of completion of the Acquisition, to be admitted to the Official List and to trading on the regulated market of the London Stock Exchange.

### *Mandatory Conversion*

The MCNs will automatically convert into the New Prudential Shares on the Mandatory Conversion Date. The number of New Prudential Shares per MCN deliverable on conversion will be equal to the arithmetic average of the 20 conversion ratios determined on the basis of the volume weighted average share price of the New Prudential Shares on the London Stock Exchange (converted into US dollars at the spot rate published by Bloomberg at 11.00 a.m. on the relevant trading day) (each a “Share Price”) on each of the 20 consecutive trading days ending on the third trading day prior to the Mandatory Conversion Date (such arithmetic average, the “Mandatory Conversion

Ratio”). For the purposes of calculating the Mandatory Conversion Ratio, the conversion ratio for a given trading day will be determined as follows:

- if the Share Price is less than or equal to the Minimum Conversion Price (as defined below), the conversion ratio will be equal to the Maximum Conversion Ratio as at completion of the Acquisition, of the number of New Prudential Shares per MCN determined by dividing US\$100,000 by the Minimum Conversion Price (the “Maximum Conversion Ratio”);
- if the Share Price is equal to or greater than the Maximum Conversion Price (as defined below), the conversion ratio will be equal to the Minimum Conversion Ratio as at completion of the Acquisition, of the number of New Prudential Shares per MCN determined by dividing US\$100,000 by the Maximum Conversion Price (the “Minimum Conversion Ratio”); and
- if the Share Price is greater than the Minimum Conversion Price but less than the Maximum Conversion Price, the conversion ratio will be determined by dividing US\$100,000 by the Share Price.

The Maximum Conversion Ratio and the Minimum Conversion Ratio are subject to anti dilution adjustments. The Minimum Conversion Price will be equal to 100% of the reference share price and the Maximum Conversion Price will be equal to 125% of the reference share price. The reference share price will be determined on or immediately prior to the completion date of the Acquisition as being £3.613 billion, converted into US dollars at the agreed spot rate of US\$1.5224 / £1 and divided by the number of New Prudential Shares to be allotted, issued and credited as fully paid to AIG on the completion date of the Acquisition.

#### *Optional Conversion*

The MCNs permit the holders to elect to convert each MCN into New Prudential Shares on any date falling 41 days after the issue of the MCNs and before the 26th trading day before the Mandatory Conversion Date at the applicable Minimum Conversion Ratio for the MCNs converted and, following a change of control of New Prudential, at the Maximum Conversion Ratio for each MCN converted. In the event that a holder elects to convert the MCNs into New Prudential Shares following a change of control of New Prudential, each holder will receive an additional number of New Prudential Shares in respect of the aggregate amount of all unpaid fixed coupon amounts up to and including the Mandatory Conversion Date.

New Prudential may also elect to convert the MCNs into New Prudential Shares at the applicable Maximum Conversion Ratio for each MCN converted and, on such conversion at New Prudential’s election, each holder will receive an additional number of New Prudential Shares in respect of the aggregate amount of all unpaid fixed coupon amounts up to and including the Mandatory Conversion Date.

#### *Fixed coupon amounts*

The MCNs will pay a fixed coupon amount of 3.75% per annum, payable semi-annually in arrear on 23 September and 23 March of each year. New Prudential’s obligation in respect of the payment of fixed coupon amounts will rank *pari passu* with its other obligations which constitute (or would constitute but for any applicable limit on the amount of such capital) as tier one capital and the most senior class of issued preference shares and senior only to its issued ordinary share capital.

#### *Distributions*

Each MCN entitles its holder to receive an amount in US dollars equal to the amount by which any extraordinary dividend declared or distribution made by New Prudential to its shareholders exceeds certain pre-determined amounts set out in the table below. Any distribution will be payable in cash. The amount of any distribution per MCN will be equal to the product of (1) the number of New Prudential Shares that each MCN would have converted into if it had been converted at the Maximum Conversion Ratio prevailing as at the date of the declaration of such dividend or making of such distribution and (2) the amount per New Prudential Share by which the relevant cash distribution exceeds the applicable amount set out in the table below:

<b>During the year ended:</b>	<b>Amount</b>
31 December 2010	£0.0900 per New Prudential Share
31 December 2011	£0.0950 per New Prudential Share
31 December 2012	£0.1000 per New Prudential Share
31 December 2013	£0.0300 per New Prudential Share but only in respect of dividends declared or distributions made prior to the Mandatory Conversion Date

Any distribution will be payable within five business days following the date on which the dividend or distribution giving rise to the payment of the distribution is paid.

The right of holders of the MCNs in respect of the payment of any distribution under or arising from the MCNs, principal and any amount payable (including, without limitation, any liquidated damages payable by New Prudential) as a result of or arising from New Prudential's failure or inability to deliver New Prudential Shares on conversion will rank *pari passu* with the holders of New Prudential Shares.

#### *Non-payment of fixed coupon amounts and any distributions*

All payments under the MCNs are subject to New Prudential satisfying a solvency condition both at the time of, and immediately after, the relevant payment. New Prudential will satisfy the solvency condition if it is able to pay its debts to senior creditors and subordinated creditors (other than subordinated creditors ranking *pari passu* with or junior to the fixed coupon amounts payable under the MCNs) as they fall due and its total assets exceed its total liabilities by at least 4% or such other figure as specified by the FSA.

Any fixed coupon amount not paid by New Prudential because New Prudential fails to satisfy the solvency condition described above both at the time of, and immediately after, the relevant payment date shall constitute deferred fixed coupon amount. New Prudential may also elect to defer any fixed coupon amount if New Prudential determines (acting in good faith and by reference to the then current financial condition of New Prudential and at its sole discretion) that, on or after the 20th business day but not later than the 5th business day prior to such payment date, it fails to comply with certain capital adequacy and regulatory conditions applicable to it or it is required under the terms of any security ranking *pari passu* or junior to the obligation not to pay the relevant fixed coupon amount and such fixed coupon amount shall also constitute deferred fixed coupon amount. New Prudential may only satisfy its obligation to settle any deferred fixed coupon amount in New Prudential Shares by making an adjustment to the Maximum Conversion Price and Minimum Conversion Price in accordance with the Conversion Adjustment Mechanism (as defined below).

In the event that New Prudential does not make payment in cash in full of a fixed coupon amount or any distribution, such fixed coupon amount or distribution will be settled in New Prudential Shares through an adjustment to the Maximum Conversion Price and the Minimum Conversion Price (the "Conversion Adjustment Mechanism").

#### *Conversion Adjustment Mechanism*

An adjustment made in accordance with the Conversion Adjustment Mechanism will satisfy New Prudential's obligation to pay any fixed coupon amount or distribution not paid in full in cash. Any adjustment will be effective, in the event of non-payment due to New Prudential's failure to satisfy the solvency condition, from the date on which the relevant fixed coupon amount or distribution was not paid in full in cash or, in the event of non-payment for any other reason, from the earliest of the first trading day on which the circumstances giving rise to the relevant non-payment cease to exist, the date on which the issuer elects to convert the MCNs or the Mandatory Conversion Date.

In the event of the conversion of the MCNs prior to the first trading day on which the circumstances giving rise to the relevant non-payment cease to exist, a holder of the MCNs will be entitled to the number of additional New Prudential Shares which the holder of the relevant MCNs would have been entitled to if the relevant adjustment had become effective before the conversion. New Prudential will issue such additional New Prudential Shares, in the event of a conversion of the MCNs at the election of New Prudential or on the Mandatory Conversion Date, on the earliest of the date on which New Prudential elects to convert the MCNs, the Mandatory Conversion Date or 5 trading days after the circumstances giving rise to the relevant non-payment cease to exist or, in the event of a conversion of the MCNs at the election of the holder, 5 trading days after the circumstances giving rise to the relevant non-payment cease to exist.

#### *Other provisions*

The MCNs contain a dividend and capital restriction which prohibits (1) the declaration or payment of a dividend or distribution or the making of any other payments on any securities ranking *pari passu* or junior to the fixed coupon amounts payable under the MCNs or (2) the redemption, purchase or acquisition of such securities if New Prudential fails to pay all coupon payments in full due to it failing to satisfy the solvency condition (as described above) or being in compliance with its regulatory capital requirements or it is prohibited from doing so by any other security ranking *pari passu* with fixed coupon amounts payable under the MCNs.

Events of default are limited to non-payment of amounts due and the winding-up of New Prudential. Following the occurrence of an event of default, a holder may elect to exercise its right to convert the MCNs and, on exercise of

such right, the number of New Prudential Shares to be delivered will be equal to the Maximum Conversion Ratio per MCN. Upon a liquidation or winding-up of New Prudential, the claims of holders to receive Ordinary Shares will convert into a claim of the holders to participate in the liquidation proceeds of New Prudential with a claim per MCN equal to the number of New Prudential Shares as if the MCNs had been converted immediately before the order is made or effective resolution is passed at the Maximum Conversion Ratio.

All payments in respect of the MCNs will be made without withholding or deduction for taxes of any kind, unless such withholding or deduction is required by law. In such event, New Prudential will pay additional amounts in respect thereof.

The terms and conditions of the MCNs will be governed by English law.

### ***Tier 1 Notes***

The Tier 1 Notes will be issued by Prudential and will be issued in the form of registered notes having a denomination of US\$100,000 each (and integral multiples of US\$1,000 in excess thereof). The Tier 1 Notes are perpetual and Prudential is under no obligation to redeem them in cash at any time.

Prudential will apply to have the Tier 1 Notes admitted to the Official List and to trading on the regulated market of the London Stock Exchange.

### ***Subordination***

In the event of the winding-up of Prudential, the Tier 1 Notes will be subordinated to the claims of all Senior Creditors, rank *pari passu* with all other obligations of Prudential which constitute (or would constitute but for any applicable limitation on the amount of such capital) Tier 1 capital and with the most senior class of preference shares issued by Prudential and rank senior to the issued ordinary shares of Prudential.

For this purpose, “Senior Creditors” means (i) any unsubordinated creditor of Prudential; (ii) any creditor of Prudential in respect of liabilities that rank (or are expressed to rank) subordinate to claims of other creditors of Prudential (other than those whose claims constitute or would constitute but for any limit on the amount of such capital Tier 1 capital or are expressed to rank *pari passu* or junior to claims of such creditors); (iii) any creditor of Prudential whose claims are in respect of Prudential’s outstanding debt securities which constitute Tier 2 capital (or such other securities outstanding which rank *pari passu* with or senior to such Tier 2 capital); and (iv) all other creditors of Prudential other than those that rank or are expressed to rank equally with or junior to the Tier 1 Notes.

### ***Solvency condition***

All payments under the Tier 1 Notes will be subject to Prudential satisfying a solvency condition both at the time of, and immediately after, the relevant payment.

Prudential will satisfy the solvency condition if it is able to pay its debts to Senior Creditors (as defined above) as they fall due and its total assets (determined on a non-consolidated gross assets basis) exceed its total liabilities (determined on a non-consolidated gross liabilities basis and excluding liabilities to creditors that are not Senior Creditors) by at least 4% or such other percentage as specified by the FSA.

### ***Interest***

From the completion date of the Acquisition to the date falling exactly ten years and one day after the completion date (the “First Call Date”), the Tier 1 Notes will pay a fixed rate of interest of 6.25% per annum, payable quarterly in arrear on 23 March, 23 June, 23 September and 23 December. From and including the First Call Date, the interest rate will be reset to such rate that is equal to 3-month LIBOR plus 3.566%.

Prudential may elect not to pay interest on any interest payment date if Prudential determines (by reference to the then current financial condition of Prudential and at its sole discretion) that, on or after the 20th business day but not later than the 5th business day prior to such payment date, certain capital adequacy and regulatory conditions applicable to it or it is required under any securities ranking *pari passu* to the Tier 1 Notes not to pay the relevant interest payment. Interest not paid will constitute deferred interest (“Deferred Interest”).

Deferred Interest and, at the option of Prudential, interest that has not been deferred (“Current Interest”) may only be satisfied in accordance with an alternative coupon satisfaction mechanism (the “ACSM”). The ACSM requires Prudential to issue ordinary shares, the proceeds of which will be used to satisfy payments of Deferred Interest or Current Interest.

### *Redemption*

The Tier 1 Notes are perpetual securities and have no fixed maturity.

Prudential will only be able to redeem the Tier 1 Notes prior to the First Call Date in certain limited circumstances relating to their regulatory treatment or tax events. Prudential may, on any interest payment date falling on or after the First Call Date, redeem the Tier 1 Notes at their outstanding aggregate principal amount plus any accrued but unpaid interest and any deferred interest. Any redemption is subject to Prudential being in compliance with its capital requirements, satisfying the solvency conditions (as described above) and giving the FSA prior notice and receiving no objection from the FSA to such redemption and, in the case of any redemption prior to the First Call Date, obtaining the FSA's consent to such redemption in the form of a waiver or otherwise.

In certain limited circumstances relating to the tax treatment of the Tier 1 Notes, Prudential will have the option, following giving the FSA prior notice and receiving no objection from the FSA, to convert the Tier 1 Notes into another series of listed, undated cumulative subordinated notes having the same material terms as the Tier 1 Notes. If, following the giving of prior notice to the FSA, the FSA objects to such conversion, Prudential may redeem the Tier 1 Notes.

If the Tier 1 Notes cease to qualify for the Enlarged Group's regulatory capital purposes, Prudential may redeem them at any time. Should such redemption occur prior to the First Call Amount in these circumstances, the Tier 1 Notes may be redeemed at a make-whole redemption amount. Such make-whole redemption amount will be equal to the then present value of the principal amount of the Tier 1 Notes outstanding and the present value of each remaining scheduled quarterly interest payment to be due in full to and including the First Call Date discounted on a quarterly basis at a rate equal to the yield on a comparable maturity US treasury gilt plus 5.383%.

### *Other provisions*

All payments in respect of the Tier 1 Notes will be made without withholding or deduction for taxes of any kind, unless such withholding or deduction is required by law. In such event, New Prudential will pay additional amounts in respect thereof.

The terms and conditions of the Tier 1 Notes will be governed by English law.

### ***Debt Financing***

Prudential has appointed each of Credit Suisse Securities (Europe) Limited and its affiliates, HSBC and its affiliates and J.P. Morgan Securities Ltd. and its affiliates to act as exclusive joint lead managers and joint bookrunners ("Joint Lead Arrangers") in connection with the raising of approximately US\$5.3 billion (net of costs, fees and expenses) (US\$5.5 billion gross) of subordinated debt securities by way of one or more Bond Offerings.

The Joint Lead Arrangers will assist Prudential with the Bond Offerings. The debt securities are expected to be sold in transactions not involving a public offering of securities. The proceeds of the Bond Offerings will be applied as part of the consideration for the Acquisition.

In connection with the Bond Offerings, Prudential has entered into a committed US\$5.4 billion Hybrid Capital Facility pursuant to which the Joint Lead Arrangers have committed to subscribe for up to US\$2.4 billion Lower Tier 2 notes and/or up to US\$3 billion Upper Tier 2 notes and/or provide up to US\$2.4 billion Lower Tier 2 capital loans and/or up to US\$3 billion Upper Tier 2 capital loans. The facility will be available for drawing until the earlier of completion of the Acquisition or 1 March 2011. Drawings will be used towards the purchase of AIA. Notes issued under the Hybrid Capital Facility will be listed and it is expected that they will be issued pursuant to Prudential's MTN Programme. The obligations of the Joint Lead Arrangers to subscribe for notes will be subject to customary conditions precedent (save that market and issuer adverse change conditions are excluded) for the issue of notes under Prudential's MTN Programme. The commitments under the Hybrid Capital Facility in respect of the Lower Tier 2 notes and loans will be mandatorily cancelled by an amount equal to the net proceeds of any notes and loans issued pursuant to the Bond Offerings which qualify on issue as Lower Tier 2 capital and the commitments under the Hybrid Capital Facility in respect of the Upper Tier 2 notes and loans will be mandatorily cancelled by an amount equal to the net proceeds of any notes and loans issued pursuant to the Bond Offerings which qualify on issue as Upper Tier 2 or Tier 1 capital.

Prudential, AIG and AIA Aurora have also entered into the Subordinated Note Commitment Letter, under which, to the extent that the Joint Lead Arrangers are unable to procure subscriptions in full for the Bond Offerings for an aggregate amount equal to US\$5.4 billion by the date on which certain conditions in the Acquisition Agreement have been satisfied or waived (the "Determination Date"), AIA Aurora has agreed to subscribe for Lower Tier 2 capital notes and/or Upper Tier 2 capital notes on completion of the Acquisition in an aggregate amount equal to the

lesser of: (i) US\$1.875 billion; and (ii) the amount required to make the aggregate amount of the Lower Tier 2 capital notes and/or Upper Tier 2 capital notes subscribed for by investors under the Bond Offerings and pursuant to the Subordinated Note Commitment Letter equal to US\$5.4 billion. The effectiveness of the Subordinated Note Commitment Letter is conditional on the consent of the Joint Lead Arrangers being obtained.

If and to the extent that the aggregate of the amount of the Lower Tier 2 capital notes and/or Upper Tier 2 capital notes to be subscribed by AIA Aurora pursuant to the Subordinated Note Commitment Letter and the amount of Lower Tier 2 capital notes and Upper Tier 2 capital notes subscribed for by investors under the Bond Offerings is less than US\$5.4 billion, calculated as at the Determination Date, AIA Aurora will have the option to subscribe for additional subordinated debt securities, such subordinated debt securities to be on the terms set forth in the Subordinated Note Commitment Letter.

Lower Tier 2 capital notes and/or Upper Tier 2 capital notes subscribed for by AIA Aurora under the Subordinated Note Commitment Letter will be listed and such Lower Tier 2 capital notes and/or Upper Tier 2 capital notes will be issued pursuant to Prudential's MTN Programme. The obligations of AIA Aurora to subscribe for subordinated debt securities will be subject to customary conditions precedent (save that market and issuer adverse change conditions are excluded) for the issue of subordinated debt securities under Prudential's MTN Programme.

AIA Aurora is subject to a lock-up in respect of the Lower Tier 2 capital notes and/or Upper Tier 2 capital notes subscribed for under the Subordinated Note Commitment Letter for a period of 12 months from the date of issue of such notes, subject to customary exceptions.

If and to the extent that AIA Aurora is required to subscribe for Lower Tier 2 capital notes and/or Upper Tier 2 capital notes under the Subordinated Note Commitment Letter, such notes shall be subscribed for on completion of the Acquisition, shall form part of the consideration for the Acquisition and the cash consideration which would otherwise be payable on completion of the Acquisition will be reduced by the aggregate nominal value of such notes.

Prudential intends to raise an amount equal to approximately US\$5.3 billion (net of costs, fees and expenses which are expected to be up to US\$200 million) (US\$5.5 billion gross) pursuant to the Bond Offerings, of which up to US\$5.4 billion may be drawn under the Hybrid Capital Facility or by way of subscription under the Subordinated Note Commitment Letter, in order to ensure that it has sufficient regulatory capital. Prudential intends to raise the balance of US\$100 million through its ordinary course capital markets debt issuance programs. In addition, Prudential has entered into a committed bridge facility dated 1 March 2010 between, *inter alia*, Prudential (in its capacity as borrower), Credit Suisse AG, London Branch, HSBC and J.P. Morgan plc (in their capacity as mandated lead arrangers), Credit Suisse, HSBC and JPMorgan Chase Bank, N.A. (in their capacity as original lenders) and HSBC (in its capacity as agent) (the "Bridge Facility"). Prudential will not make any drawings under the Bridge Facility unless circumstances change such that it can do so and remain in compliance with its regulatory capital requirement, which is considered to be unlikely.

Pursuant to the Bridge Facility, the lenders have agreed to provide a US\$5.4 billion senior unsecured facility for the purposes of the Acquisition. The lenders are obliged to provide funds, up to the total committed amount, provided that there are no non-payment events of default, insolvency or insolvency proceedings and provided that Prudential has not breached certain undertakings relating to, *inter alia*, disposals, and Class 1 or Class 2 acquisitions and the negative pledge. In addition, Prudential may not amend, vary, novate, supplement, supersede, waive or terminate any term of the Acquisition Agreement or enter into any agreement with AIG in a way which materially or adversely affects the interests of the lenders. The certain funds period under the Bridge Facility runs from 1 March 2010 to the earlier of (a) 1 March 2011; (b) the date the Acquisition Agreement is terminated; and (c) the completion date of the Acquisition. During this time, Prudential will be able to draw up to US\$5.4 billion of funds under the Bridge Facility to fund a portion of the Acquisition consideration, save that the amount available for drawing will be reduced by the net proceeds of any notes issued pursuant to the Bond Offerings and under the Subordinated Debt Commitment Letter and any drawings under the Hybrid Capital Facility. Once drawn, Prudential has an option to extend the maturity of the Bridge Facility to 1 March 2012. The termination and default provisions of the Bridge Facility are on normal commercial terms.

The annual post-tax financing costs of the borrowings described in this section 3 of Part V of this prospectus is estimated to be approximately £300 million (assuming this financing comprises (i) the issue of US\$3 billion of MCNs and US\$2 billion of Tier 1 Notes to AIA Aurora; and (ii) US\$5.5 billion (gross) of external debt financing which is intended to be raised under the Bond Offerings, comprising of US\$5.5 billion (gross) of upper and lower Tier 2 notes, the cost of which is estimated at market rates prevailing at the date of this prospectus). Only a portion of the principal amount of the MCNs will be classified in the balance sheet as a liability with the residual being treated as a component of equity (see note 7 to the pro forma net asset statement in section A of Part XVI (*Unaudited Pro*

*Forma Financial Information*)). Due to this accounting treatment, the £75 million coupon relating to the MCNs would not be included in the IFRS income statement as an expense and it is not included in the £300 million above. The MCN liability referred to above includes the present value of the future coupon payments and the unwind of the discount for the first year is an interest expense estimated at £4 million. The annual pre-tax financing cost of drawing the whole of the £1 billion available under the Subordinated Debt Financing Facility (which is not expected to be drawn) is estimated to be £110 million (based on the prevailing market rates at the date of this prospectus).

#### **4. Principal terms of the Rights Issue**

The substantial part of the cash financing for the Acquisition will be the net proceeds of the Rights Issue. The Rights Issue will be made on the basis of:

##### **11 Rights Issue Shares at 104 pence each for every 2 Existing Shares**

held by Qualifying Shareholders on the Record Date.

The Rights Issue is expected to raise proceeds of approximately £13,843 million, net of Rights Issue and Transaction-related expenses. The Issue Price for UK Shareholders of 104 pence per Rights Issue Share represents a discount of approximately 80.8% to the Closing Price of 542.5 pence per Prudential Share on 14 May 2010, being the last business day before the announcement of the terms of the Rights Issue and a 39.3% discount to the theoretical ex-rights price based on that Closing Price. The Issue Price per Rights Issue Share for HK Shareholders and Singapore Shareholders is HK\$11.78, which was calculated using the £/HK\$ exchange rate of 11.3277, the noon buying rate on 14 May 2010 (being the last business day prior to the announcement of the terms of the Rights Issue).

The Rights Issue is fully underwritten and the terms of the Underwriting Agreement are summarised in paragraph 16.2 of Part XIX (*Additional Information*).

Holdings of Existing Shares in certificated and uncertificated form will be treated as separate holdings for the purpose of calculating entitlements under the Rights Issue, as will holdings under different designations, in different accounts and on different registers. Entitlements to Rights Issue Shares will be rounded down to the nearest whole number and resulting fractions of Rights Issue Shares will not be allotted to any Qualifying Shareholders, but will instead be aggregated ultimately for the benefit of Prudential and treated in the same way as Rights Issue Shares not taken up.

The Rights Issue Shares will, when issued and fully paid, rank *pari passu* with the Existing Shares, including the rights to receive all dividends or distributions declared with a record date falling after the date of issue of the Rights Issue Shares. Accordingly, the final 2009 dividend will not be paid in respect of any Rights Issue Shares because the record date for that dividend was 9 April 2010.<sup>(34)</sup>

Application will be made to the UKLA and the London Stock Exchange for the Rights Issue Shares to be admitted to the premium segment of the Official List and to trading on the London Stock Exchange's main market for listed securities. Application has been made to the Hong Kong Stock Exchange, and will be made to the SGX-ST, for listing of and permission to deal in the Rights Issue Shares on the Hong Kong Stock Exchange and the Main Board of the SGX-ST, respectively. It is expected that UK Admission will become effective and that dealings in the Rights Issue Shares, nil paid, will commence on the London Stock Exchange at 8.00 a.m. (London time) on Tuesday 8 June 2010 with dealings in the Rights Issue Shares, fully paid, expected to commence at 8.00 a.m. (London time) on Thursday 24 June 2010. It is also expected that HK Admission will become effective and that dealings in the Rights Issue Shares, nil paid, will commence on the Hong Kong Stock Exchange at 9.30 a.m. (Hong Kong time) on Thursday 10 June 2010 with dealings in the Rights Issue Shares, fully paid, expected to commence at 9.30 a.m. (Hong Kong time) on Monday 28 June 2010. Further, it is expected that Singapore Admission will be effective and that dealings in the Rights Issue Shares, nil paid, will commence on the SGX-ST at 9.00 a.m. (Singapore time) on 9 June 2010, with dealings in the Rights Issue Shares, fully paid, expected to commence at 9.00 a.m. (Singapore time) on Monday 28 June 2010.

If a Qualifying Shareholder does not take up the offer of Rights Issue Shares (to the extent permitted), his or her proportionate shareholding will be diluted by approximately 84.6% as a result of the Rights Issue, and by approximately 86.3% as a result of both the Rights Issue, and assuming the Transactions complete, the issue of New Prudential Shares to AIA Aurora as part of the consideration for the Acquisition (assuming (i) the issue of Prudential Shares to shareholders who have elected to receive the scrip dividend alternative for the 2009 final

<sup>(34)</sup> One of the consequences of adjourning the Annual General Meeting is that, in order to pay a dividend of 13.56 pence on 27 May 2010 (as announced on 1 March 2010), that dividend will be paid as a second interim dividend. Accordingly, references in this prospectus to the 2009 final dividend should be read as references to the second interim dividend of the same amount.

dividend, expected to be issued on 27 May 2010; (ii) no options granted under the Prudential Share Schemes are exercised and (iii) no other Prudential Shares or New Prudential Shares issued between the date of this prospectus and completion of the Transactions, and without taking into account any conversion of the MCNs).

Even if a Qualifying Shareholder takes up the offer of Rights Issue Shares in full, his or her proportionate shareholding will be diluted by approximately 10.9% if the Transactions complete because of the issue of New Prudential Shares to AIA Aurora as part of the consideration for the Acquisition (on the basis of the assumptions referred to above).

The Rights Issue is conditional, among other things, upon the passing of the Rights Issue Resolution (which itself is conditional upon the passing of the Scheme Resolutions) and the Underwriting Agreement having become unconditional in all respects (other than the condition relating to UK Admission) and not having been terminated in accordance with its terms prior to UK Admission. The Rights Issue is not conditional on completion of the Acquisition or the Scheme. However, if before UK Admission the Acquisition Agreement has been terminated or the conditions to the Acquisition Agreement cease to be capable of satisfaction and, if capable of waiver, have not been waived, the Rights Issue will not proceed.

If completion of the Acquisition does not occur, which Prudential believes is unlikely, Prudential's current intention is that the net proceeds of the Rights Issue will be invested on a short-term basis while Prudential considers how the net proceeds of the Rights Issue (after deduction of Rights Issue and Transaction related expenses and hedging costs) may be returned to Prudential's shareholders. In considering how any such proceeds might be returned to Prudential's shareholders the Directors will take into account, amongst other things, the tax implications for Prudential's shareholders.

**The latest time and date for acceptance and payment in full under the Rights Issue is expected to be:**

- for UK Shareholders, 11.00 a.m. (London time) on Wednesday 23 June 2010;
- for HK Shareholders, 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010; and
- for Singapore Shareholders, 5.00 p.m. (Singapore time) for acceptances by Singapore Application Forms and 9.30 p.m. (Singapore time) for ATM acceptances, in each case on Thursday 17 June 2010.

Further details of the terms and conditions of the Rights Issue are set out in Part IX (*Terms and Conditions of the Rights Issue*).

## **5. Scheme**

The acquisition of Prudential by New Prudential that, with the Acquisition, results in the combination of the AIA Group and the Prudential Group to form the Enlarged Group will be effected by means of the Scheme between Prudential and the shareholders of Prudential. Under the terms of the Scheme the Prudential Shares will be cancelled and, in consideration for this cancellation, the shareholders of Prudential on the register at the Scheme Record Time will receive:

**for each Prudential Share one New Prudential Share**

For the Scheme to become effective, a special resolution implementing the Scheme must be passed by Prudential shareholders at the General Meeting and the Scheme must be approved at the Court Meeting by a majority in number of the shareholders of Prudential present and voting representing 75% or more in value of all Prudential Shares held by such shareholders.

The Scheme also requires the sanction of the Court, and its timing will depend, amongst other things, on the timing of receipt of regulatory approvals and change of control consents in respect of the Scheme, though the Scheme is not conditional upon the Rights Issue or the Acquisition.

If the Scheme becomes effective, it will be binding on all shareholders of Prudential on the register at the Scheme Record Time irrespective of whether or not they attend or vote in favour of the Scheme at the Court Meeting or in favour of the special resolution to be proposed at the General Meeting.

It is intended that the New Prudential Shares will be admitted to the premium segment of the Official List of the UKLA and to trading on the main market for listed securities of the London Stock Exchange. It is also intended that the New Prudential Shares will be accepted as eligible securities by HKSCC for deposit, clearance and settlement in CCASS and admitted to the Singapore Official List for the listing and quotation of the New Prudential Shares on the Main Board of the SGX-ST.

The prospectus setting out the details of the introduction of the New Prudential Shares to the Official List and to admission to trading on the London Stock Exchange will be published on Prudential's website on Monday 17 May 2010.

## **6. Regulatory approvals**

Certain approvals from anti-trust authorities, insurance regulators and other supervisory authorities in various jurisdictions are required for the Transactions, as a result of both the acquisition of AIA by New Prudential and as a result of the allotment and issue to AIA Aurora of the consideration shares and Mandatory Convertible Notes in New Prudential.

In respect of the acquisition of AIA, anti-trust approval has been granted in Korea and voluntary applications for anti-trust approval have been made in Indonesia and Singapore. In respect of the allotment and issue to AIA Aurora of the consideration shares and Mandatory Convertible Notes in New Prudential, anti-trust approval has been granted in the United States. Discussions are ongoing with regulators and additional approvals may also be required.

As a consequence of the structure of the Transactions a number of regulatory approvals are being sought in a number of jurisdictions. Regulatory approvals are being sought in a number of jurisdictions (including Hong Kong) or have already been received (as is the case in Bermuda and the British Virgin Islands) in respect of the change in control of the AIA Group as a result of the Acquisition. Regulatory approvals are also being sought in a number of jurisdictions (including Malaysia, Hong Kong, the United Kingdom and certain states in the United States) or have already been received (as is the case in Bermuda) in respect of the change in control of the Prudential Group pursuant to the Scheme and as a result of the allotment and issue to AIA Aurora of the consideration shares and Mandatory Convertible Notes in New Prudential. Discussions are ongoing with regulators, including the FSA and the OCI, and additional approvals may also be required.

**PART VI**  
**INFORMATION ABOUT THE ENLARGED GROUP**

**1. Structure of the Enlarged Group**

Following the Scheme and the Acquisition, New Prudential will be the holding company of the Enlarged Group. Both AIA and Prudential will become wholly-owned subsidiaries of New Prudential.

**2. Business Overview**

The Enlarged Group intends to organise its business into the following broad divisions:

- Asia (comprising the Asian life businesses of the Prudential Group and the AIA Group and the Asian asset management business)
- UK (comprising the UK life businesses of the Prudential Group)
- US (comprising Jackson, National Planning Holdings and Curian Capital LLC)
- Asset Management (comprising M&G).

The Enlarged Group will use both the Prudential Group brands and the AIA brands.

On an aggregated basis and without applying adjustments for the Transactions or the Rights Issue<sup>(35)</sup>, the Enlarged Group would have 68% of its embedded value for FY 2009 attributable to the Asian business. For FY 2009, 58% and 61% of the Enlarged Group's pre-tax EEV new business profit<sup>(36)</sup> and pre-tax IFRS operating profit, in each case on an aggregated basis, was attributable to the Asian business.

In recognition of the importance of Asia to the Enlarged Group, Prudential expects to have from 25 May 2010, a dual-primary listing in Hong Kong alongside the listing of its ordinary shares in London and a secondary listing in Singapore. Prudential is not proposing to offer new ordinary shares in connection with the listings in Hong Kong and Singapore other than those being offered under the Rights Issue, as described in this prospectus.

**3. Objectives, strengths and strategies**

The central objective of the Enlarged Group will be to deliver sustainable value to shareholders.

To deliver this objective, the strategy of the Enlarged Group will be to meet, profitably, customers' changing needs for savings, income and protection products in its chosen markets across Asia, the US and the UK. In particular, the Enlarged Group will focus on the objective of allocating capital to the most attractive opportunities and geographical markets, both in terms of return and payback period.

The Transactions bring together two leading insurance companies to create the Enlarged Group with a business that will have a significant focus on the very attractive Asian markets, which are characterised by high GDP growth, high savings rates and very low life premium penetration. The Enlarged Group will have the opportunity to benefit from its significant presence in these growing Asian markets.

It is anticipated that the Enlarged Group will be the leading life insurer in Hong Kong, Singapore, Malaysia, Indonesia, Vietnam, Thailand and the Philippines and the leading foreign life insurance business in India and China, as well as having strong and highly cash generative operations in the US and the UK.

The following table sets forth the market position of the AIA Group and the Prudential Group and the expected market position of the Enlarged Group following the Acquisition in certain Asian insurance markets. The rankings have been measured for 2008 or 2009 as set out for each country in the Rank by Market Share tables in paragraph 8

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(35) As set out in Part XVI of this prospectus.

(36) See Part IV (*Important Notices*) for information regarding the comparability of the EEV metrics as calculated by each of the Prudential Group and AIA Group.

of this Part VI below. Save where otherwise stated the market share percentages of the Enlarged Group have been based on weighted new business premiums in each market for 2009.

Country	AIA Group rank by market share	Prudential Group rank by market share	AIA Group and Prudential Group combined rank by market share <sup>(1)</sup>	New business market share of Prudential Group and AIA Group combined <sup>(2)</sup>
Hong Kong . . . . .	3	2	1	22%
Singapore . . . . .	4	1	1	30%
Malaysia . . . . .	4	1	1	28%
Thailand . . . . .	1	12	1	25%
Indonesia . . . . .	7	1	1	25%
Philippines . . . . .	1	3	1	29% <sup>(c)</sup>
Vietnam . . . . .	5	1	1	41%
China . . . . .	1 <sup>(a)</sup>	4 <sup>(a)</sup>	1 <sup>(a)</sup>	29% <sup>(a)</sup>
India . . . . .	8 <sup>(b)(3)</sup>	1 <sup>(b)</sup>	1 <sup>(b)</sup>	11% <sup>(b)</sup>

*Notes:* (1) Combined rankings are based on (a) Prudential having been ranked as the leading life insurer in Singapore, Malaysia, Indonesia and Vietnam, (b) AIA having been ranked as the leading life insurer in the Philippines and Thailand, (c) ICICI Prudential having been ranked as the leading private life insurer in India and (d) AIA having been ranked as the leading foreign life insurer in China. Combined Hong Kong ranking based on combined market share set out above being greater than the market share of any other company in the Hong Kong life insurance market.

(2) Hong Kong, OCI; Singapore, Watson Wyatt Asian Life insurance market update, September 2009; Malaysia, LIAM, ISM (data for Prudential includes PAMB takaful sales); Thailand, TLAA; Indonesia, AAJI (AIA's second subsidiary in Indonesia (AIA Indonesia) was sold in 2009. The data above reflects only the currently owned subsidiary AIA Financial); The Philippines, Individual company filings used to calculate WFYP and ranking (market share is estimated as there are no consolidated data available for the total market); Vietnam, AVI; China, NIICC; India, IRDA.

(3) As set out in paragraph 6.3 of Part VIII (*Information about the AIA Group*), it is currently intended that the AIA Group's equity interest in AIA India will be disposed of either before or around the time of completion of the Acquisition.

(a) non-domestic insurance company

(b) private insurance company

(c) based on 2008 data.

In integrating the two businesses, the Enlarged Group's core aim will be to maintain the commercial strength of both operations, while bringing together the best in class from both companies. Prudential believes that the Prudential Group's and AIA Group's businesses have highly complementary products and distribution channels across the region, which should put the Enlarged Group in a good position to capitalise on the rapid growth in these markets.

Prudential believes that the Prudential Group and the AIA Group have complementary capabilities, and key growth opportunities for the Enlarged Group will include: improvements in AIA sales force productivity based upon Prudential's agency management capabilities; value enhancement from AIA's current bancassurance relationships by leveraging Prudential's capabilities in Asia with banks such as SCB, ICICI and UOB; managing the AIA product mix in line with Prudential's; and increasing utilisation of customer management and data mining tools.

After completion of the Acquisition, Prudential will continue to seek opportunities to enhance value for shareholders including through disposals, determined by reference to Prudential's stringent criteria of growth, profitability, capital efficiency and strategic benefit. Such disposals may also provide an effective way to accommodate the requirements of regulators (for example, in China where Prudential expects that it may be required to restructure the Enlarged Group's operations).

#### 4. Integration approach and expected financial benefits

##### 4.1 Integration approach

Rob Devey, Chief Executive of Prudential UK and Europe, has been appointed to lead the integration of the Prudential Group and AIA Group. In this capacity, he reports directly to Tidjane Thiam, Group Chief Executive. Barry Stowe will remain Chief Executive Officer of PCA and Mark Wilson Chief Executive Officer of the AIA Group.

In integrating the two businesses, the core aim will be to maintain the commercial strength of both operations. For Prudential, the Acquisition is primarily a growth focused transaction, although cost synergies will also be sought.

Prudential intends that the Enlarged Group will use both the Prudential and AIA Group brands, maintain separate agency forces and strengthen both agency forces by the sharing of best practices.

Prudential plans for the Enlarged Group's shared services in areas such as product development, risk management, branding, marketing and customer services to be integrated to the extent possible and to increase effectiveness in

these areas by leveraging economies of scale. Overlapping activities between the Prudential Group and AIA Group are intended to be merged and service quality to be enhanced by sharing best practices across both groups. Integration plans will be tailored to the circumstances applicable to each country, dependent upon the relative scale of the Prudential Group's and AIA Group's businesses in each market and based on discussions with local regulators and joint venture partners.

*The following discussion contains forward-looking statements based on current expectations and targets which involve material risks and uncertainties. These expectations and targets have been prepared for use in this prospectus, represent the best estimate of the Prudential Group as of the date of this prospectus, and are based on the methodology and assumptions and qualifications described below. Actual results and the timing of certain events may differ significantly from those projected and targeted in these forward-looking statements due to a number of factors, including, but not limited to, the occurrence or non-occurrence of a number of assumptions, the most significant of which are set forth below, as well as the factors set out in Part II (Risk Factors), including, but not limited to, the sections headed "The Enlarged Group may fail to realise the anticipated benefits, including estimated synergies, and may fail to achieve its targets in relation to the Acquisition" and "The integration of the Prudential Group and AIA Group may be more difficult than anticipated", and in the section headed "Forward-looking statements" of Part IV (Important Notices).*

#### **4.2 Revenue synergies<sup>(37)</sup>**

Prudential believes that there is significant potential to improve the value of new business (VNB)<sup>(38)</sup> of the AIA Group from the 2009 level of US\$837 million pre-tax, through growth in the AIA Group's APE (from a combination of anticipated market growth and return of the AIA Group to normalised business levels from the depressed levels experienced in 2009, during which the AIA Group's VNB was severely affected by the AIG Events and the global economic crisis) and revenue synergies.

Assuming that AIA Group underlying APE as a whole will grow at a rate of 15% per annum (from a combination of anticipated market growth and the normalisation of the AIA Group's business levels) and that the revenue synergies described below are achieved, Prudential believes the AIA Group business is capable of targeting a value of new business of US\$1.7 billion post-tax in 2013 from a post-tax value of new business in 2009 of US\$610 million<sup>(39)</sup>.

From the combination of the Prudential Group and AIA Group, Prudential seeks to achieve US\$800 million pre-tax (US\$650 million post-tax) of annualised run-rate new business profit revenue synergies during 2013. The assumed AIA Group underlying APE growth rate of 15% per annum applies to these synergies from the period in which they are expected to be achieved. These revenue synergies are expressed net of estimated revenue dis-synergies of US\$100 million pre-tax new business profit over that period, which may arise from agent attrition, perceived conflicts from the perspective of bancassurance partners and other similar factors. The implementation steps are expected to be phased in over three years and the estimated pre-tax cost of achieving these synergies is up to US\$180 million, including a budget of up to US\$100 million for sales costs, which will be expensed through income over the lifetime of the applicable contracts.

The following major sources of revenue synergies have been identified: managing product mix for margin improvement and a number of distribution benefits, including agency management to enhance productivity and activity, increasing effectiveness of current bancassurance partnerships and increased utilisation of customer management and data mining tools.

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(37) All revenue and cost synergies assume that (i) the Acquisition closes on 1 July 2010; (ii) all regulatory and anti-trust approvals for changes of control will be received in all markets without impediments to combine legal entities or develop shared operational functions (for the avoidance of doubt no assumption is made that any of the restrictions on the utilisation of capital referred to in section 5 of this Part VI (*Information about the Enlarged Group*) are lifted except to the extent the relevant regulator has at the date of this prospectus agreed to lift such restrictions); (iii) no change in the accounting, regulatory or tax environment, including any application of any accounting, regulatory or tax regulations by Prudential, its independent auditors or any relevant regulatory authority in any jurisdiction during the period; and (iv) the planned cost savings or headcount reductions will not be impeded by factors such as government or regulatory intervention, industrial action or other external factors.

(38) The value of new business (VNB) is the embedded value of new insurance contracts written in the year.

(39) In relation to synergies, the tax rate has been derived from the pre and post tax calculation of the AIA Group embedded value. The tax rates used were the tax rates for individual countries. These tax rates have been held constant for all synergy calculations.

## Expected sources of revenue synergies<sup>(40)</sup>

<u>Source of synergies</u>	<u>Estimated approximate pre-tax value of new business synergies (US\$m)</u>
Managing AIA product mix for margin improvement . . . . .	450
Distribution benefits which include: . . . . .	350
Improve agency management to enhance AIA productivity and activity	
Increasing effectiveness of current AIA bancassurance partnerships	
Increased utilisation of customer management and data mining tools	
Total revenue synergies . . . . .	<u>800</u>

These are the sources of revenue synergies identified in Prudential's work to date. It is possible that further opportunities to realise revenue synergies may be identified and realised, for example from further improvements in bancassurance productivity in areas not yet quantified, enhanced capital management, portfolio rationalisation and the combination of the two asset management operations.

The pre-tax new business margins of AIA and Prudential Corporation Asia in 2009 were 40% and 57% respectively. Prudential believes that there is significant opportunity to narrow this margin gap between AIA and Prudential by managing the AIA product mix in line with Prudential's, for example by increasing the level of unit-linked product sales and the number of health and protection riders on those products.

The Enlarged Group will have an agency force in excess of 550,000<sup>(41)</sup>. The Prudential Group's agents demonstrated significantly higher levels of productivity than those of AIA in 2009, with average productivity in 2009 being higher in all markets other than Thailand. Prudential believes that its expertise will enable it to target the activity levels and the productivity of the AIA Group's agents in line with the Prudential Group's through well established proprietary recruitment, training and incentivisation processes.

Furthermore, the Enlarged Group, excluding AIA India, will have access to approximately 26,000 bank branches and Prudential believes that there is an opportunity to apply its expertise in the bancassurance channel to increase the volumes and value of sales through the AIA Group's existing bank relationships.

Finally, Prudential believes that increased utilisation of customer management and data mining tools can be effectively applied to the Enlarged Group's customers and can accelerate initiatives already underway.

### 4.3 Cost synergies<sup>(42)</sup>

From the combination of the Prudential Group and AIA Group, Prudential seeks to achieve US\$370 million of annualised run-rate pre-tax cost synergies during 2013. Of these targeted savings, US\$200 million is planned to be generated by combining the AIA Group head office with the Asia regional head office of Prudential and US\$170 million from combining in-market life business operations.

The implementation steps are expected to be phased in over three years and the estimated pre-tax cost of achieving these savings is US\$380 million.

## Expected sources of cost synergies<sup>(40)</sup>

<u>Source of targeted cost synergies</u>	<u>Estimated approximate pre-tax cost synergies (US\$m)</u>
People costs . . . . .	140
Property . . . . .	30
Investment management . . . . .	15
Third party procurement . . . . .	60
Special projects . . . . .	60
IT . . . . .	30
Other . . . . .	<u>35</u>
Total . . . . .	<u>370</u>

(40) During 2013.

(41) Excludes AIA agency force in India as it is currently intended that the AIA Group's equity interest in AIA India will be disposed of before or around the time of completion of the Acquisition.

(42) All figures in this section reference the financial year 2009 cost base.

#### 4.4 Targets

Taking into account both the targeted revenue and cost synergies, in each case subject to the assumptions and costs noted above<sup>(43)</sup>, Prudential believes that it is capable of achieving:

- IFRS pre-tax operating profit<sup>(44)</sup> in 2013 for the combined Asian business of the Enlarged Group of at least £3,260 million;
- EEV pre-tax new business profit in 2013 for the combined Asian business of the Enlarged Group of at least £2,800 million; and
- the remittance of at least US\$1,000 million per annum from the AIA Group in 2011 and onwards.

#### 5. Regulatory capital (IGD)

Prudential's IGD capital surplus was calculated to be £3.4 billion at 31 December 2009 (before allowing for the 2009 final dividend). Prudential forecasts that as at 1 July 2010 its IGD surplus capital following completion of the Transactions will be £5.2 billion (based on an assumed 1 July 2010 closing date and an exchange rate assumption of £1:US\$1.46 at the time of closing). This forecast takes into account:

- the increase in capital surplus as a result of:
  - the gross proceeds of the proposed Rights Issue of £14.5 billion;
  - the issue to AIA Aurora of New Prudential Shares having a value of approximately £3.8 billion;
  - the issue to AIA Aurora of mandatory convertible notes and perpetual tier one notes with an aggregate principal amount of £3.5 billion;
- US\$5.5 billion (£3.8 billion at the exchange rate stated above) raised pursuant to the Bond Offerings and/or as drawings under the Hybrid Capital Facility and/or issued as notes under the Subordinated Note Commitment Letter;<sup>(45)</sup>
- the reduction in capital surplus as a result of the total estimated cost of the transaction of approximately £25.6 billion, that includes the acquisition price, transaction fees and £500 million of budgeted hedging costs (noting that the actual impact of the hedging arrangements on the acquisition price and the income statement will depend on the evolution of the sterling/dollar exchange rate through to completion of the Acquisition); and
- a net increase in capital surplus of £1.8 billion as a result of including the forecast IGD surplus of the AIA Group entities, changes since 31 December 2009 in net assets of Prudential eligible to be included in capital (including changes resulting from the forecast operating result less dividends paid or expected to be paid to shareholders of Prudential before 30 June 2010) and other adjustments.

Following completion of the Acquisition, certain amounts of surplus capital (that is capital in excess of the minimum that is held to meet local legal regulatory requirements) held by companies in the AIA Group will continue to be subject to restrictions on utilisation of that capital in other parts of the Enlarged Group and therefore will not be eligible to be treated as part of the IGD surplus. Prudential forecasts that (based on an assumed 1 July 2010 closing date) the amount of surplus capital restricted in this way (principally in AIA Co, AIA-B; AIA Singapore and AIA Thailand) will be approximately £1.1 billion (which is not included in the forecast IGD surplus capital of £5.2 billion referred to above).

(43) All the targets assume (i) constant exchange rates, including a £:US\$ exchange rate of £1:US\$1.5224; (ii) no business acquisitions; (iii) no change in the accounting, regulatory or tax environment, including any application of any accounting, regulatory or tax regulations by Prudential, its independent auditors or any relevant regulatory authority in any jurisdiction during the period; (iv) all regulatory and anti-trust approvals for changes of control will be received in all markets without impediments to combine legal entities or develop shared operational functions (for the avoidance of doubt no assumption is made that any of the restrictions on the utilisation of capital referred to in section 5 of this Part VI (*Information about the Enlarged Group*) are lifted except to the extent the relevant regulator has at the date of this prospectus agreed to lift such restrictions); and (v) a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the year ended 31 December 2009, as described in Part XIV (*Historical Financial Information for Prudential Group*).

(44) Based on the Prudential basis of IFRS operating profit based on long-term investment returns and before amortisation of acquired value in-force and one-time costs of achieving synergies and transaction (including hedging) costs.

(45) As described in more detail in Part V (*Information about the Transactions*) paragraph 3 (*Consideration for the Acquisition*) in the sub-paragraph headed "Debt Financing".

## **Sensitivity analysis**

Prudential has estimated the impact of the following stresses on the IGD capital for the Enlarged Group as at 1 July 2010 as follows:

- an instantaneous 20% fall in equity markets would reduce IGD surplus by £0.6 billion;
- a 40% fall in equity markets (comprising an instantaneous 20% fall followed by a further 20% fall over a four week period) would reduce the IGD surplus by £1.3 billion;
- a 150 basis point reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £2.4 billion; and
- credit defaults of ten times the expected level would have an impact of £1.7 billion in excess of the annual reserve release.

In addition the Joint Lead Arrangers have entered into a contingent subordinated debt financing facility to Prudential of up to £1 billion. This facility would only be available to be drawn during the period of twelve months following the completion of the Acquisition, on the occurrence of certain stresses on Prudential's IGD capital. Prudential is entitled to extend the availability of the facility for a further twelve months at its option. If drawn, the facility will provide Prudential with capital resources to enhance its IGD capital at the relevant time. The facility will provide for Lower Tier 2 loans with a term of six years. The amount drawn will replenish the IGD capital to the amount referred to under 'FSA Supervision Arrangements for the Enlarged Group' in Part X of this prospectus. There will be limited conditions to drawing the facility. If drawn, the Joint Lead Arrangers will have the right to exchange the drawings under the facility for Lower Tier 2 notes and/or Upper Tier 2 notes. Drawings under the facility will be used to prepay any amounts outstanding under the Bridge Facility. The commitments under the facility will be mandatorily cancelled, and, subject to FSA approval, any drawings under the facility will be mandatorily prepaid, by an amount equal to the capital benefit arising from (a) any disposals by the Enlarged Group and (b) any capital release from any member of the Enlarged Group, in each case which is counted towards Prudential's IGD capital ratios. The commitments under the facility will also be mandatorily cancelled by an amount equal to the proceeds of any other issuance of regulatory capital by Prudential (except where such issuance is used to refinance or replace any existing regulatory capital instruments). Whilst the facility is in place, Prudential will be subject to restrictions on making acquisitions and on paying dividends which are not consistent with the group dividend policy as described below.

## **6. Dividend Policy**

The Directors intend to focus on delivering a growing dividend for the Enlarged Group, which will be determined after taking into account the Enlarged Group's financial flexibility and the Directors' assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believe that in the medium term a dividend cover of two times post-tax operating earnings is appropriate.

The 2010 interim dividend is expected to reflect the pro forma earnings of the Enlarged Group as if the Acquisition had taken place on 1 January 2010.

Dividends are waived on shares held for employees under certain of the Prudential Share Schemes.

## **7. Capitalisation and indebtedness**

The following table shows the capitalisation of Prudential as at 31 December 2009 and indebtedness of Prudential and AIA on an aggregated basis (excluding amounts in respect of Prudential and AIA life funds) as at 28 February 2010. With the exception of capitalisation balances which are extracted without material adjustment from the historical financial information set out in Part XIV and reported on by KPMG Audit Plc, the balances in Section 7 are extracted without material adjustment from unaudited information contained in underlying financial accounting systems and other management documents.

	<u>£m</u>
<b>Capitalisation of Prudential as at 31 December 2009:</b>	
Share capital (2,532,227,471 ordinary shares of 5p each fully paid) . . . . .	127
Share premium . . . . .	<u>1,843</u>
Total share capital and share premium . . . . .	<u>1,970</u>
<b>Indebtedness as at 28 February 2010:</b>	
1. Prudential's core structural borrowings of shareholder-financed operations (see (a) below) . . . . .	3,496
2. Prudential's operational borrowings attributable to shareholder-financed operations (see (b) below) . . . . .	3,168
3. AIA's borrowings attributable to shareholder-financed operations (see (c) below) . . . . .	<u>413</u>
Total aggregated indebtedness (1) + (2) + (3) (see (d) below) . . . . .	<u>7,077</u>

There has been no material change in the issued share capital and share premium amounts of Prudential since 31 December 2009.

There has been no material change in the aggregated indebtedness of the Prudential Group and the AIA Group attributable to shareholder-financed operations at 14 May 2010 as compared to the £7,077 million recorded at 28 February 2010 as shown in the indebtedness statement above.

**(a) Prudential's core structural borrowings of shareholder-financed operations as at 28 February 2010**

	<u>£m</u>
<b>Parent company</b>	
Subordinated debt:	
<b>Innovative Tier 1:</b>	
US\$1,000m 6.5% Perpetual Subordinated Capital Securities . . . . .	657
US\$250m 6.75% Perpetual Subordinated Capital Securities (note i) . . . . .	164
US\$300m 6.5% Perpetual Subordinated Capital Securities (note i and ii) . . . . .	206
US\$750m 11.75% Perpetual Subordinated Capital Securities . . . . .	<u>483</u>
	1,510
<b>Lower Tier 2:</b>	
€500m 5.75% Subordinated Notes 2021 (note iii) . . . . .	447
€20m Medium-Term Subordinated Notes 2023 (note iv) . . . . .	18
£435m 6.125% Subordinated Notes 2031 . . . . .	428
£400m 11.375% Subordinated Notes 2039 . . . . .	<u>380</u>
	1,273
Senior debt:	
£300m 6.875% Bonds 2023 . . . . .	300
£250m 5.875% Bonds 2029 . . . . .	<u>249</u>
	549
<b>Total parent company</b> . . . . .	3,332
<b>Jackson</b>	
<b>Lower Tier 2:</b>	
US\$250m 8.15% Surplus Notes 2027 (note v) . . . . .	<u>164</u>
<b>Total</b> . . . . .	<u>3,496</u>

**Notes**

- i The US\$250 million 6.75% borrowings and the US\$300 million 6.5% borrowings can be converted, in whole or in part, at Prudential's option and subject to certain conditions, on any interest payment date falling on or after 23 March 2010 and 23 March 2011 respectively, into one or more series of Prudential preference shares.
- ii Interest on the \$300 million 6.5% borrowings was swapped into floating rate payments but, in 2008, was swapped back into fixed rate payments of 6.5% until September 2010.
- iii The €500 million 5.75% borrowings have been swapped into borrowings of £333 million with interest payable at six month £Libor plus 0.962%.
- iv The €20 million borrowings were issued at 20-year Euro Constant Maturity Swap (capped at 6.5%). These have been swapped into borrowings of £14 million with interest payable at three month £Libor plus 1.2%.
- v The Jackson borrowings are unsecured and subordinated to all present and future indebtedness, policy claims and other creditor claims of Jackson.

**(b) Prudential's operational borrowings attributable to shareholder-financed operations as at 28 February 2010**

	<u>£m</u>
Borrowings in respect of short-term fixed income securities programmes:	
Commercial paper . . . . .	2,235
Medium-Term Notes 2010 . . . . .	8
Medium-Term Notes 2013 . . . . .	<u>249</u>
	<u>2,492</u>
Non-recourse borrowings of US operations (note i):	
Investment subsidiaries of Jackson . . . . .	22
Piedmont and CDO funds (note ii) . . . . .	<u>155</u>
	<u>177</u>
Other borrowings:	
Bank loans and overdrafts (note iii) . . . . .	133
Obligations under finance leases . . . . .	3
Other borrowings (note iv) . . . . .	<u>363</u>
	<u>499</u>
<b>Total</b> . . . . .	<b><u>3,168</u></b>

**Notes**

- i 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.
- ii Piedmont is an investment trust investing in certain asset-backed and mortgage-backed securities in the US. These borrowings pertain to debt instruments issued to external parties.
- iii Bank loans and overdrafts include a short-term loan of £130 million in respect of Asian operations.
- iv Other borrowings represents amounts whose repayment to the lender is contingent on future surpluses emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on the contracts, there is no recourse to other assets of the Prudential Group and the liability is not payable to the degree of shortfall.
- v In addition to the operational borrowings shown in the table above, Prudential has issued £200 million Floating Rate Notes 2010, which were wholly subscribed to by a Prudential Group subsidiary. These borrowings are eliminated on consolidation and so have been excluded from the table above.

**(c) AIA's borrowings attributable to shareholder-financed operations as at 28 February 2010**

	<u>US\$m (note i)</u>	<u>£m</u>
Bank loans and overdrafts . . . . .	574	377
Loans from other AIG companies . . . . .	50	33
Other borrowings . . . . .	<u>4</u>	<u>3</u>
<b>Total</b> . . . . .	<b><u>628</u></b>	<b><u>413</u></b>

**Notes**

- i AIA borrowings shown above in US\$ have been translated to pounds sterling at a rate of 1.52.

**(d) Guaranteed and secured borrowings**

Prudential

At 28 February 2010, a total of £543 million of borrowings are secured which includes borrowings with no recourse to assets beyond the investment fund to which they relate or future surpluses on contracts specified in the arrangement. There were no significant guarantees of third party indebtedness at that date.

AIA

Properties with a book value of US\$758 million (£498 million) and cash and cash equivalent of US\$43 million (£28 million) at 28 February 2010 are pledged as security with respect to amounts disclosed as bank loans of US\$496 million and other loans of US\$4 million.

At 28 February 2010, AIA has issued capital guarantees and guarantees of indebtedness of approximately US\$1 million. No borrowings are guaranteed by third parties.

**(e) Guarantees, contingent liabilities and contingent indebtedness**

Prudential

Prudential's outstanding guarantees and contingent liabilities are disclosed in note H14 to the financial information set out in Part XIV of this prospectus. There has been no material adverse change in Prudential's outstanding guarantees and contingent liabilities since 31 December 2009.

Prudential has access to committed credit facilities and committed lending liquidity facilities as described in detail in the paragraph entitled "Shareholder borrowings and financial flexibility" in section 9 of Part XII of this Prospectus. There has been no change in the terms of these facilities as at 28 February 2010.

AIA

AIA Group's contingent liabilities at 30 November 2009 are described in note 42 of the historical financial information of the AIA Group as disclosed in Part XV of this prospectus. These contingent liabilities at 28 February 2010 are as stated in that note with the exception that the value of mortgage loans to which AIA is exposed under the Australian residential mortgage credit agreement has fallen to US\$3,320 million (£2,184 million) and the associated liabilities and related reinsurance assets had fallen to US\$20 million (£13 million); and the accumulation value for minimum guaranteed rates of return has risen to US\$1,279 million (£841 million).

There has been no material adverse change in AIA's contingent liabilities since 28 February 2010.

**(f) Mortgages and charges**

Prudential

As at 28 February 2010, no member of the Prudential Group has any outstanding mortgages or charges on its property, plant and equipment that would have a material impact on the financial position of the Prudential Group.

AIA

Save as disclosed elsewhere in the prospectus as at 28 February 2010 AIA did not have any outstanding mortgages, charges or other similar indebtedness.

**(g) Obligations under sale and repurchase agreements**

Prudential

Obligations under sale and repurchase agreements attributable to shareholder-financed operations as at 28 February 2010 amounted to £676 million.

AIA

Obligations under sale and repurchase agreements as at 28 February 2010 amounted to US\$554 million (£364 million).

**8. Industry overview and competition**

There are other significant participants in each of the financial services markets in which the Enlarged Group operates. Its competitors include both mutual and stock financial companies. In addition, regulatory and other developments in many of the Enlarged Group's markets have blurred traditional financial service industry lines and opened the market to new competitors and increased competition. In some of the Enlarged Group's markets, other companies may have greater financial resources, allowing them to benefit from economies of scale, and may have stronger brands than the Enlarged Group does in that market.

The principal competitive factors affecting the sale of the Enlarged Group's products in its chosen markets are:

- price and yields offered,
- financial strength and ratings,
- commission levels, charges and other expenses,
- range of product lines and product quality,
- brand strength, including reputation and quality of service,

- distribution channels,
- investment management performance and
- historical bonus levels.

An important competitive factor is the ratings the Enlarged Group receives in some of its target markets, most notably in the United States, from recognised rating organisations. The intermediaries with whom the Group works, including financial advisers, tied agents, brokers, wholesalers and financial institutions consider ratings as one factor in determining which provider to purchase financial products from.

As at 31 March 2010:

Prudential's long-term senior debt is rated as A2 (negative outlook) by Moody's, A+ (negative watch) by Standard & Poor's and A+ (negative watch) by Fitch;

Prudential's short-term debt is rated as P-1 by Moody's, A-1 by Standard & Poor's and F1+ (negative watch) by Fitch;

The Prudential Assurance Company Limited long-term fund is rated Aa2 (negative outlook) by Moody's, AA (negative watch) by Standard & Poor's and AA+ (negative watch) by Fitch;

Jackson's financial strength is rated AA (negative watch) by Standard & Poor's and Fitch, A1 (negative outlook) by Moody's, and A+ (under review – negative) by AM Best; and

AIA Co is rated A+ (developing) by Standard & Poor's.

The Enlarged Group has not yet been rated.

The Enlarged Group will offer different products in its different markets in Asia, the UK and the US and, accordingly, will face different competitors and different types of competition in these markets. In all of the markets in which the Enlarged Group will operate its products are not unique and, accordingly, it will face competition from market participants who offer a varying range of similar and identical products.

The information and statistics provided for the Asia Pacific life insurance market in this section include Hong Kong, Korea, Thailand, Singapore, China, Malaysia, the Philippines, Indonesia, Vietnam, Taiwan, India, Australia, and New Zealand but excluding Japan.

For the purpose of this section, data on "life insurance premiums" indicated as derived from *Sigma* reports ("World insurance in 2008: life premiums fall in the industrialised countries-strong growth in the emerging economies" published by Swiss Re) is primarily based on the following metrics from *Sigma* reports: "premium income", "premium volume", "premiums", "life insurance premium" and "life premiums". Market share data based on "life insurance premiums" or "total premiums" is generally based on data published by the industry source indicated.

Described below are some of the key sources and methodologies used in calculating certain information and statistics provided in this section. Please note that the description below is not an exhaustive list of the sources and methodologies used to present the information and statistics set out in this section.

*Sigma* reports present life insurance premium data on a local currency basis converted to US dollars using the average local currency to US dollar exchange rate for the year indicated. The figures are presented on a nominal basis and are not inflation-adjusted. For the purposes of this document, simple and compound average growth rates for life insurance premiums have been calculated using the as-converted US dollar figures published in the *Sigma* reports. Since the data is converted at the average yearly exchange rate for each year and is presented in nominal terms, exchange rate and inflation fluctuations may impact the growth rates described in this document.

*Sigma* reports present GDP data on a local currency basis converted to US dollars using the average local currency to US dollar exchange rate for the year indicated. GDP data from the *Sigma* reports is presented on a nominal basis and are not inflation-adjusted. For the purposes of this document, simple and compound average growth rates for GDP have been calculated using the as-converted US dollar figures published in the *Sigma* reports. Since the data are converted at the average yearly exchange rate for each year and is presented in nominal terms, exchange rate and inflation fluctuations may impact the growth rates described in this document.

The *Sigma* reports referred to above are publicly available and not prepared for the purposes of this document.

This section also includes penetration rate, density rate, savings rate and total population data from the *Sigma* reports. Penetration rate is a market's life insurance premium as a percentage of its GDP. Density rate is a market's life insurance premium per capita. Savings rate is savings as a percentage of disposable income.

Household savings rate data is based on data published in Euromonitor International.

Data on the population above the age of 65 is based on data published in Euromonitor International.

### Life insurance market

The life insurance markets in Asia Pacific, the US and the UK generated US\$1,279 billion of life insurance premiums in 2008. Prudential operates in these three key regions: Asia (in the following 12 countries, China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand, Vietnam), UK and US.

The Asia Pacific life insurance market generated US\$358.3 billion of life insurance premiums in 2008, comprising 14.4% of aggregate global life insurance premiums. Although the Asia Pacific region was affected by the global financial turmoil in 2008, it recorded GDP growth of 15.4%. Life insurance premiums in the Asia Pacific region grew at a CAGR of 17.5% from 2003 to 2008, primarily driven by strong regional economic growth, favourable demographic changes, social welfare reforms, healthcare demand and insurance market reforms. This compared to a GDP CAGR of 17.1% over the same period.

The UK is the world's third largest life insurance market and the largest in Europe, with total premium volume in 2008 of £185 billion (US\$343 billion). Life insurance premiums in the UK grew at a CAGR from 2003 to 2008 of 17.2%. This compared to a GDP CAGR of 8.3% over the same period.

The US life insurance market generated US\$578 billion of life insurance premiums in 2008, comprising approximately 23% of aggregate global life insurance premiums, representing the world's largest life insurance market. Life insurance premiums in the US grew at a CAGR from 2003 to 2008 of 3.8%. This increase compared to a GDP CAGR of 5.4% over the same period.

The following table sets forth certain life insurance premium and macroeconomic data for the Asia Pacific region, Japan, the US and the UK for the periods indicated:

	Life insurance premiums			GDP 2008 (US\$bn)	Penetration rate 2008 (%)	Density rate 2008 (US\$)	Savings rate 2008 (%)
	2008 (US\$bn)	2008 Share of world market in%	CAGR 2003-2008 (%)				
Hong Kong . . . . .	21.3	0.86	16.1	216	9.9	2,930	31.4
Korea <sup>(1)</sup> . . . . .	66.4	2.67	9.6	826	8.0	1,348	18.4
Thailand . . . . .	5.0	0.20	9.0	273	1.8	77	10.9
Singapore . . . . .	11.4	0.46	15.5	182	6.3	2,549	34.3
China . . . . .	95.8	3.85	24.2	4,324	2.2	72	36.5
Malaysia <sup>(1)</sup> . . . . .	6.1	0.25	12.1	219	2.8	226	23.4
Philippines . . . . .	1.4	0.06	15.6	169	0.9	16	7.9
Indonesia . . . . .	4.7	0.19	27.9	514	0.9	20	12.6
Vietnam . . . . .	0.7	0.03	14.8	90	0.7	8	5.7
Taiwan . . . . .	52.7	2.12	17.3	396	13.3	2,288	10.0
India . . . . .	48.9	1.96	29.2	1,218	4.0	41	32.2
Australia . . . . .	42.7	1.71	13.8	968	4.4	2,038	14.8
New Zealand . . . . .	1.1	0.04	0.2	127	0.8	253	(8.8)
Japan . . . . .	367.1	14.74	(0.8)	4,845	7.6	2,870	10.0
US . . . . .	578.2	23.22	3.8	14,265	4.1	1,901	5.8
UK . . . . .	342.8	13.76	17.2	2,677	12.8	5,582	-1.1

Source: Swiss Reinsurance Company Sigma Reports No. 3/2004 and No. 3/2009; Euromonitor International for savings rates

(1) Life insurance industry data is for the 12 months ended 31 March of the year subsequent to the year indicated

## Asia

### Industry overview and trends

#### Strong economic growth

The Asia Pacific region has recently experienced strong economic growth and increases in income per capita. GDP in the Asia Pacific region grew at a CAGR of 17.1% from 2003 to 2008, with GDP growth of 15.4% in 2008. This growth is significantly higher than the growth experienced by UK and US (CAGR of 8.3% and 5.4% from 2003 to 2008, and GDP growth of (3.5%) and 3.0% in 2008, respectively).

The following table sets forth key macroeconomic data for the Asia Pacific region for the periods indicated.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>CAGR 2003-8</u>
GDP (US\$bn) . . . . .	4,325	4,953	6,111	6,861	8,251	9,522	17.1%
Nominal GDP growth (%) . . . . .	17.3	14.5	23.4	12.3	20.3	15.4	
GDP per capita (US\$) . . . . .	1,483	1,677	2,047	2,259	2,660	3,038	

Source: Swiss Reinsurance Company Sigma Reports No. 3/2004, No. 2/2005, No. 5/2006, No. 4/2007, No. 3/2008 and No. 3/2009

#### *High historical life insurance premium growth rates*

Asia Pacific life insurance premiums increased significantly in recent years, growing at a CAGR of 17.5% from 2003 to 2008 (life insurance premiums grew from US\$159.9 billion in 2003 to US\$358.3 billion in 2008). Emerging economies within the Asia Pacific region such as China, India and Indonesia each achieved life insurance premium CAGRs of over 20.0% from 2003 to 2008. Relatively more developed economies within the Asia Pacific region such as Hong Kong, Taiwan and Singapore recorded life insurance premium CAGRs of 16.1%, 17.3% and 15.5%, respectively, during the same period.

#### *Continued low penetration and density rates*

Markets such as China, Thailand, the Philippines, Indonesia, Vietnam and India all have reported density rates under US\$100. Prudential believes that if these economies grow and standards of living improve, the low density and penetration rates in these markets indicate significant growth potential for the Asia Pacific insurance industry.

#### *Favourable demographic changes*

The Asia Pacific region had a population of approximately 3.1 billion people, or approximately 47% of the total world population as of 31 December 2008. The Asia Pacific region has experienced high population growth rates historically, and the region's population is expected to increase by more than 300 million people by 2020. Moreover, from 2003 to 2008, the population in the region above the age of 65 grew at a CAGR of 2.9% (compared to 0.8% and 1.6% for the UK and North America, respectively). In particular, the percentage of the population above the age of 65 in Korea and Singapore has grown significantly from 2003 to 2008, with CAGRs of 4.8% and 5.1%, respectively. The Directors believe that the increasing size of the Asia Pacific region's population and certain ageing trends and demographic mixes within the region is likely to result in increasing demand for insurance products in the future.

The following table sets forth certain demographic data for the Asia Pacific region for the periods indicated:

	<u>Population (mm)</u>		<u>Population aged 65 and above</u>	
	<u>2008</u>	<u>CAGR 2003-2008</u>	<u>% population 2008</u>	<u>CAGR 2003-2008</u>
Asia Pacific. . . . .	3,134.3	1.4%	7.0	2.9%

Source: Euromonitor International for population above the age of 65; Swiss Reinsurance Company Sigma Reports No. 3/2004 and No. 3/2009 for total population

#### *High household savings rates*

Households in China (36.5% in 2008), Hong Kong (31.4% in 2008), Singapore (34.3% in 2008), Korea (18.4% in 2008) and Malaysia (23.4% in 2008) have recorded savings rates above 15% from 2003 to 2008, compared to lower household savings rates in the United States (5.8% in 2008) and the United Kingdom ((1.1%) in 2008). Prudential believes that the high household savings rates in many markets within the Asia Pacific region represent an opportunity for the insurance industry as customers benefiting from these high levels of savings may diversify such savings across a spectrum of financial products, including those offered by insurance companies.

#### *Growing middle class, significant high net worth populations and increasing financial sophistication*

The Asia Pacific region has a growing middle class and a significant high net worth population. In particular, markets such as Hong Kong and Singapore already have an established middle class, and many other markets in the Asia Pacific region have an emerging middle class. In 2008, the region (including Kazakhstan, Myanmar and Sri Lanka) had approximately 1 million high net worth individuals, which represents an aggregate of approximately US\$4.2 trillion in wealth, or approximately 13.0% of total worldwide wealth. In addition, the high net worth population in China is currently the fourth largest in the world after the United States, Japan and Germany.

### *Gaps in health and protection coverage driving growth for health and protection insurance products*

There is a wide spectrum of public and private healthcare schemes across the Asia Pacific region. While many markets have government-provided healthcare, such healthcare is often subject to limitations, including with respect to the extent and quality of coverage. Moreover, individual out-of-pocket costs for healthcare are a significant percentage of healthcare expenditures in the Asia Pacific region, based on data published by the Organization for Economic Co-operation and Development. Even in markets such as Hong Kong and Korea, which provide broad healthcare coverage for residents, individual out-of-pocket healthcare expenditures account for over 30% of total healthcare expenditures, based on data published by the World Health Organization (compared with 15% for Japan and 13% for the US). Individual out-of-pocket costs for healthcare are projected to continue to be a significant percentage of healthcare expenditures in many Asia Pacific markets: by 2014, a projected 66% in Singapore, 60% in Hong Kong, 55% in Malaysia, 54% in China, 45% in Korea and 25% in Thailand. This compares to 55% in the United States, 26% in Europe and 14% in Japan. Per capita health expenditures of retirees in East Asia (as classified by the World Health Organization) are projected to triple by 2015. Many markets in the region have been receptive to private sector solutions that address health and protection coverage gaps and reduce individual out-of-pocket healthcare expenditures.

There is a growing gap in health and protection coverage in the Asia Pacific region and there is growing customer awareness of health and protection needs and insurance products. Prudential believes that these trends present an opportunity in both the group health insurance segment (serving employers who provide health and protection insurance benefits to their employees) and in the individual segment (in particular, to high net worth individuals who seek more comprehensive healthcare coverage).

### *Developing pension markets*

In 2008, the Asia Pacific region accounted for approximately 47% of the world's population but only a small portion of global pension assets. In particular in 2007, China, Korea, India, Hong Kong and Singapore had an aggregate of approximately 38% of the world's population, but only had private pension assets to the value of US\$280 billion, 2.7% of the equivalent value of private pension assets held in the US (US\$10 trillion). In addition, government sponsored pension programmes in developed economies like Singapore and Hong Kong have created an opportunity for the private sector and benefited insurance companies in the region. For example, a significant portion of Singapore's pension assets are held by the Central Provident Fund and insurance products credited for approximately 67% of the Central Provident Fund's pension assets in the first half of 2008. Prudential believes the relatively low percentage of pension assets represent a growth opportunity for the Asia Pacific insurance industry.

### *Shift to multi-channel distribution*

While life insurance companies in the Asia Pacific region have historically focused on traditional agency distribution, many life insurance companies have expanded their distribution network to include other channels such as bancassurance, direct marketing and brokers. In certain markets within the Asia Pacific region, bancassurance has become a significant distribution channel and has enabled life insurance companies to reach a broad customer base, in part as a result of certain markets' extensive banking networks. Prudential believes that there is potential for a shift from traditional agency to multi-channel distribution in many Asia Pacific markets.

### *Country market overview*

#### *Hong Kong*

The Hong Kong life insurance market was the sixth largest in the Asia Pacific region, with approximately US\$21.3 billion in life insurance premiums in 2008. Prudential considers Hong Kong to be a sophisticated and developed insurance market within the Asia Pacific region. The Hong Kong life insurance industry has experienced double digit life insurance premium growth, with a CAGR of approximately 16.1% between 2003 and 2008. The Directors believe this recent premium growth and Hong Kong's recent economic growth (GDP grew at a CAGR of approximately 6.3% from 2003 to 2008), coupled with its penetration rate (9.9% in 2008) and density rate (over US\$2,900 in 2008), suggest a developed life insurance market within the Asia Pacific region with a demonstrated customer demand for insurance products.

The Hong Kong life insurance market had approximately 46 life insurance companies and 19 composite insurance companies as of 30 June 2009. The following table sets forth the top five life insurance companies in Hong Kong by market share of life insurance APE in 2009 based on data published by the OCI:

<u>Company</u>	<u>Rank by Market Share<sup>(1)</sup></u>
HSBC Insurance . . . . .	1
Prudential Group . . . . .	2
AIA Group . . . . .	3
BOC Life . . . . .	4
Hang Seng Insurance . . . . .	5

(1) Market share data excludes retirement scheme-related group business classes G and H, as categorised by the OCI

#### *Thailand*

Thailand's life insurance market was the ninth largest in the Asia Pacific region in 2008, with approximately US\$5.0 billion of life insurance premiums. Life insurance premiums grew at a 9.0% CAGR between 2003 and 2008. The Directors believe the relatively small size of the life insurance market and the relatively low penetration rate (1.8% in 2008) and density rate (approximately US\$77 in 2008) suggest a developing life insurance market within the region with significant growth opportunities.

The following table shows ranking by market share of the top five life insurance companies and the Prudential Group for 2009, ranked by weighted first-year premium, based on data from the Thailand Life Assurance Association:

<u>Company</u>	<u>Rank by Market Share</u>
AIA Group . . . . .	1
Thai Life . . . . .	2
SC New York Life . . . . .	3
Muang Thai . . . . .	4
Bangkok Life . . . . .	5
Prudential Group . . . . .	12

#### *Singapore*

Singapore's life insurance market is the seventh largest in the Asia Pacific region, with approximately US\$11.4 billion of life insurance premiums in 2008. Life insurance premiums grew at a 15.5% CAGR between 2003 and 2008. Prudential believes Singapore is an attractive and developed life insurance market within the Asia Pacific region because of its status as a regional financial centre, its compulsory social security savings scheme (the Central Provident Fund), penetration rate (6.3% in 2008) and density rate (over US\$2,500 in 2008). The Directors believe that the country's small population and significant wealth have created a market that presents unique growth opportunities for insurance companies.

There were approximately 16 life insurance companies in the Singapore life insurance market as of 30 June 2009. The following table sets forth the top five life insurance companies in Singapore by market share of life insurance premiums in the first half of 2009 on a weighted new business basis:

<u>Company</u>	<u>Rank by Market Share</u>
Prudential Group . . . . .	1
NTUC Income . . . . .	2
GE Life . . . . .	3
AIA Group . . . . .	4
ManuLife . . . . .	5

Source: Watson Wyatt Asian Life insurance market update, September 2009.

#### *Malaysia*

With life insurance premiums of approximately US\$6.1 billion in the 12 months ended 31 March 2009, Malaysia's life insurance market is the eighth largest in the Asia Pacific region. Life insurance premiums grew at a CAGR of 12.1% between 31 March 2003 and 31 March 2009. The Directors believe that Malaysia's recent economic growth (GDP grew at a CAGR of approximately 15.8% from 2003 to 2008) and penetration rate (2.8% in the 12 months

ended 31 March 2009) suggest a developing life insurance market within the Asia Pacific region with strong growth opportunities.

There were approximately 16 registered life insurers in Malaysia's life insurance market as of 31 December 2008. The following table sets forth the top five life insurance companies in Malaysia by market share of life insurance premiums on APE basis in 2009 based on data published by the Life Insurance Association of Malaysia and Insurance Services Malaysia:

<u>Company</u>	<u>Rank by Market Share<sup>(1)</sup></u>
Prudential Group . . . . .	1
GE Life . . . . .	2
ING . . . . .	3
AIA Group . . . . .	4
Allianz . . . . .	5

(1) Market share data includes Takaful business

### *India*

India's life insurance market was the tenth largest in the world and fourth largest in the Asia Pacific region in 2008, with approximately US\$48.9 billion of life insurance premiums. Life insurance premiums grew at a 29.2% CAGR between 2003 and 2008. The US\$48.9 billion in premiums written by the Indian life insurance sector in 2008 implied a global market share of 2.0% and 13.6% in an Asian Pacific context. India's exceptionally strong growth in industry premiums, which is the highest in the region, is primarily due to new entrants ramping up their franchise expansion. Prudential believes that India's long-term life insurance market growth prospects remain exceptional in view of the ongoing rapid development of the Indian economy.

There were approximately 23 life insurance companies in the Indian life insurance market as of 31 March 2009. The following table sets forth the top four private life insurance companies in India by market share of weighted first-year premium in 2009 based on data published by the Insurance Regulatory and Development Authority:

<u>Company</u>	<u>Rank by Market Share</u>
ICICI Prudential . . . . .	1
SBI Life . . . . .	2
Bajaj Allianz Life . . . . .	3
Reliance Life . . . . .	4

### *China*

With life insurance premiums of approximately US\$95.8 billion in 2008, the Chinese life insurance market is the largest in the Asia Pacific region and the sixth largest in the world. China's life insurance market has recorded significant growth in recent years, with total premiums increasing at a CAGR of 24.2% between 2003 and 2008. Prudential believes that China's large economy (the third largest in the world in terms of GDP), recent economic growth (GDP grew at a CAGR of approximately 25.1% from 2003 to 2008) and large population (19.8% of the world's total as of 31 December 2008) combined with the life insurance market's recent premium growth and penetration rate (2.2% in 2008), suggest a large life insurance market with significant growth opportunities.

China's life insurance market is currently dominated by five domestic Chinese life insurance companies that collectively held an aggregate market share of almost 79% of life insurance premiums in 2009. Foreign life insurance companies held an aggregate market share of approximately 5% of life insurance premiums in 2009 according to data published by the China Insurance Regulatory Commission. The following table sets forth the top five foreign life insurance companies by market share of weighted first-year premiums in 2009 based on data published by the National Insurance Industry Communication Club of China:

<u>Company</u>	<u>Rank by Market Share</u>
AIA Group . . . . .	1
Aviva COFCO . . . . .	2
Hua Tai . . . . .	3
CITIC-Prudential . . . . .	4
Metlife . . . . .	5

### *Korea*

With approximately US\$66.4 billion in life insurance premiums in the 12 months ended 31 March 2009, the Korean life insurance market is the eighth largest in the world and the second largest in the Asia Pacific region. Life insurance premiums grew at a CAGR of approximately 9.6% between 31 March 2003 and 31 March 2009. Prudential believes that the size of the market, together with its penetration rate (8.0% in the 12 months ended 31 March 2009) and density rate (over US\$1,300 in the 12 months ended 31 March 2009), suggest a developed life insurance market within the region with a demonstrated customer demand for insurance products.

There were approximately 22 life insurance companies in the Korean life insurance market as of 31 December 2008.

### *The Philippines*

With life insurance premiums of approximately US\$1.4 billion in 2008, the Philippines' life insurance market is the eleventh largest in the Asia Pacific region. Life insurance premiums grew at a CAGR of 15.6% from 2003 to 2008. Prudential believes that the market's low penetration rate (0.9% in 2008) and density rate (approximately US\$16 in 2008) suggest a life insurance market in the early stages of development with significant growth opportunities.

The following table sets forth the top five life insurance companies in 2008 in the Philippines for weighted first year premiums:

<u>Company</u>	<u>Rank by Market Share</u>
Philamlife . . . . .	1
Sunlife . . . . .	2
Pru Life . . . . .	3
Insular Life . . . . .	4
AXA . . . . .	5

*Source: These ratings have been derived internally by Prudential from publicly available results released by the companies listed above.*

### *Indonesia*

Indonesia's life insurance market is the tenth largest in the Asia Pacific region, with approximately US\$4.7 billion of life insurance premiums in 2008. Indonesia's life insurance market has recorded significant growth in recent years, with life insurance premiums increasing at a CAGR of 27.9% between 2003 and 2008. Prudential believes that this recent premium growth coupled with the country's large population (fourth largest in the world) and low penetration rate (0.9% in 2008) and density rate (approximately US\$20 in 2008) suggest a developing life insurance market with strong growth opportunities.

The following table sets forth the ranking of the top five life insurance companies in Indonesia and AIA based on weighted first year premiums in 2009 based on data published by the Life Insurance Association of Indonesia:

<u>Company</u>	<u>Rank by Market Share</u>
Prudential Group . . . . .	1
Bumputera 1912 . . . . .	2
Mega Life . . . . .	3
Allianz Life Indonesia . . . . .	4
AXA Group . . . . .	5
AIA . . . . .	7

### *Taiwan*

With approximately US\$52.7 billion of life insurance premiums in 2008, Taiwan's life insurance market is the third largest in the Asia Pacific region and the ninth largest in the world. Life insurance premiums grew at a CAGR of 17.3% from 2003 to 2008. Prudential believes that the market's penetration rate (13.3% in 2008) and density rate (over US\$2,200 in 2008) suggest that it is a developed market within the Asia Pacific region with a demonstrated customer demand for life insurance products.

### *Vietnam*

Vietnam's life insurance market had approximately US\$0.7 billion of life insurance premiums in 2008. Life insurance premiums grew at a CAGR of 14.8% from 2003 to 2008. Prudential believes that the country's growing economy (GDP grew at a CAGR of approximately 18.8% from 2003 to 2008) and a population that is largely

uninsured (0.7% penetration rate in 2008) suggest strong growth opportunities in the life insurance market despite the challenges of distributing insurance products in a market in which only 28% of the population is urbanised.

The following table sets forth the top five life insurance companies in Vietnam based on weighted first year premiums for 2009 based on data published by the Association of Vietnam Insurers:

<u>Company</u>	<u>Rank by Market share</u>
Prudential Group . . . . .	1
Bảo Việt Life . . . . .	2
Manulife . . . . .	3
ACE Life . . . . .	4
AIA Group . . . . .	5

#### *Australia*

Australia's life insurance market is the fifth largest in the Asia Pacific region, with approximately US\$42.7 billion of life insurance premiums in 2008. Life insurance premiums grew at a CAGR of 13.8% from 2003 to 2008. AIA Australia focuses on the life risk insurance segment. This segment, which consists primarily of protection products (as opposed to wealth, investment and superannuation products), had total premiums of approximately US\$6.8 billion in 2008. Prudential believes that the Australian life insurance market is a developed market within the Asia Pacific region supported by a robust economic and regulatory framework, compulsory employer contributions to Australia's superannuation system (a pension system) and favourable tax treatment for individuals purchasing life insurance products through the superannuation system (group insurance).

#### *New Zealand*

New Zealand's life insurance market had approximately US\$1.1 billion of life insurance premiums in 2008. Prudential believes that the market is supported by a relatively developed economic framework and that it has a low penetration rate (0.8% in 2008).

#### **External competition**

The competitive landscape across the Asia Pacific region differs widely by geographical market, reflecting differing levels of market maturity and regulation. Prudential's competitors include both the subsidiaries of global life insurers and local domestic (including state-owned) entities. Subsidiaries of global life insurance groups that operate in the Asia Pacific region tend to operate in multiple markets in the region, and some currently have top five market shares in a small number of markets. The majority of local domestic life insurers in the Asia Pacific region remain focused on their core home markets. The developed and liberalised markets of Hong Kong and Singapore are dominated by subsidiaries and branches of global life insurance groups. The developing markets in South East Asia such as Indonesia, Vietnam and the Philippines also see a high level of participation by global life insurance groups. The large and relatively mature markets of Korea and Taiwan are dominated by local domestic insurers. In certain countries with continued foreign ownership restrictions (such as China and India), the life insurance markets are dominated by local domestic insurers or by joint venture entities between global insurance groups and local companies.

The global life insurers that are Prudential's competitors in the Asia Pacific region include Allianz, Aviva, AXA Asia Pacific, ING and Manulife. Other competitors relevant in one or two of Prudential's key markets include HSBC Life in Hong Kong, Korea Life, Kyobo Life and Samsung Life in Korea, Thai Life in Thailand, Great Eastern in Singapore and Malaysia, and China Life, China Pacific and Ping An in China.

#### **US**

The US experienced relatively strong GDP growth throughout the period, with GDP in 2008 totalling US\$14,265 billion with a CAGR from 2003 to 2008 of 5.4%.

The following table sets forth key macroeconomic data for the US for the periods indicated.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>CAGR 2003-8</u>
GDP (US\$bn) . . . . .	10,988	11,735	12,487	13,247	13,844	14,265	5.4%
Nominal GDP growth (%) . . . . .	4.8	6.8	6.4	6.1	4.5	3.0	
GDP per capita (US\$) . . . . .	37,864	40,133	42,343	44,423	46,009	46,893	

Sources: Swiss Reinsurance Company: Sigma Reports No. 3/2004, No. 2/2005, No. 5/2006, No. 4/2007, No. 3/2008 and No. 3/2009;

Following the recent downturn in 2007, 2008 and the first half of 2009, the US economic growth solidified and broadened in the second half of 2009. However, overall prospects remain uncertain. The US economic recovery is expected to remain sluggish by past standards, as the forces driving it are to a certain extent temporary in nature,

notably the exceptional fiscal stimuli put in place and the additional liquidity provided by the Federal Reserve to support credit markets.

### ***Strong growth prospects***

Despite the uncertain economic situation, Prudential believes that the fundamentals of the US life and retirement market remain strong.

The US retirement market is the largest in the world and is expected to grow significantly over the next 5 to 10 years, underpinned by favourable demographic and socio-economic trends, as 78 million baby boomers (source: US Census Bureau) are expected to reach retirement over the next 20 years and their retirement assets will shift from asset accumulation to the phase of income distribution. There are already US\$2 trillion of assets generating retirement income in the US — and this amount is forecast to rise to some US\$7 trillion by 2029 (source: Tiburon Strategic Advisers, LLC).

The following table sets forth certain life insurance premium and macroeconomic data for the United States for the periods indicated.

	<b>Life insurance premiums</b>		<b>GDP</b>	<b>Penetration rate</b>	<b>Density rate</b>	<b>Savings rate</b>
	<b>2008</b>	<b>CAGR</b>				
	<b>2008</b>	<b>2003-2008</b>	<b>2008</b>	<b>2008</b>	<b>2008</b>	<b>2008</b>
	<b>(US\$bn)</b>	<b>Share of world market in %</b>	<b>(US\$bn)</b>	<b>(%)</b>	<b>(US\$)</b>	<b>(%)</b>
US . . . . .	578.2	23.2	14,265	4.1	1,901	5.8

Sources: Swiss Reinsurance Company: Sigma Reports No. 3/2004 and No. 3/2009 and Euromonitor International for savings rates

Life insurance premiums in the United States increased in recent years, growing at a CAGR of 3.8% from 2003 to 2008 (from US\$481 billion in 2003 to US\$578 billion in 2008). Including group pension 401(k) business, life insurance penetration was 4.1% in 2008.

### ***Market growth underpinned by demographic and socio-economic factors***

The following table sets forth certain demographic data for the United States for the periods indicated.

	<b>Population (mm)</b>		<b>Population aged 65 and above</b>	
	<b>2008</b>	<b>CAGR</b>	<b>% population</b>	<b>CAGR</b>
		<b>2003-2008</b>	<b>2008</b>	<b>2003-2008</b>
US . . . . .	304.2	0.9	12.8	1.6

Sources: Euromonitor International for population above the age of 65; Swiss Reinsurance Company: Sigma Reports No. 3/2004 and No. 3/2009 for total population

Market growth in the US is expected to be driven by the concentration of wealth in the older segments of the population. Life expectancy has been increasing materially over the past decades, while at the same time average retirement ages have fallen significantly. These trends led to a large increase in the average time individuals spend in retirement, and, consequently, have increased the risk that individuals' finances will be insufficient to cover the costs of living in retirement.

### ***Consumer sentiment shifting back to equity-linked products***

The typical retail product offering in the US life insurance market consists of life and annuity products. Annuity products are long-term individual retirement products, which offer tax-deferred accumulation on the funds invested until proceeds are withdrawn from the policy. Annuities include fixed annuities (FA), fixed-index annuities (FIA) and variable annuities (VA).

VA are tax-advantaged, deferred annuities where the rate of return depends upon the performance of the underlying portfolio. They are used for asset accumulation in retirement planning and to provide income in retirement. VA products are typically sold with guaranteed benefit options, which customers can elect and pay for.

There was a consumer shift from VA to FA and FIA products in 2008 and the first half of 2009 but this trend began to reverse in the second half of 2009, and is expected to continue to reverse in 2010 and into the near future as equity market sentiment gradually recovers.

### ***Quality and independent advice key to consumer choice***

US life insurance companies typically market their retail products through independent agents, independent broker-dealer firms, regional broker-dealers, wirehouses and banks, registered investment advisers as well as career agencies.

In the US insurance market, over the past decades, independent distribution channels have significantly outpaced traditional career agents and are expected to continue to grow in the future. In general, independent channels can provide a broader range of products, although they typically sell products from only a handful of firms. While they are not controlled by one firm and insurers tend to lose control over what they sell, independent channels are viewed as more objective by consumers. This channel is less costly to insurers than a career channel due to the lower level of support provided.

### ***Recent economic turmoil caused disruption to annuity market***

The recent economic turmoil has impacted on the competitive environment in the US life and retirement market. Specifically, in the VA market, product supplier concentration has occurred as a result of the recent economic events. What used to be a variable annuity market with around 15 major providers has contracted to a market with currently only about five major providers. The combined VA market share of the top five VA providers increased from 42.9% in full-year 2008 to 49.9% in full-year 2009 (Source: Morningstar Annuity Research Center).

Weaker and financially distressed competitors have been trying to restructure their business models by disposing of assets and books of business as well as downsizing their cost bases.

Over the medium term, the perception of financial strength coupled with access to quality, advice-based distribution and cost-effective technology, will continue to be key drivers of competitiveness in the US retirement market, along with continued innovation in product design and speed to market.

### ***Increasing regulatory scrutiny***

The US market is facing increased regulatory scrutiny, and regulatory actions are expected to lead to increased distribution costs due to the need for advisers to obtain securities licences, and decreasing adviser commissions across the various channels.

### ***Competition***

The Prudential Group's insurance operations in the US operate under the Jackson brand. Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

Jackson's competitors in the United States include major stock and mutual insurance companies, mutual fund organisations, banks and other financial services companies. National banks, in particular, may become more significant competitors in the future for insurers who sell annuities, as a result of recent legislation, court decisions and regulatory actions. Jackson's principal life insurance company competitors in the United States include AXA Financial Inc., Hartford Life Inc., Lincoln National, AIG, ING, MetLife, Prudential Financial and TIAA-CREF.

Jackson does not have a significant career agency sales force to distribute its annuity products in the United States and, consequently, competes for distributors such as banks, broker-dealers and independent agents.

The following table sets forth the top five variable annuities providers in the US by market share in 2009 based on data published by Morningstar (formerly VARDS):

<b><u>Company</u></b>	<b><u>Rank by Market Share</u></b>
Prudential Financial . . . . .	1
MetLife . . . . .	2
TIAA-CREF . . . . .	3
Jackson . . . . .	4
Lincoln . . . . .	5

The following table sets forth the top five fixed annuities providers in the US by market share in 2009 based on data published by the Life Insurance and Market Research Association (“LIMRA”):

<u>Company</u>	<u>Rank by Market Share</u>
NY Life .....	1
AIG .....	2
MetLife .....	3
AEGON .....	4
Pacific Life .....	5
Jackson .....	13

The following table sets forth the top five fixed index annuities providers in the US by market share in 2009 based on data published by AnnuitySpecs.com:

<u>Company</u>	<u>Rank by Market Share</u>
Allianz .....	1
Aviva .....	2
American Equity .....	3
Jackson .....	4
Lincoln .....	5

## UK

The UK life insurance market is characterised by an ageing population with a concentration of wealth in the mass affluent and high net worth sectors. Distribution is currently dominated by intermediaries, though the implementation of the FSA’s Retail Distribution Review may result in some realignment of the distribution landscape. The EU Solvency II Directive, which sets out new principles of insurance regulation, may also have an impact on the insurance industry in Europe.

### *Industry overview and trends*

#### *Significant life insurance market*

The UK life insurance market generated US\$342.8 billion of life insurance premiums in 2008, comprising 13.8% of aggregate global life insurance premiums and making the UK the world’s third largest life insurance market. Life insurance premiums in the UK grew at a CAGR of 17.2% from 2003 to 2008 while penetration increased from 8.9% in 2003 to 12.8% in 2008.

The following table sets forth the key macroeconomic and life insurance market data for the UK for the periods indicated.

	<u>Life insurance premiums</u>			<u>GDP</u>	<u>Penetration rate</u>	<u>Density rate</u>	<u>Savings rate</u>
	<u>2008 (US\$bn)</u>	<u>2008 Share of world market (%)</u>	<u>CAGR 2003–2008 (%)</u>	<u>2008 (US\$bn)</u>	<u>2008 (%)</u>	<u>2008 (US\$)</u>	<u>2008 (%)</u>
UK .....	342.8	13.8	17.2	2,677	12.8	5,582	-1.1

Sources: Swiss Reinsurance Company: Sigma Reports No. 3/2004 and No. 3/2009 and Euromonitor International for savings rate

#### *Ageing population*

Based on Office of National Statistics data on life expectancies and current population sizes, it is projected that there will be a 16% increase in the number of people aged 60 and over by the end of 2018. This demographic trend affects the cost of health care and pensions and there are likely to be growing changes in the concept of work and retirement in the future, with people working longer and phased or partial retirement becoming more commonplace.

Prudential believes that this trend towards an ageing population may result in increased demand for retirement products, notably annuities.

The following table sets forth certain demographic data for the United Kingdom for the periods indicated.

<u>Age Group</u>	<u>2008</u>	<u>2018</u>	<u>Population (mm)</u>		<u>% Change 2008-2018</u>	<u>% Change 2008-2028</u>
			<u>2028</u>	<u>% Change 2008-2018</u>		
0-14 . . . . .	10.8	11.5	11.9	6%	10%	
15-29 . . . . .	12.3	12.3	12.3	0%	0%	
30-44 . . . . .	13.0	12.8	14.2	-2%	9%	
45-59 . . . . .	11.8	13.2	12.2	12%	3%	
60-74 . . . . .	8.8	10.0	11.4	14%	30%	
75+ . . . . .	4.8	5.8	7.9	21%	65%	
All ages . . . . .	61.4	65.6	69.8	7%	14%	

Source: UK Office of National Statistics: National Population Projections 2008-based

**Low savings rates and high levels of consumer debt**

In January 2010, average household debt was £8,939 excluding mortgage debt, and £58,040 including mortgage debt. The following table shows the household savings rates in the UK for the periods indicated.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Household savings ratio (%) . . . . .	3	0.7	1.2	0.9	-1.7	-1.1

The household savings ratio is households’ saving as a percentage of total available households’ resources.

Source: Euromonitor International

**Shift in responsibility for retirement provision towards individuals**

As pension benefits offered by the state and companies become increasingly less generous, responsibility for saving and retirement has shifted towards individuals. The level of the state pension has increased in line with inflation rather than earnings and the age for pension entitlement will increase from 65 to 68 in 2024. Companies have generally replaced defined benefit pension schemes with less generous defined contribution pension schemes, whereby the individual bears investment risk. These developments, coupled with low personal savings rates, have contributed to a significant ‘savings gap’.

**Distribution trends**

Intermediaries remain the dominant distribution channel in the life and pension market, with around 70% of the market currently distributed through this channel. Financial advisers have tended to move upmarket to target the high net worth and mass affluent segments of the market. The FSA’s Retail Distribution Review, which is expected to be fully implemented in 2012, may prompt a realignment of the distribution landscape. It is still too early to predict the full impact of the RDR but it is anticipated that it will result in a shake-up of the advisory sector with many older IFAs, operating in smaller firms and focusing on a transactional ‘sales’ based approach, being forced from the industry by a combination of the loss of commission, the requirement to undertake training and higher capital requirements. Prudential has been preparing for the introduction of RDR for some time and is continuing to work with the regulator, industry bodies and distributors on ways to help advisers make the transition to the new environment.

**Competition**

Prudential’s principal competitors include many of the major stock and mutual retail financial services and fund management companies operating in the United Kingdom. These companies include Aviva, Legal & General, Standard Life, Resolution, Lloyds Banking Group, Aegon, AXA, Zurich Financial Services, Fidelity, Invesco, Jupiter, Threadneedle and Schroders. The Enlarged Group will compete with other providers of financial products to be included on financial advisers’ panels of preferred providers.

In the United Kingdom, the level of bonuses on the Prudential Group’s with-profits products is an important competitive measure for attracting new business through financial advisers. The ability to declare competitive bonuses depends, in part, on a company’s financial strength, which enables it to adopt an investment approach with a higher weighting in equities and real estate and allows it to smooth the fluctuations in investment performance upon which bonuses are based.

## **Asset Management**

The average profit margin in the asset management industry across 32 major markets representing more than 95% of the global asset management market, fell from 38% of net revenues at the end of 2007 to 34% at the end of 2008—the lowest in 4 years. The economic environment has improved in the second half of 2009 and Prudential believes there are grounds for cautious optimism.

### ***UK and European asset management market and trends***

According to McKinsey Asset Management Survey 2009, the Western European asset management market is the second largest in the world, and in 'normal' markets is expected to grow at 4% per annum on average to 2014.

According to The Boston Consulting Group (BCG) Asset Management Survey 2009, the industry is polarised, with growth expected only for:

- passively managed products, including Exchange Traded Funds (ETFs), where it is a game of scale because of the minute (and shrinking) margins;
- active long-only houses that can demonstrate a track record of sustained out-performance in the long term; and
- innovative products, like guaranteed products and hedge funds.

On the other hand, traditional actively managed funds with average performance have the lowest growth prospects over the period 2008-2012 and will be under margin pressure.

In both the UK and Europe, changes are expected in the asset management market. In the UK the Retail Distribution Review is expected to foster transparency of fees leading to an impartial advice model. In Europe, the trend appears to be for banks to open their fund architecture. This presents a major opportunity for managers with well performing funds in the right classes (e.g. M&G) who are able to obtain approval from the fund selectors of the banks. Another key development is the Undertakings for Collective Investments in Transferable Securities ("UCITS") IV regulations. UCITS funds were very robust during the crisis and are becoming the default financial services product, exportable across geographies.

M&G's principal competitors are the main fund management companies operating in the United Kingdom and Europe. These companies include Fidelity, Invesco Perpetual, Jupiter, Threadneedle, Schroders, Legal and General Investment Management, Standard Life Investments and BlackRock.

### ***Asian asset management and market trends***

The total asset management market in Asia ex-Japan is £800 billion with retail accounting for 54% of assets under management and 70% of pre-tax profit at the end of 2008. The retail and high net worth investors markets are expected to grow at 10-20% per year in Asia ex-Japan as a whole, driven by favourable socio-economic trends. Specifically, high economic growth and savings rates coupled with low penetration of mutual funds as a share of household financial assets compared to Europe. Margins in Asia are expected to continue to be higher than the rest of the world.

Across the region, banks currently dominate fund distribution and it is expected that they will continue to remain the largest channel for the foreseeable future. Overall, the market distribution mix in 2010 is expected to remain largely the same as 2009, with banks accounting for the majority of sales in most markets (e.g. 75% in China, 75% in Hong Kong, 56% in Thailand (in 2008), 62% in Singapore, 52% in Japan), brokers keeping a large share in Korea (50%), Japan (46%) and India (40%) and IFAs and other channels strong in Taiwan (58%), India (29%) and to a lesser extent in Singapore (13%).

Asia was traditionally an actively managed funds environment, but over the last 2-3 years ETFs have had strong growth, in excess of 20% per year, and this growth trend may continue.

## PART VII

### INFORMATION ABOUT THE PRUDENTIAL GROUP

Unless otherwise indicated, the financial data set out in this Part VII has been extracted without material adjustment from the historical financial information for the Prudential Group as reported on by KPMG Audit Plc set out in Part XIV of this prospectus or from the Prudential Group's unaudited accounting records, operating systems and other information prepared by Prudential.

#### 1. Overview

The Prudential Group is a large global financial services group, providing retail financial services in the United Kingdom, the United States and Asia. It has been in existence for over 160 years and has £290 billion in assets under management (as at 31 December 2009). Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

The Prudential Group is structured around four main business units: Prudential Corporation Asia, Jackson, Prudential UK insurance operations and M&G. These are supported by central functions which are responsible for Prudential Group strategy, cash and capital management, leadership development and succession, reputation management and other core group functions.

Prudential Corporation Asia's core business is life insurance, health and protection, either attached to a life policy or on a standalone basis, and mutual funds. It also provides selected personal lines property and casualty insurance, group insurance, institutional fund management and consumer finance (Vietnam only). The product range offered is tailored to suit the individual country markets. Insurance products are distributed mainly through an agency salesforce together with selected banks, while the majority of mutual funds are sold through banks and brokers. Joint venture partners are mandatory in some markets: for example, the life insurance operation in China is a 50% equity joint venture with CITIC, in India the Prudential Group has a 26% equity stake in a joint venture with ICICI and in Malaysia its Takaful business is a 70% equity joint venture with Bank Simpanan Nasional. In the fund management business Prudential Group holds a 49% equity stake in a joint venture with ICICI, in China it has a 49% equity stake in a joint venture with CITIC and in Hong Kong it has a 36% equity stake in a joint venture with Bank of China International.

As at 31 December 2009, Prudential Corporation Asia had:

- over 15 million customers in 28 businesses spread across 13 countries;
- distribution relationships with over 75 institutions across Asia including SCB, E-Sun Bank and joint venture partners ICICI in India and CITIC in China;
- one of the largest networks of tied agents, comprising over 410,000 agents; and
- consistently high brand recognition, outperforming many other financial services companies and had received multiple awards for its customer service.

In the United States, the Prudential Group offers a range of products through Jackson, including fixed, fixed index and variable annuities; life insurance; guaranteed investment contracts; and funding agreements. Jackson distributes these products through independent insurance agents; securities broker-dealers; registered investment advisers; a small captive agency channel, consisting of approximately 100 life insurance agents; and banks, credit unions and other financial institutions.

Jackson also offers fee-based separately managed accounts and investment products through Curian Capital, LLC, which is Jackson's registered investment adviser.

As at 31 December 2009, in the United States, Jackson:

- was among the 20 largest life insurance companies in terms of General Account assets<sup>(46)</sup>;
- was ranked 4<sup>th</sup> in total annuity sales in 2009, up from 11<sup>th</sup> in 2008<sup>(47)</sup>;
- was ranked the top insurance company for overall sales support satisfaction in the Financial Research Corporation's Adviser Insight Series on market effectiveness<sup>(48)</sup>;

(46) Source: Statutory financial data per National Underwriter Insurance Data Services from Highline Data, rankings as at 30 September 2009, latest rankings available.

(47) Source: Life Insurance and Market Research Association.

(48) Source: Adviser Insight Marketing Effectiveness, 2009

- was once again rated as a ‘World Class’ service provider for the fifth successive year by Service Quality Measurement Group<sup>(49)</sup>; and
- completed a record sales year with total annual premium equivalent (“APE”) retail sales of £912 million, the highest level in Jackson history.

As at 31 March 2010, Jackson was rated A1 (negative outlook) by Moody’s, AA (negative watch) by Standard & Poor’s and Fitch and A+ (under review - negative) by AM Best.

In the United Kingdom, the Prudential Group offers a range of retail financial products and services, including long-term insurance and asset accumulation and retirement income products (life insurance, pensions and pension annuities), retail investment and unit trust products, and fund management services. The Prudential Group in the United Kingdom primarily distributes these products through financial advisers, partnership agreements with banks and other financial institutions, and direct marketing, by telephone, mail, internet and face-to-face advisers.

As at 31 December 2009, the Prudential Group in the United Kingdom:

- was one of the market leaders in the individual annuity market and the with-profits market<sup>(50)</sup>;
- was awarded two Five-Star awards at the Financial Adviser Service Awards in the Life and Pensions and Investments categories; and
- was named “Best Annuity Provider” at the 2010 Professional Adviser Awards; and
- delivered top-quartile investment performance in 38% of M&G’s retail funds in the three years to December 2009<sup>(51)</sup>.

As at 31 March 2010, the financial strength of PAC was rated Aa2 (negative outlook) by Moody’s, AA (negative watch) by Standard & Poor’s and AA+ (negative watch) by Fitch.

## **2. History and development**

The Prudential Group has been writing life assurance policies in the United Kingdom for over 160 years. It has had one of the largest long-term funds in the United Kingdom for over a century. The Prudential Group expanded its business into British Commonwealth countries, including Singapore and Malaysia in the 1920s and 1930s. In 1986, the Prudential Group acquired Jackson National Life Insurance Company, a US insurance company writing life and fixed annuity business. A group strategy review in the early 1990s identified significant opportunities for the Prudential Group in the Asian life sector and Prudential Corporation Asia was established in 1994 to develop a material and profitable Asian business. In 1999, the Prudential Group acquired M&G, a leading UK fund manager. In June 2000, Prudential completed its listing of ADRs on the New York Stock Exchange.

In March 2010, the Prudential Group contributed significantly to the achievement of its strategic objective to focus on Asian growth when it reached an agreement with AIG, on terms for the combination of the Prudential Group and the AIA Group. The Acquisition will be effected (by way of the Scheme) through the acquisition of both Prudential and AIA by a new company, New Prudential.

## **3. Strengths and strategy**

The Prudential Group aims to deliver growth in shareholder value across three continents and different economies, in different stages of development, focusing on the most profitable opportunities in the pre- and post- retirement sector. The Prudential Group has sought to achieve this by maintaining a strong discipline in relation to profitable new business growth in the long term. As a result, the Prudential Group has delivered a strong performance even during the recent testing market conditions.

The Prudential Group’s principal strengths include:

- financial strength;
- proven operational expertise and excellence, in distinct economies, across the world;
- prudent management of capital resources;
- investment and risk management skills;
- geographic spread;
- the Prudential Group’s brands;

(49) Source: Service Quality Measurement Group

(50) Source: Association of British Insurers (“ABI”)

(51) Source: Morningstar

- product innovation; and
- distribution expertise.

The Prudential Group's strategy is to profitably meet its customers' changing needs for savings, income and protection in its chosen markets. By maintaining focus and discipline in the implementation of this strategy, and by allocating capital to the most attractive opportunities, the Prudential Group believes it is able to generate sustainable and differentiated value for shareholders.

Through the Prudential Group's international, selective and disciplined approach, it seeks to maintain a diverse portfolio of businesses, which embrace countries at different stages of development, but which share one key attribute: the opportunity for the Prudential Group to build a market-leading operation with prospects for sustainable, long-term, profitable growth and a superior rate of return on capital. The Prudential Group's financial strength is fundamental to its strategy and it has combined a disciplined approach to risk management with targeted group-wide actions to grow and protect its capital.

A key part of the Prudential Group's growth strategy and differentiation from its competitors is its presence in Asia, which includes 28 businesses that are spread over 13 countries. Its approach to Asia is intended to be highly sophisticated and discriminating in terms of product offering, distribution and branding.

Asia is complex and its economies differ significantly, with varying levels of economic development, from the OECD members, the significant potential of India and China, the dynamic city states of Singapore and Hong Kong, to the fast-growing markets of South East Asia such as Indonesia, Vietnam and Malaysia.

In the US, which remains the world's largest retirement market, the Prudential Group aims to continue to focus on building its share of the expanding and cash-generative annuities market. The Prudential Group aims to build on its progress in the US by maintaining focus on value over volume, with a particular emphasis on variable annuity products, continuing to target the most profitable business. It will also look to diversify earnings growth and capitalise on its scaleable platform by making bolt-on acquisitions of closed books, when suitable opportunities emerge.

In the UK, the strategy remains to focus rigorously on balancing new business with cash and capital preservation, with the aim of generating surplus capital for investment group-wide that delivers significantly higher returns than in the UK. The UK business continues to use its strong brand heritage and customer franchise and provides a good foundation for the group-wide strategy.

The strategy for the asset management businesses in the UK and Asia is to continue to capitalise on their strong investment track record and trusted brands. Asset management is a core competence of the Prudential Group and is a key component of its strategy, providing a reliable source of cash and high quality profits.

## **4. Prudential Group's business today**

### **4.1 Asian business — life insurance**

#### *Market Overview*

Asia has attractive growth opportunities due to its current high levels of economic activity in the Prudential Group's target markets that are translating into higher levels of personal wealth, greater disposable incomes, higher savings rates and a growing appetite for good quality protection and savings products. Traditionally, older people have relied on their children to provide for them, but within just one generation this is expected to be far less common. Demographic shifts towards an increasingly ageing population are also beginning to drive increased household savings rates and an increasing need for healthcare and retirement solutions.

Asian governments are actively encouraging the development of a strong, dynamic private sector to meet people's growing need for financial solutions.

Consequently, Asia's life insurance markets can appear very attractive to US and European insurers. However, there are some formidable barriers to successful entry, including entrenched incumbents, unfamiliar regulations, language and cultural differences, mandatory domestic partners in some markets and a shortage of experienced staff.

#### *Introduction*

The Prudential Group's current strategy in Asia is to leverage its platform to generate further shareholder value by continuing to increase the scale of its operations. This is reflected in the following strategic commitments: further increasing agency scale and productivity, continuing to build distribution through partnerships, an increased focus

on health and protection and retirement products, further developing direct marketing channels and up-sell and cross-selling capabilities.

The Prudential Group was an early mover in recognising the long-term growth potential in the Asian insurance industry. From the presence it established in Asia in the 1920s, it has created a business in the region that holds market-leading positions in the world's most populous and dynamic economies. Prudential is one of the leading foreign companies or joint ventures in seven of its 12 life markets.<sup>(52)</sup>

The Prudential Group's operations in Asia are unified under the 'Prudence' face icon. This icon has a consistently high recognition rate, outperforming other financial service companies in the region. The Prudential Group operates distinct life insurance businesses in 12 markets. These are all managed by local teams, with strategic leadership and technical support provided by the regional team (based in Hong Kong). Opportunities are taken to leverage synergies and best practices around the region, and from the wider Prudential Group, particularly in areas such as product development, distribution channel management and asset liability practices. The Asian businesses operate with common principles and within a regionally managed risk framework. The Prudential Group consistently wins industry awards for the quality of its operations in Asia, including its customer service.

Underpinning the Prudential Group's success in the region is the breadth and depth of its management teams and staff. These comprise a combination of market-leading international specialists and the best local talent.

Although externally the highest profile measure of success is new business volumes and how this translates into market share, the Prudential Group's internal focus is on EEV new business profit, as opposed to these volume measures. The Prudential Group's business in Asia maintains strict financial discipline to ensure that there is always a strong correlation between business volumes and the value generated, as reflected in the shareholders' embedded value metrics. As the scale of the Prudential Group's business in Asia continues to increase, as evidenced by the increase in embedded value before acquired goodwill from £5.3 billion at 31 December 2008 to £5.8 billion at 31 December 2009, there is a greater focus on demonstrating the emergence of this value in terms of distributable IFRS profits and cash.

Given the current economic climate, a thorough review has been undertaken of all the operations' solvency positions from the local regulatory and the IGD perspectives. Optimising capital efficiency from the Prudential Group's perspective has always been a priority, and with the recent market turbulence across the world, the Prudential Group continued to pay particular attention to this during 2009.

#### *Disposal of PCA Life Taiwan's agency business*

When the Prudential Group entered the Taiwanese market in 1999, traditional "compulsory dividend" life policies were the only type of savings and protection policy permitted by the regulator. These policies are unique to Taiwan and have claims, guaranteed surrender values and local statutory reserves calculated on a prescribed actuarial basis, which includes an underlying interest rate assumption based on two-year interest rates at the time the policy is sold.

The Prudential Group's acquisition of Chinfon Life in 1999 included a back book with interest rate assumptions at around 6.5% and expected liability duration of 30 to 40 years. Since then interest rates in Taiwan have declined and stood at just 1.4% at 31 December 2008. Under the local solvency rules, the related provisions can be offset by profits generated from new business, which was an important consideration in introducing a unit-linked business in 2002. The net cash strain the Prudential Group experienced from this back book was running at the rate of around £50 million per annum.

However, the Prudential Group is domiciled in the EU and therefore is subject to the requirements of the EU's Insurance Groups Directive ("IGD") when assessing solvency. The Prudential Group saw an opportunity to materially improve its capital position by releasing the economic capital supporting the Taiwan back book. Therefore on 20 February 2009, the Prudential Group announced that it had agreed to transfer the assets and liabilities derived from its agency distribution channel, including the back book, to China Life Insurance Ltd (Taiwan). The disposal which was completed on 19 June 2009 led to a one-off negative IFRS shareholders' funds impact of approximately £600 million after restructuring costs but increased the Prudential Group's IGD solvency position by approximately £800 million.

The Prudential Group remains an active and committed player in the Taiwanese life insurance market through its successful bancassurance, direct marketing and other non-agency distribution channels. Bank and direct sales in Taiwan, measured on an APE basis, grew by 84% in 2009 to £107 million.

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(52) Market share rankings are shown in section 8 of Part VI of this prospectus.

## *Distribution*

Agency is the primary distribution channel in most Asian markets and for the Prudential Group the agency force generated 63% of new business volumes in 2009. Success in agency distribution requires building and maintaining meaningful scale in terms of agent numbers together with managing agent training and sales practices that drive agency productivity.

As at the end of 2009, the Prudential Group had approximately 410,000 agents, only marginally below the 413,000 number for 2008 (excluding Taiwan). Throughout 2009 agent activity remained at 2008 levels, a testament to how this distribution channel has been managed amid a challenging environment, in which the Prudential Group continued to focus on maintaining a professional and productive agency force with the discipline to terminate agents not meeting specific performance criteria.

Average premiums per policy in 2009 declined from 2008 levels as the proportion of sales derived from health and protection products increased (while these products have high new business margins, they tend to have lower average premiums). More recently the trend for average premiums per case reflects a return to 2008's pre-crisis levels.

The Prudential Group complements its agency distribution in the region with a number of distribution agreements with leading banks and brokers. The strategy for bank distribution, which accounted for 24% of APE sales in 2009, does not rely on a single approach, with bank staff (relationship managers) selling insurance products as well as deploying a trained and specialised sales force within the bank branches. These Financial Service Consultants ("FSCs") are managed to quality and productivity standards, and they are rewarded for results. During 2009, sales from FSCs accounted for 60% of the region's new business from the bank channel. Overall, the bank channel grew 13% in 2009.

During 2008 and in early 2009 the Prudential Group expanded and extended its bank distribution agreement with SCB. The Prudential Group now works with SCB in nine markets.

On 6 January 2010, the Prudential Group announced an agreement to acquire UOB Life Assurance Limited in Singapore. The total consideration was SGD428 million (approximately £192 million). As part of this transaction the Prudential Group also entered into a long-term strategic partnership to develop a major regional bancassurance business with UOB. Through this partnership, the Prudential Group's life insurance products are now being distributed through UOB Group's bank branches across Singapore, Indonesia and Thailand.

On 15 January 2010 the Prudential Group's Japanese insurance subsidiary announced the suspension of the underwriting of new policyholder contracts post 15 February 2010. This decision will be reviewed on an ongoing basis in the light of changes to the business environment. The Prudential Group reinforced its commitment to honouring all existing policyholder contracts and providing policyholders with an appropriate level of customer service. Measures have been taken to ensure there is adequate staff and supporting infrastructure for customer servicing, taking into account that the company closed its proprietary distribution channel in 2006 and since then has been working with third party distributors only.

This suspension does not affect the Prudential Group's asset management business in Japan, which is a separate entity from the insurance business with its own operating platform and distribution networks. The Prudential Group does not expect any significant impact on its asset management business.

## *Products*

The life insurance products offered by Prudential Corporation Asia include a range of with-profits (participating) and non-participating term, whole life endowment and unit-linked policies. The Prudential Group also offers health, disablement, critical illness and accident cover to supplement its core life products. The Prudential Group's business in Asia has a high proportion of regular premium mode products that provide both savings and protection benefits. In 2009, the new business profit mix was 56% health and protection products, 31% unit-linked and 13% non-linked products. At the end of 2009 Prudential Corporation Asia offered health and protection products in all of its markets and unit-linked products in 11 of the 12 countries, the exception being Thailand as the regulation permitting unit-linked products only came into place in 2009.

Unit-linked products combine savings with protection, with the cash value of the policy depending on the value of the underlying unitised funds. Participating products provide savings with protection where the basic sum assured can be enhanced by a profit share (or bonus) from the underlying fund as determined at the discretion of the insurer. Non-participating products offer savings with protection where the benefits are guaranteed or determined by a set of defined market-related parameters. Health and protection products provide mortality or morbidity benefits and include health, disablement, critical illness and accident covers. Health and protection products are commonly offered as supplements to main life policies but can also be sold separately.

The profits from participating policies are shared between the policyholder and insurer (typically in a 90:10 ratio) in the same way as with-profits business in the United Kingdom as detailed under the heading “with-profits products” in section 4.4 below. Under unit-linked products the profits that arise from managing the policy, its investments and the insurance risk accrue entirely to shareholders, with investment gains accruing to the policyholder within the underlying unitised fund. The profits from health and protection and non-participating products consist of any surplus remaining after paying policy benefits.

The Prudential Group has implemented a structured and disciplined approach to expanding its health and protection portfolio with the local businesses supported by a regional team with sales management, product development, underwriting, claims, operations and business development expertise. Underwriting processes have been re-engineered to improve customer service and claims turnaround has been enhanced while quotation systems have been upgraded to inform agents of the availability of appropriate health riders e.g. augmenting a core life policy with critical illness cover.

Critical factors in the Prudential Group’s success in health and protection include integrating the product initiatives with the distribution channels and tailoring sales support activities to the sales force. For example, health products have been incorporated into agency incentive programmes and a standalone healthcare product was launched into the SCB channel with simplified underwriting and compelling media campaigns to capture direct business and provide leads for other channels.

In Malaysia and Indonesia, the Prudential Group also offers life insurance policies that are constructed to comply with Islamic principles, known as Takaful. The main principles are that policyholders co-operate among themselves for the common good, uncertainty is eliminated in respect of subscription and compensation and there is no investment in prohibited areas such as gambling or alcohol.

Asia’s growing and increasingly urban middle class population face a growing need for financial advice and products to help people save for retirement, secure an income during retirement and protect their financial well-being throughout life. The Prudential Group has already taken a lead in raising the awareness of the need for retirement financial planning through the ‘What’s Your Number?’ campaigns, and the retirement planning message continues to be reinforced through fully integrated marketing and promotional materials and refreshed product ranges.

#### *New business premiums*

In 2009, total sales of insurance products were £2,019 million, down 17% from 2008 (£2,422 million excluding Taiwan agency). Of this amount, regular premium insurance sales increased 9% to £1,177 million and single premium insurance sales decreased 37% to £842 million.

The following table shows the Prudential Group’s Asian life insurance new business premiums by territory for the periods indicated. In this table, “Other Countries” includes Thailand, the Philippines and Vietnam.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Singapore . . . . .	660	419	395
Hong Kong . . . . .	618	661	326
Malaysia . . . . .	119	127	203
Taiwan (excluding Taiwan agency) . . . . .	31	91	201
Japan . . . . .	144	145	103
Korea . . . . .	420	289	156
China (the Prudential Group’s 50% interest in joint venture with CITIC) . . . . .	69	95	110
Indonesia . . . . .	227	261	227
India (the Prudential Group’s 26% interest in joint venture with ICICI) . . . . .	203	262	210
Other countries . . . . .	<u>91</u>	<u>72</u>	<u>88</u>
Total	<u>2,582</u>	<u>2,422</u>	<u>2,019</u>

## **4.2 Asian business — asset management**

The Prudential Group’s Asian asset management business manages funds for the Prudential Group’s Asian and UK Life businesses. It further supports the Asian Life business with the design of funds for investment-linked products.

In addition, the Prudential Group’s Asian asset management business runs a sizeable third-party client business which accounts for 46% of its funds under management as at 31 December 2009. Today it has retail operations in ten markets. During 2009 in China, CITIC-Prudential was awarded the Qualified Domestic Institutional Investors

("QDII") licence, and in Malaysia, Asia Asset Management launched Prudential Al-Wara as its new Islamic fund management subsidiary.

The mutual fund industry continues to diversify its investments, with expectations being for a significant increase in net flows over the coming years. Bank distribution continues to dominate in most markets in Asia, with the Prudential Group having established strong relationships with both regional and local banks and placing significant emphasis on providing good service. The Prudential Group's Asian asset management business is also growing its third party institutional and pension fund management business.

#### *Distribution*

In order to capitalise on the exciting and sizeable opportunities in Asia's retail financial services market, the Prudential Group's Asian asset management business maintained its focus on building a strong third-party customer retail franchise. The customer proposition is driven by the Prudential Group's strong investment capabilities, which enable it to develop innovative product suites, and distribute them through diverse channels including regional banks, local banks, private banks, and securities houses and an internal sales force. The Prudential Group's Asian asset management business has become one of the largest and most successful domestic asset management companies in the region, as demonstrated by the fact that the Prudential Group occupies a number of top ten market share positions in the markets in which it operates and the fact that a significant proportion of its funds are either in the top-two quartiles or outperformed their benchmarks as of January 2010.

During 2009, the Prudential Group's Asian asset management business continued to build its retail distribution network across Asia. For example, in Japan, the business has successfully established distribution relationships with mega distributors.

#### *Products*

The Prudential Group's Asian asset management business offers mutual fund investment products in India, Taiwan, Japan, Singapore, Malaysia, Hong Kong, Korea, Vietnam, China and United Arab Emirates, allowing customers to participate in debt, equity, money market and alternative asset investments.

Fund innovation is essential for stimulating sales and gaining 'shelf space' with distributors. During 2009 fund launches were curtailed reflecting the difficult market conditions; nevertheless, there were some notable successes: in Dubai, the Prudential Group successfully raised £300 million (US\$469 million) from a Qatar Fixed Maturity Plan Series; £220 million (US\$345 million) was raised from an equity fund in China; £109 million (US\$170 million) from a target return fund in India; and a new Brazil Fund, launched in Taiwan, raised £94 million (US\$147 million).

The Prudential Group's Asian asset management business levies transaction charges (initial and surrender depending on the type of fund and the length of the investment) and also a service charge based on assets under management. The charges vary by country and fund, with money market style funds generally having the lowest charges and equity funds the highest.

#### *Net flows and funds under management*

The Prudential Group's Asian asset management business's total funds under management ("FUM") as at 31 December 2009 were £42.4 billion. This included £4.2 billion of assets from the Prudential Group, £18.7 billion from Prudential Corporation Asia's life funds, and £19.5 billion from third-party customers. Compared to 2008, the overall FUM increased by 22% (excluding the FUM related to the sold Taiwan agency business).

Third party net inflows were £2 billion in 2009, driven principally by money market funds in India, with strong net equity inflows in Japan and the United Arab Emirates being offset by net outflows of equity funds in Korea and fixed income funds in India.

### **4.3 US business**

The Prudential Group conducts its US insurance operations through Jackson and its subsidiaries, including Curian Capital, LLC, a registered investment adviser. The US operations also include PPM America, the Prudential Group's US internal and institutional fund manager, and the Prudential Group's US broker-dealer operations (National Planning Corporation, SII Investments, Inc., INVEST Financial Corporation and Investment Centers of America, Inc.). At 31 December 2009, the Prudential Group's US operations had more than 2.8 million policies and contracts in effect and PPM America managed approximately £47 billion of assets. In 2009, new business premiums totalled a record £8,909 million.

### *US market overview*

The United States is the world's largest retirement savings market, and is continuing to grow rapidly. As 78 million baby boomers<sup>(53)</sup> reach retirement age, their retirement assets will be expected to shift from asset accumulation to income distribution. There are already US\$2 trillion of assets generating retirement income in the US — and this amount is forecast to rise to approximately US\$7 trillion by 2029<sup>(54)</sup>.

During 2009, the US financial services industry continued to face an array of challenges. After the S&P 500 index fell to a 12-year low in March, it rebounded and ended the year up 23.5% (compared to a 38.5% decline in 2008). Governmental interest rates increased but remained at historic lows, and rating agencies downgraded the financial strength ratings of many of the largest US insurance companies.

Further uncertainty arose early in 2009 as several companies scaled back their product offerings due to capital constraints which, combined with the financial strength downgrades, caused consumers to question the long-term financial stability of product providers. At the same time, tightening credit spreads and the rally in equity markets throughout the last nine months of 2009 created more favourable market conditions for the sale of variable annuities. These developments in the annuity market provided a competitive advantage to companies with strong financial strength ratings and a relatively consistent product set.

Prudential's US business, Jackson, benefited from this activity in the US annuity market, as customers are increasingly seeking product providers that offer consistency, stability and financial strength. Jackson's strategy continues to target increasing volumes in variable annuities in line with the goal of capital preservation. As Jackson focused on optimising the balance between new business profits and capital consumption, no institutional sales were made during the full year of 2009.

### *Jackson National Life Insurance Company*

Jackson is a leading provider of retirement income and savings solutions in the mass and mass-affluent segments of the US market, primarily to those planning for retirement or in retirement already. It offers tools that help people plan for their retirement, and offers products with specialised features and guarantees to meet customers' needs. By seeking to add value to both the representatives who sell Jackson products, and to their customers, Jackson has built a strong position in the US retirement savings and income market with a more than nine-fold increase in variable annuity sales from 2001 to 2009. Over the same period, Jackson improved its market share from 2.3% in 2001 to 5.9% in 2009 and moved from 17th in total annuity sales to 4th<sup>(55)</sup>.

The success in the marketplace of Jackson continues to be driven by its industry-leading distribution organisation and product innovation, coupled with its sound evaluation of product economics. The Prudential Group's long-term goals for Jackson include the continued and profitable expansion of its share of the US annuities and retail asset management markets, which it plans to achieve by building on its strong position in the advice-based distribution channels. Ongoing profitable growth in Jackson's share of the US annuities market largely depends on the continued enhancement and expansion of its existing product offering, increased penetration of existing distribution channels and entry into new distribution channels, as well as opportunistic inorganic growth.

Jackson markets its retail products primarily through advice-based distribution channels, including independent agents, independent broker dealer firms, regional broker dealers, banks and registered investment advisers. Jackson also markets life insurance and fixed annuity products through its captive insurance agency, which is concentrated in the south eastern United States.

The annuity industry is consolidating to the strongest players, and this consolidation has contributed to a substantial increase in Jackson's distribution relationships. Jackson experienced a large influx of new advisers in 2009, increasing its licensed agent and registered representative count by more than 30,000 to 117,453, which has driven significant increases in market share for Jackson, particularly in variable annuities. Jackson signed a distribution agreement with Merrill Lynch, which began selling Jackson products in late 2009.

Many baby boomers are increasingly seeking advice to help them recover the losses suffered during the crisis. With strong growth in its distribution relationships in advice-based channels, Jackson is well positioned to benefit from this trend.

Innovation in product design and speed to market continue to be key drivers of Jackson's competitiveness in the variable annuity market. High-quality and cost-effective technology has allowed Jackson to offer a comprehensive product portfolio that can be customised to meet the needs of individual customers. Jackson offers products on an unbundled basis, enabling customers to select those benefits that meet their unique financial requirements and to pay only for those benefits they desire. In the Prudential Group's view, leveraging this advantage is a more

(53) Source: US Census Bureau

(54) Source: Tiburon Strategic Advisers, LLC

(55) Source: Life Insurance and Market Research Association

sustainable long-term strategy than competing on price: Jackson will not sacrifice product economics for a short-term increase in market share.

During 2009, Jackson maintained its track record of continued product innovation by enhancing its variable annuity product line through offering a bonus variable annuity and six new portfolio investment options. Jackson also continued to modify its Guaranteed Minimum Withdrawal Benefits (“GMWB”).

The significant increase in new business in 2009, following the difficult market conditions in 2008, resulted in higher call volumes to Jackson’s service centres. Despite this increased workload, Jackson continued to demonstrate the ability to service investors’ and advisers’ needs accurately and efficiently, earning a World Class certification for its Michigan call centre in the Service Quality Measurement Group’s (“SQM”) latest benchmarking study of North American service centres. Historically, this World Class designation is earned by only 5% of service centres. Furthermore, 2009 marked the fifth year that Jackson has achieved a World Class designation for customer service. Jackson also earned SQM’s ‘Highest Customer Satisfaction by Industry’ award for having the highest rate of customer satisfaction in the financial services industry. During 2009, Jackson created a series of educational presentations and materials designed to address the concerns that advisers were facing in such a challenging economic environment. In Financial Research Corporation’s 2009 Advisor Insight study, Jackson ranked number one in overall adviser satisfaction with marketing effectiveness.

National Planning Holdings (“NPH”) is Jackson’s affiliated independent broker-dealer network. The business is comprised of four broker-dealer firms, including National Planning Corporation, SII Investments, Inc., INVEST Financial Corporation and Investment Centers of America, Inc. The US broker-dealer business continued to grow in 2009 through strong recruiting efforts. By utilising its high-quality, state-of-the-art technology, NPH’s advisers receive the tools they need to operate their practices more efficiently. At the same time, through its relationship with NPH, Jackson continues to benefit from an important retail distribution outlet, in addition to receiving valuable insight into the needs of financial advisers and their clients.

Curian Capital LLC (“Curian”), Jackson’s registered investment adviser, provides innovative fee-based separately managed accounts and investment products to advisers through a sophisticated technology platform. Curian expands Jackson’s access to advisers and provides a complement to Jackson’s core annuity product lines.

### Products

The following table shows total new business premiums in the United States by product line and distribution channel for the periods indicated. Total new business premiums include deposits for investment contracts with limited or no life contingencies.

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>By Product</b>			
<b>Annuities</b>			
Fixed annuities			
Interest-sensitive . . . . .	481	1,629	915
Fixed index . . . . .	447	501	1,433
Immediate . . . . .	91	95	138
Variable annuities . . . . .	<u>4,554</u>	<u>3,491</u>	<u>6,389</u>
Total . . . . .	<u>5,573</u>	<u>5,716</u>	<u>8,875</u>
Life insurance . . . . .	<u>26</u>	<u>31</u>	<u>34</u>
<b>Institutional products</b>			
GICs, funding agreements and Federal Home Loan Bank of Indianapolis (FHLBI) advances . . . . .	408	560	—
Medium term note funding agreements . . . . .	<u>527</u>	<u>634</u>	<u>—</u>
Total . . . . .	<u>935</u>	<u>1,194</u>	<u>—</u>
<b>Total</b> . . . . .	<u><u>6,534</u></u>	<u><u>6,941</u></u>	<u><u>8,909</u></u>

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>By Distribution Channel</b>			
Independent agents . . . . .	623	1,225	1,229
Bank . . . . .	812	1,077	1,566
Broker-dealer . . . . .	4,153	3,428	6,099
Captive agents . . . . .	10	16	15
Institutional products department . . . . .	<u>936</u>	<u>1,195</u>	<u>—</u>
Total . . . . .	<u>6,534</u>	<u>6,941</u>	<u>8,909</u>

*Annuities*

*Fixed annuities*

*Interest-sensitive annuities*

In 2009, interest-sensitive fixed annuities accounted for 10% of total new business premiums and 24% of policyholder liabilities of the US operations. These annuities, which allow for tax-deferred accumulation of funds, are used for asset accumulation in retirement planning and for providing income in retirement and offer flexible payout options. The contract holder pays Jackson a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and administrative charges are deducted, as appropriate. On more than 90% of in-force business, Jackson may reset the interest rate on each contract anniversary, subject to a guaranteed minimum, in line with state regulations. When the annuity matures, Jackson either pays the contract holder the amount in the contract holder account or begins making payments to the contract holder in the form of an immediate annuity product. This latter product is similar to a UK annuity in payment.

Fixed annuity policies are subject to early surrender charges for the first six to nine years of the contract. In addition, the contract may be subject to a market value adjustment at the time of surrender. During the surrender charge period, the contract holder may cancel the contract for the surrender value.

Jackson's profits on fixed annuities arise primarily from the spread between the return it earns on investments and the interest credited to the contract holder's account (net of any surrender charges or market value adjustment) less expenses.

Jackson's fixed annuities continue to be a profitable book of business, benefiting from favourable spread income in recent years. However, the fixed annuity portfolio could be impacted by the continued low interest rate environment as lower crediting rates could result in increased surrenders and lower sales if customers seek alternative investment opportunities.

Approximately 61% of the interest-sensitive fixed annuities Jackson wrote in 2009 provide for a market value adjustment that could be positive or negative, on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment.

*Fixed index annuities*

Fixed index annuities accounted for 16% of total new business premiums in 2009 and 10% of policyholder liabilities of the US operations. Fixed index annuities are similar to fixed annuities in that the contract holder pays Jackson a premium, which is credited to the contract holder's account, and periodically, interest is credited to the contract holder's account and administrative charges are deducted, as appropriate. Jackson guarantees an annual minimum interest rate, although actual interest credited may be higher and is linked to an equity index over its indexed option period.

Jackson's profit arises from the investment income earned and the fees charged on the contract, less the expenses incurred, which include the costs of the guarantees, and the interest credited to the contract. Fixed index annuities are subject to early surrender charges for the first 5 to 12 years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value.

Fixed index annuities continue to be a profitable product, benefiting from favourable spread and the effective management of equity risk. The fixed index book provides a natural offsetting equity exposure to the guarantees issued in conjunction with Jackson's variable annuity products, which allows for an efficient hedging of the net equity exposure.

### Immediate annuities

In 2009, immediate annuities accounted for 2% of total new business premiums and 2% of policyholder liabilities of the US operations. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years and/or the life of the policyholder. If the term is for the life of the policyholder, then Jackson's primary risk is mortality risk. This product is generally used to provide a guaranteed amount of income for policyholders and is used both in planning for retirement and in retirement itself. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

### Variable annuities

In 2009, variable annuities accounted for 72% of total new business premiums and 49% of policyholder liabilities of the US operations. Variable annuities are tax-advantaged deferred annuities where the rate of return depends upon the performance of the underlying portfolio, similar in principle to UK unit-linked products. They are also used for asset accumulation in retirement planning and to provide income in retirement.

The contract holder can allocate the premiums between a variety of variable sub-accounts with a choice of fund managers and/or a guaranteed fixed-rate option. The contract holder's premiums allocated to the variable accounts are held apart from Jackson's general account assets, in a separate account, which is analogous to a unit-linked fund. The value of the portion of the separate account allocated to variable sub-accounts fluctuates with the underlying investments. Variable annuity policies are subject to early surrender charges for the first four to seven years of the contract. During the surrender charge period, the contract holder may cancel the contract for the surrender value. Jackson offers one variable annuity that has no surrender charges.

Jackson offers a choice of guaranteed benefit options within its variable annuity product portfolio, which customers can elect and pay for. These include the guaranteed minimum death benefits ("GMDB"), which guarantees that, upon death of the annuitant, the contract holder or beneficiary receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the return of original premium, the highest past anniversary value of the contract, or as the original premium accumulated at a fixed rate of interest. In addition, there are three other types of guarantees: guaranteed minimum withdrawal benefits ("GMWB"), guaranteed minimum accumulation benefits ("GMAB") and guaranteed minimum income benefits ("GMIB"). GMWBs provide a guaranteed return of the principal invested by allowing for periodic withdrawals that are limited to a maximum percentage of the initial premium. One version of the GMWBs provides for a minimum annual withdrawal amount that is guaranteed for the contract holder's life without annuitisation. GMABs generally provide a guarantee for a return of a certain amount of principal after a specified period. GMIBs provide for a minimum level of benefits upon annuitisation regardless of the value of the investments underlying the contract at the time of annuitisation. Due to the inability to economically hedge or reinsure new issues, GMIBs are no longer offered, with existing coverage being reinsured with an unaffiliated reinsurer.

As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of guarantees.

In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business to manage Jackson's equity exposure in a cost-effective fashion. Jackson believes that the internal management of equity risk coupled with the utilisation of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure.

Profits in the variable annuity book of business will continue to be subject to the impact of market movements both on sales and allocations to the variable accounts and the effects of the economic hedging programme. While Jackson hedges its risk on an economic basis, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility. Jackson continues to believe that, on a long-term economic basis, the equity exposure remains well managed. As evidence of Jackson's hedging programme, over the cumulative 24-month period of 2008 and 2009, which included a historic decline and partial recovery of equity markets as well as significant interest rate movements, Jackson's variable annuity guaranteed benefits and related hedges resulted in a net operating loss of £7 million, after allowing for variable annuity guarantee fees in the period.

### Life insurance

Reflecting the competitive life insurance market and the overall trend towards asset accumulation products, Jackson's life insurance products accounted for less than 1% of the total new business premiums and 9% of

policyholder liabilities of the US operations in 2009. Jackson sells several types of life insurance, including term life, universal life and variable universal life. Term life provides protection for a defined period and a benefit that is payable to a designated beneficiary upon death of the insured. Universal life provides permanent individual life insurance for the life of the insured and includes a savings element. Variable universal life is a life insurance policy that combines death benefit protection and the important tax advantages of life insurance with the long-term growth potential of professionally managed investments. Jackson's life insurance book has also delivered consistent profitability, driven primarily by positive mortality and persistency experience.

#### *Institutional products*

Institutional products consist of guaranteed investment contracts ("GICs"), funding agreements, including agreements issued in connection with participation in the Federal Home Loan Bank of Indianapolis ("FHLBI") programme, and medium term note funding agreements. During 2009, there was no new institutional business as the company restricted sales in this business line in order to conserve and direct capital to higher margin variable annuity business. As at 31 December 2009, institutional products accounted for 6% of policyholder liabilities of US operations. The GICs are marketed by the institutional products department to defined contribution pension and profit sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds, and are issued to the FHLBI in connection with its programme. Three types of institutional products are offered:

- Traditional GICs;
- Funding agreements; and
- Medium term note funding agreements.

#### *Traditional guaranteed investment contracts*

Under a traditional GIC, the policyholder makes a lump sum deposit. Interest is paid on the deposited funds, usually on a quarterly basis. The interest rate paid is fixed and is established when the contract is issued.

Traditional GICs have a specified term, usually two to three years, and typically provide for phased payouts. Jackson tailors the scheduled payouts to meet the liquidity needs of the particular retirement plan. If deposited funds are withdrawn earlier than scheduled, an adjustment is made that approximates a market value adjustment.

Jackson sells GICs to retirement plans, in particular 401(k) plans. The traditional GIC market is extremely competitive. This is due in part to competition from synthetic GICs, which Jackson does not sell.

#### *Funding agreements*

Under a funding agreement, the policyholder either makes a lump sum deposit or makes specified periodic deposits. Jackson agrees to pay a rate of interest, which may be fixed but which is usually a floating short-term interest rate linked to an external index. Interest is paid quarterly to the policyholder. The average term for the funding agreements is one to two years. At the end of the specified term, policyholders may re-deposit the principal in another funding agreement. Jackson makes its profit on the spread between the yield on its investment and the interest rate credited to policyholders.

Typically, brokerage accounts and money market mutual funds are required to invest a portion of their funds in cash or cash equivalents to ensure sufficient liquidity to meet their customers' requirements. The funding agreements permit termination by the policyholder on 7 to 90 days' notice, and thus qualify as cash equivalents for the clients' purposes. There were no funding agreements terminable by the policyholder with less than 90 days' notice outstanding at 31 December 2009.

Jackson is a member of the FHLBI. Membership allows Jackson access to advances from FHLBI that are collateralised by mortgage-related assets in Jackson's investment portfolio. These advances are in the form of funding agreements issued to FHLBI.

#### *Medium term note funding agreements*

Jackson has also established European and global medium-term note programmes. The notes offered may be denominated in any currency with a fixed or floating interest rate. Notes are issued to institutional investors by a special purpose vehicle and are secured by funding agreements issued by Jackson.

### *Distribution and marketing*

Jackson distributes products in all 50 states of the United States and in the District of Columbia, although not all products are available in all states. Operations in the state of New York are conducted through a New York insurance subsidiary.

Jackson focuses on independent distribution systems and supports its network of independent agents and advisers with education and training programmes.

#### *Independent agents and broker-dealers*

Jackson's subsidiary, Jackson National Life Distributors, LLC ("JNLD"), is the primary marketing and distribution organisation for annuities and life insurance products. The insurance and fixed annuity products are distributed through independent agents located throughout the United States. These approximately 21,000 appointed insurance agents or brokers (as at 31 December 2009), who also may represent other companies, are supported by four regional marketing divisions. JNLD generally deals directly with writing agents and brokers thereby eliminating intermediaries, such as general agents. This distribution channel has enabled Jackson to generate significant volumes of business on a low, variable cost basis. Jackson also provides agents with product information and sales materials.

JNLD's wholesalers meet directly with broker-dealers and financial planners and are supported by an extensive internal sales staff. As at 31 December 2009, there were more than 780 active selling agreements with regional and independent broker-dealer organisations throughout the United States, which provides Jackson access to nearly 65,000 appointed agents.

Jackson provides training for its broker-dealers and also provides them with product information and sales materials.

#### *Banks, credit unions and other financial institutions*

Jackson's Institutional Marketing Group distributes annuity and life insurance products through banks, credit unions and other financial institutions and through third-party marketing organisations that serve these institutions. Jackson is a leading provider of annuities offered through banks and credit unions and as at 31 December 2009 had access to more than 12,500 financial institution representatives through existing relationships with banks and credit unions. Jackson has established distribution relationships with medium-sized regional banks, which it believes are unlikely to develop their own insurance product capability.

#### *Independent broker-dealers*

Jackson's retail distribution is managed by the Prudential Group's independent broker-dealer network, NPH, which is made up of four firms, National Planning Corporation, SII Investments, Inc., INVEST Financial Corporation and Investment Centers of America, Inc. NPH had 3,478 registered representatives at the end of 2009.

#### *Registered investment adviser*

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

The registered investment adviser industry began as a service offered to very high net worth investment clients, focusing on platforms rather than specific products, and providing institutional quality management, custom portfolios and tax services. The industry has evolved to offer personalised investment advice, high-quality money management, good returns and reasonable costs to a broader range of clients.

#### *Institutional products department*

Jackson markets its institutional products through its institutional products department. It has direct contacts with banks, municipalities, asset management firms and direct plan sponsors. Institutional products are distributed and marketed through intermediaries to these groups.

#### *Captive agency*

In connection with the acquisition of Life of Georgia in 2005, Jackson established the JNL Southeast Agency ("JNLSA"), the company's first captive agency since 1970. JNLSA, with more than 100 life insurance agents as at

31 December 2009, was formed to help retain the Life of Georgia book of business and to create a new distribution channel for Jackson's life insurance.

#### *Factors affecting pricing of products and asset liability management*

Jackson prices products based on assumptions about future mortality, investment yields, expenses and persistency. Pricing is influenced by its objectives for return on capital and by competition. Although Jackson includes a profit margin in the price of its products, the variation between the assumptions and actual experience can result in the products being more or less profitable than it was assumed they would be. This variation can be significant.

Jackson designs its interest-sensitive products and conducts its investment operations to match closely the duration of the assets in its investment portfolio with the annuity, term life, whole life, universal life and guaranteed investment contract product obligations. Jackson seeks to achieve a target spread between what it earns on its assets and what it pays on its liabilities by investing principally in fixed-rate securities and in options and futures to hedge equity-related movements in the value of its products.

Jackson segregates its investment portfolio for certain investment management purposes and as part of its overall investment strategy into four portfolios: fixed annuities without market value adjustment, fixed annuities with market value adjustment, fixed index annuities and institutional liabilities. The portfolios backing fixed annuities with and without market value adjustments and the fixed index annuities have similar characteristics and differ primarily in duration. The portfolio backing the institutional liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the institutional portfolio is managed to permit less interest rate sensitivity and has limited exposure to mortgage-backed securities. As at 31 December 2009, 10% of the institutional portfolio was invested in residential mortgage-backed securities.

The fixed-rate products may incorporate surrender charges, market value adjustments, two-tiered interest rate structures or other limitations relating to when policies can be surrendered for cash, in order to encourage persistency. As at 31 December 2009, 62% of Jackson's fixed annuity reserves had surrender penalties or other withdrawal restrictions. Substantially all of the institutional portfolio had withdrawal restrictions or market value adjustment provisions.

Fixed index annuities issued by Jackson also include an equity component that is hedged using equity options and futures contracts issued on the corresponding exchange. The equity component of these annuities constitutes an embedded derivative under IAS 39 "Financial Instruments: Recognition and Measurement" that is carried at fair value, as are other derivative instruments.

Guaranteed benefits issued by Jackson in conjunction with the sales of variable annuity contracts expose Jackson to equity risk as the benefits generally become payable when equity markets decline below the guaranteed amount. Certain of these benefits are carried at fair value under IAS 39 with changes in fair value recorded in income. Jackson hedges the tail risk associated with the equity exposure using equity options and futures contracts, which are also carried at fair value under IAS 39. Jackson hedges the economic risk associated with these contracts and, therefore, has not explicitly hedged its fair value risk. In addition, certain benefits have mortality risk and are therefore precluded from being carried at fair value. As a result of these factors, the income statement may include a timing mismatch related to changes in fair value. However, as demonstrated during 2008 and 2009, Jackson's hedges operated effectively, as designed.

#### *Reserves*

Except for certain non-insurance deposit-type accounts and as allowed under IFRS, Jackson uses reserves established on a US GAAP basis as the basis for consolidation into the Prudential Group's IFRS accounts.

For the fixed and variable annuity contracts and institutional products, the reserve is the policyholder's account value. For the immediate annuities, reserves are determined as the present value of future policy benefits. Mortality assumptions are based on the 1983 Individual Annuitant Mortality Table and the Annuity 2000 Mortality Table for newer issues. Interest rate assumptions currently range from 2.0% to 7.0%.

For the traditional term life contracts, reserves for future policy benefits are determined using the net level premium method and assumptions as to mortality, interest, policy persistency and expenses. Mortality assumptions are generally from 25% to 160% of the 1975-1980 Basic Select and Ultimate tables, depending on underwriting classification and policy duration. Interest rate assumptions range from 4.0% to 8.0%. Persistency and expense assumptions are based on Jackson's experience.

For the interest-sensitive and single premium life contracts, reserves approximate the policyholder's account value.

### *Reinsurance*

Jackson reinsures portions of the coverage provided by its life insurance products with other insurance companies under agreements of indemnity reinsurance. Reinsurance assumed from other companies is not material.

Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to obtain a greater diversification of risk for the life insurer. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured. Jackson's reinsured business is ceded to numerous unaffiliated reinsurers and the amount of business ceded to any one reinsurer is not material. Typically, the reinsurers have an AM Best Co rating of A or higher.

Jackson limits the amount of risk it retains on new policies. Currently, the maximum risk that is retained on new policies is US\$2.0 million. Jackson is not a party to any risk reinsurance arrangement with any reinsurer pursuant to which the amount of reserves on reinsurance ceded to such reinsurer equalled more than 1% of total policy reserves.

Beginning in late 1995, Jackson entered into reinsurance agreements to cede 80% of its new level premium term life insurance business written in the United States to take advantage of competitive pricing in the reinsurance markets. Beginning on 1 January 1999, it began to cede 90% of new writings of level premium term products. Jackson intends to continue to cede a significant proportion of new term life insurance business for as long as pricing in the reinsurance markets remains favourable.

Jackson cedes the guaranteed minimum income benefit on variable annuities to an unaffiliated reinsurer.

### *Policy administration*

Jackson provides a high level of administrative support for both new and existing policyholders. Jackson's ability to implement new products quickly and provide customer service is supported by integrated computer systems that issue and administer complex life insurance and annuity contracts. Jackson continues to develop its life insurance administration and underwriting systems and its fixed and variable annuity administration systems to enhance the service capabilities for both new and existing policies.

### *PPM America*

PPM America is Prudential's US fund management operation, with offices in Chicago and New York. Its primary focus is to manage funds for Jackson and therefore the majority of funds under management are fixed interest in nature. PPM America also serves as investment adviser for certain mutual funds, several private investment funds and structured finance vehicles, and the US equity and fixed income portion of portfolios of certain affiliates within Prudential.

## **4.4 UK business**

### *Introduction*

As at 31 December 2009, the Prudential Group's UK business was structured into two business units, each focusing on its respective target customer markets. The Prudential Group's UK business units are UK Insurance Operations and M&G.

The following discussion describes:

- the UK retail financial services market;
- the Prudential Group's UK business units, products and distribution channels;
- the Prudential Group's reinsurance arrangements and reserving practice; and
- shareholders' participation in the Prudential Group's long-term insurance business.

In 2009, the Prudential Group's UK business generated new business insurance premiums of £5,014 million and gross investment inflows of £24,875 million. As at 31 December 2009, M&G had £174 billion of funds under management. See paragraph 4.5 below for an analysis and description of this asset manager and its funds under management.

### *UK retail financial services business overview*

Prudential UK (the UK insurance operations) continues to focus on realising value from the opportunities created by the increasing need for retirement solutions. The Prudential Group's UK business competes in selected areas of the UK's retirement savings and income markets where it believes that it can generate attractive returns from capital

employed. In line with the Prudential Group's strategy, the business continues to place significant emphasis on the disciplined deployment of capital to seize opportunities that play to the core strengths of the business and this focus enabled it to deliver a strong relative performance in 2009.

In 2009, Prudential UK performed strongly against a challenging background of difficult capital markets, volatile equity markets and widespread economic uncertainty which led consumers to look for greater certainty and security through trusted and financially strong brands. Prudential UK believes that the business has a good combination of competitive advantages including its longevity experience, multi-asset investment capabilities, strong brand and financial strength. These help put Prudential UK in a robust position to generate attractive returns across its businesses.

The UK is characterised by an ageing population and the concentration of wealth in the mass affluent and high net worth sectors — a combination that positions the retirement and near-retirement segment as the fastest-growing in the marketplace. Low savings rates and high levels of consumer debt, coupled with an increasing shift in responsibility for providing retirement income away from the Government and employers towards individuals, have resulted in individuals in the UK being inadequately provided for during increasingly long periods of retirement.

#### *Areas of focus in 2009*

- Maintaining a leadership position in individual annuities;
- Building on the Prudential Group's multi-asset capabilities and expertise;
- Growing other income streams;
- Strengthening distribution capabilities;
- Delivering improvements in customer service; and
- Maintaining a disciplined approach to pricing and capital usage.

The pipeline of internal vestings from maturing individual and corporate pension policies is expected to remain strong at least over the next ten years. Management have based this assessment on a combination of analysis of the projected value of maturities of in-force business (after allowing for lapses) used within the Prudential Group's actuarial valuation models as at 31 December 2008 and analysis of the Selected Retirement Date contained with the policy data for a population covering approximately 75% of in-force pension business. This pipeline is supplemented by strategic partnerships with third parties where Prudential UK is the recommended annuity provider for customers vesting their pensions at retirement. Prudential UK is one of the largest annuity providers in the UK market<sup>(56)</sup>, with approximately 1.5 million annuities in payment as at 31 December 2009. Looking ahead, the UK annuities market is expected to grow in the near-term, and Prudential UK believes it is well-positioned to maintain a significant share of this market.

Prudential UK's with-profits business performed strongly during 2009, showing that with-profits, when invested in an actively managed and financially strong fund like Prudential's, continues to be an attractive medium to long-term investment, offering strong annualised returns compared with other investment options. Prudential UK's with-profits fund has delivered investment returns of 66.3% over the last ten years through the end of 2009 compared with the FTSE All-Share Index (total return) of 17.7% over the same period.

In the wholesale markets, Prudential UK's aim is to participate selectively in bulk and back-book buyouts using the Prudential Group's financial strength, superior investment track record and annuitant mortality risk assessment capabilities. Maintaining a strict focus on value means that Prudential UK will only participate in transactions that meet its strict return on capital requirements.

The business has also continued to make good progress against its cost reduction plans, with Prudential UK expecting that it will have achieved its total cost savings target of £195 million per annum by the end of 2010. The first phase of the Prudential UK cost reduction programme (completed in 2007) delivered savings of £115 million per annum, with a further £60 million per annum of savings expected to be delivered by the end of 2010 through the administration outsourcing agreement with Capita, which commenced in April 2008. The remaining £20 million per annum is expected to be generated from across the rest of the UK business by the end of 2010. By the end of 2009, a total of £156 million per annum of savings had been delivered.

Over time, the Capita contract is expected to result in the migration of approximately seven million in-force policies from a number of Prudential legacy IT systems to two Capita proprietary platforms, significantly enhancing operational performance and efficiencies. The first migration from a legacy system to a Capita platform was completed during 2009.

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(56) Source: ABI

## *UK products and profitability*

In common with other UK long-term insurance companies, the Prudential Group's UK products are structured as either with-profits (or participating) products, or non-participating (including unit-linked) products. Depending upon the structure, the level of shareholders' interest in the value of policies and the related profit or loss varies.

With-profits policies are supported by a with-profits sub-fund and can be single premium (for example, Prudence Bond) or regular premium (for example, certain corporate pension products). The Prudential Group's primary with-profits sub-fund is part of PAC's long-term fund. The return to shareholders on virtually all with-profits products is in the form of a statutory transfer to PAC shareholders' funds which is analogous to a dividend from PAC's long-term fund and is dependent upon the bonuses credited or declared on policies in that year. Prudential UK's with-profits policyholders currently receive 90% of the distribution from the main with-profits sub-fund as bonus additions to their policies and shareholders receive the remaining 10% as a statutory transfer.

The profits from almost all of the Prudential Group's new non-participating business accrue solely to shareholders. Such business is written in the non-profit sub-fund within PAC's long-term fund, or in various shareholder owned direct or indirect subsidiaries, the most significant of which is Prudential Retirement Income Limited ("PRIL"), which also writes all new immediate annuities arising from vesting deferred annuity policies in the with-profits sub-fund of PAC. There is a substantial volume of in-force non-participating business in PAC's with-profits sub-fund and that fund's wholly-owned subsidiary Prudential Annuities Limited ("PAL"), which is closed to new business; profits from this business accrue to the with-profits sub-fund.

The defined charge participating sub-fund ("DCPSF") forms part of PAC's long-term fund and comprises the accumulated investment content of premiums paid in respect of the defined charge participating with-profits business issued in France, the defined charge participating with-profits business reassured into PAC from Prudential International Assurance plc and Canada Life (Europe) Assurance Ltd and the with-profits annuity business transferred to PAC from the Equitable Life Assurance Society on 31 December 2007. All profits in this fund accrue to policyholders in the DCPSF.

## *Products*

The traditional life insurance product offered by UK life insurance companies was a long-term savings product with a life insurance component. The life insurance element conferred tax advantages that distinguished the traditional life insurance products offered in the United Kingdom from the savings products offered by banks, building societies and unit trust companies. The gradual reduction of these tax advantages and increasing sales of single premium life products have resulted in the distinction between life insurance and other long-term savings products becoming less important. Pension products remain tax-advantaged within certain limits.

Prudential UK expects demand for private personal pension and savings products to increase over the medium to long term, in part reflecting a change in the UK government's approach to social security that has encouraged long-term savings through tax advantages, but also in reaction to the growing realisation that state provided pensions are unlikely to provide sufficient retirement income. An ageing population is focusing on asset accumulation and other retirement products to supplement their state benefits, while younger generations are focusing on pension and long-term savings products as well as health and income protection cover.

## *Distribution*

Retail financial services and products are distributed face to face through bank branches, tied agents, company sales forces and financial advisers, or directly by mail, telephone and over the internet. Tied agents are exclusive agents who represent only one insurer and must offer customers the products most suitable to their needs, but only from the range of products offered by that insurer. In recent years the high costs of company sales forces and tied agency networks, combined with customers perceiving a lack of choice, have meant that sales forces and tied agents have lost significant market share to financial advisers, with the result that many insurers, including the Prudential Group, have chosen to close these tied agents and direct sales force networks.

Direct and e-commerce distribution methods are generally lower-cost than other methods but have not generally been conducive to providing financial advice to the consumer to date. Accordingly, products distributed directly are generally more straightforward and have lower, often fee-based, charges.

The FSA, following a consultation process, implemented "depolarisation" rules at the end of 2004. Advisers have the choice of being "single tied" as before, or "multi-tied"; advising on the products of a limited range of providers, or equivalent to an independent financial adviser ("IFA"), where they offer products from the "whole of market" as now, but they also have to offer a "fee alternative", a fee-based charging structure as an alternative to commission.

Prudential UK worked with major financial adviser groups to design and build multi-tie propositions and has been appointed to a number of multi-tie panels of these major financial adviser groups.

The FSA is conducting a review of the retail distribution marketplace called the Retail Distribution Review (“RDR”) and published a policy statement on 26 March 2010, which follows nearly two years of discussion and consultation papers. The changes are designed to encourage greater levels of transparency, professionalism and sustainability within the industry, with the prime aim of increasing consumers’ confidence in the industry and therefore their desire to engage with it. Prudential supports the concepts of adviser remuneration and the new professional standards which are included as part of the RDR and believes that these provide an opportunity to put in place a framework that will better align the interests of consumers, advisers and providers. The proposed implementation date for the proposals remains 31 December 2012.

The changes to be implemented are centred on improving the clarity with which firms describe their services to customers and the role of advisers, particularly with regards to remuneration. The advice market will be split between independent and restricted advice. This will be supported by the need for specific disclosure of status both in writing and orally at point of sale. Commission will be replaced by “Adviser Charging” with prescriptive rules aimed at ensuring consumers have total clarity on the cost of advice services. This will apply to all investment advice, but advisers will continue to be able to be remunerated by commission for pure protection business. In a separate discussion paper, the FSA proposed a number of changes to the Platform market which made clear that the same standards will apply as to the Retail market.

The Professionalism and Qualification elements are expected to be agreed in 2010. A greater role is proposed for professional bodies in helping to set and manage the ethics agenda in the industry. The FSA is proposing to revert to an internal model for the Professional Standards Board rather than establishing this as a separate independent entity.

The proposals on independent advice (which is restricted and unbiased) and raising professional standards will help to achieve improved outcomes for consumers.

The full impact of the RDR cannot yet be predicted, but it is likely that cash flow will be an issue for IFA firms that are currently reliant on initial commission. Although some IFAs may choose to exit the market, Prudential believes that many will adapt to the new environment. Prudential UK has been preparing for the introduction of RDR for some time — for instance, Prudential UK’s current individual pensions product, the Flexible Retirement Plan, is now priced excluding commission, which allows the margin deducted for advice to be specifically agreed between the customer and the adviser. A large proportion of Prudential UK’s annuity sales are made on a non-advised basis and will be unaffected by these changes.

Prudential UK is continuing to work with the regulator, industry bodies and distributors on ways to help advisers make the transition to the new environment as it believes that a strong IFA sector is beneficial for the market, and for Prudential.

As at 31 December 2009, the Prudential Group’s UK Insurance Operations distributed its products through the following channels:

	<u>Year Ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Direct & Partnerships . . . . .	2,597	2,567	2,015
Intermediated . . . . .	2,319	3,029	2,810
Wholesale (including Credit Life) . . . . .	<u>1,820</u>	<u>1,434</u>	<u>62</u>
Sub-Total . . . . .	<u>6,736</u>	<u>7,030</u>	<u>4,887</u>
DWP Rebates . . . . .	143	153	127
Total New Business Premiums . . . . .	<u>6,879</u>	<u>7,183</u>	<u>5,014</u>

*Direct and partnerships*

The direct distribution channel is primarily charged with increasing revenue from existing Prudential Group customers and with seeking new customers. Direct distribution channels include the telephone, internet and face to face advisers and focuses on annuities, investments, protection and health products. Partnerships focus on developing strong relationships with banks, retail brands and other distributors. Partnerships also seeks to help the Prudential Group’s distribution partners in their distribution and product development strategies. The Prudential Group now has a range of distribution partners including Barclays, National Australia Bank, Royal London Mutual, Save and Prosper, Scottish Life, St James’s Place and Threadneedle.

### *Intermediaries*

Prudential UK's intermediaries distribution channel increased its field sales force with an additional 13 regional sales units in 2009, and the focus is to continue developing deeper and better relationships with key accounts and through partnership arrangements. Prudential UK was successful in gaining over 50 new panel positions across its 24 key accounts in 2009, meaning that its products are now even more widely available to intermediaries than before.

### *Wholesale*

Prudential UK maintained its strict focus on value in the bulk annuity and back-book markets in 2009, completing transactions generating premium income of £39 million compared with £1,417 million in 2008. The 2008 figure included the large bulk annuity transactions which have not been repeated in 2009, due to the unavailability of transactions which met Prudential's return criteria.

### *UK business units*

#### *Long-term products*

The Prudential Group's long-term products in the United Kingdom consist of life insurance, pension products and pensions annuities. The following table shows the Prudential Group's UK Insurance Operations new business insurance and investment premiums by product line for the periods indicated. New business premiums include deposits for policies with limited or no life contingencies.

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>(in £ millions)</u>		
Life insurance			
With-profits . . . . .	406	968	1,320
Unit-linked . . . . .	<u>899</u>	<u>939</u>	<u>610</u>
Total life insurance . . . . .	1,305	1,907	1,930
Pensions			
With-profits individual . . . . .	29	77	154
Unit-linked individual . . . . .	80	89	86
Department of Work and Pensions rebates . . . . .	143	153	127
Corporate . . . . .	<u>680</u>	<u>651</u>	<u>386</u>
Total pensions . . . . .	932	970	753
Pension annuities and other retirement products			
Fixed . . . . .	1,742	2,427	1,445
Retail Price Index . . . . .	659	1,404	493
With-profits . . . . .	<u>2,228</u>	<u>459</u>	<u>382</u>
Total pension annuities and other retirement products . . . . .	4,629	4,290	2,320
Healthcare . . . . .	<u>13</u>	<u>16</u>	<u>11</u>
Total new business premiums . . . . .	<u>6,879</u>	<u>7,183</u>	<u>5,014</u>

#### *Life insurance products*

The Prudential Group's UK life insurance products are predominantly medium to long-term savings products with life cover attached, and also include pure protection (term) products. The main savings products the Prudential Group offers are investment bonds.

#### *Savings products — investment bonds*

The Prudential Group offers customers a choice through a range of investment funds to meet different risk and reward objectives. The Prudential Group launched the Flexible Investment Plan ("FIP") in 2003 and the Prudential Investment Plan ("PIP") in 2007. Through these plans, its customers have the option to invest in the With-Profits fund or in a range of unit-linked investment funds. Advisers can build an individual portfolio and asset allocation model to accurately match a client's risk/reward profile. Both FIP and PIP also give financial advisers the opportunity to choose from different external fund management groups and the flexibility to make changes to portfolio and asset allocation over time. In 2009, sales of the unit-linked option of FIP and PIP were £117 million.

The Prudence Bond, a single premium, unitised with-profits policy with no fixed term, is one of the United Kingdom's leading investment bond products in terms of with-profits market share. In September 2004, the Prudential Group launched the next generation with-profits investment bond, entitled PruFund, which is designed to provide increased transparency and smoothed investment returns to the customer. PruFund also offers clients an optional five-year guarantee on the initial investment. In 2008, PruFund became available as a fund option on the FIP and PIP products. In 2009, total new business premiums attributable to PruFund, including new business through FIP and PIP, was £1,082 million.

In March 2008, the Prudential Group launched the International Portfolio Account ("IPA") offering clients access to a wide range of quoted UK investments. Sales of Prudential's offshore bonds, the International Prudence Bond, International Prudential Portfolio Bond and International Portfolio Account were £315 million in 2009.

With-profits products aim to provide capital growth over the medium to long term, and access to a range of investment sectors without the costs and risks associated with direct investment into these sectors. Capital growth for the policyholder on with-profits bonds apart from PruFund is achieved by the addition of reversionary or annual bonuses, which are credited to the bond on a daily basis from investment returns achieved within PAC's long-term with-profits fund, offset by charges and expenses incurred in the fund. A final bonus may also be added when the bond is surrendered. PruFund delivers growth through a published expected growth rate, updated quarterly, and a transparent formulaic smoothing mechanism. In contrast the capital return on unit-linked bonds directly reflects the movement in the value of the assets underlying those funds. When funds invested in PAC's long-term with-profits fund are either fully or partially withdrawn, PAC may apply a market value adjustment to the amount paid out.

Sales of PruFund, Prudential UK's unitised and smoothed investment plan, were particularly strong in 2009. Since October 2008, PruFund has been available across Prudential UK's range of tax wrappers, including individual pensions, income drawdown and onshore and offshore bonds. Over £1.3 billion was invested across the Prudential UK retail savings product range in 2009. In 2009, Prudential UK extended further the PruFund range of investments with the launch of the PruFund Cautious series to sit alongside the PruFund Growth series within the on-shore bond wrapper. As at 31 December 2009, approximately £300 million had been invested in PruFund Cautious since it was launched in the second half of 2008. Prudential also launched the new PruSelect range of unit-linked funds across its UK pensions and investments products in 2008, more than doubling the number of funds available.

The sales growth across Prudential UK's with-profits range has been achieved on the back of sustained strong investment performance in its Life Fund over a number of years, reflecting the benefits of its diversified investment policy. The Prudential Group believes that this market will continue to see further growth as investors turn to trusted and financially strong brands and products offering an element of capital protection.

#### Life and health protection

Prudential UK has a joint venture with Discovery of South Africa which uses the Prudential brand and Discovery's expertise to build branded distribution and innovative product offerings in the private healthcare and protection markets.

Since its launch in October 2004, PruHealth has established itself in the marketplace as a private medical insurance provider, and it now has more than 200,000 customers insured.

PruProtect, launched in September 2007, follows the success of PruHealth by applying the Vitality points system. PruProtect's product is focused around a core philosophy of helping people become healthier while protecting and improving the quality of their lives. PruProtect continues to grow sales strongly following the re-launch of its product range and improved distribution model in November 2008. Sales of £14 million were achieved in 2009, an increase of 311% over 2008.

#### Pension products

Prudential UK provides both individual and corporate pension products. In 2009 new business premiums totalled £240 million for individual pensions and £386 million for corporate pensions. Pension products are tax-advantaged long-term savings products that comply with rules established by HMRC and are designed to supplement state-provided pensions. These rules require that, upon retirement, maturity benefits are used to purchase pension annuities by policyholder election at retirement or at least by the age of 75, although they do permit a portion to be taken as a tax-free lump sum. Prior to retirement, these products typically have minimal mortality risk to the Prudential Group and are primarily considered investment products. An exception is where a guaranteed annuity option has been offered on the product, with an element of risk to the Prudential Group both in underlying mortality and investment assumptions.

Prudential UK ceased marketing Guaranteed Annuity Options (“GAOs”) in 1987, but for a minority of corporate pension schemes GAOs still apply for new members. Current liabilities for this type of business make up less than 1% of the with-profits sub-fund as at 31 December 2009.

Many of the pension products Prudential UK offers are with-profits products or offer the option to have all or part of the contributions allocated to a with-profits fund. Where funds invested in the with-profits fund are withdrawn prior to the pension date specified by the policyholder, Prudential UK may apply a market value adjustment to the amount paid out. The remaining pension products are non-participating products, which include unit-linked products.

### Individual pensions

Prudential UK’s individual pension range offers unit-linked and unitised with-profits products.

In 2001, Prudential UK introduced products that continue to meet the criteria of the UK government’s stakeholder pension programme. The stakeholder pension is intended for individuals earning enough to be able to afford to make contributions to a pension but who are not currently doing so. The introduction of stakeholder pensions has had implications for, among other things, how Prudential UK designs, administers and charges for and distributes pension products. The most significant requirements involve capped charges and a low minimum contribution which must be accepted by the provider. The UK government has capped charges at 1.5% per annum of the policyholder account balance for stakeholder pensions for the first ten years, decreasing to 1% thereafter, which is below the charges on personal pension products previously offered by the UK pensions industry.

### Department of Work and Pensions rebates (“DWP Rebate”)

Prudential UK also provides individual personal pension products through the DWP Rebate arrangement. Under this arrangement, individuals may elect to contract out of the UK’s State Second Pension (referred to as “S2P”) which was previously known as State Earnings Related Pension Scheme, administered by the UK Department of Work and Pensions. If an individual elects to contract out, then he or she will designate a pension provider, such as the Prudential Group. Premiums on products sold in this manner are paid through “rebates” from the Department of Work and Pensions, which represent the amount that would be otherwise paid into S2P. Rebate amounts are invested to provide benefits to the individual. Premiums from Department of Work and Pensions Rebates are typically reported in the first quarter of each year.

### Corporate pensions

There are two categories of corporate pension products: defined benefit and defined contribution. The Prudential Group has an established defined benefit plan client base covering the small to medium-sized employer market. Prudential UK’s defined contribution client base ranges from small unlisted companies to some of the largest companies in the United Kingdom as well as a number of clients in the public sector (in particular where Prudential UK offers the Additional Voluntary Contribution facility). Additional Voluntary Contribution plans enable employees to make additional pension contributions, either regularly or as a lump sum, to supplement their occupational pension plans.

Defined benefit plans and products continue to dominate the corporate pensions market in terms of funds under management. In recent years, however, most new plans established have been defined contribution products. In addition, there is an increasing trend among companies to close defined benefit plans to new members or to convert existing schemes from defined benefit to defined contribution in order to stabilise or reduce potential pension liabilities.

Prudential UK offers group unit-linked policies and with-profits policies to the corporate pensions market. Prudential UK’s defined contribution products are Additional Voluntary Contribution plans, Group Money Purchase plans, Group Personal Pension plans, Group Stakeholder Pension plans and Executive Pension plans.

In addition, Prudential UK has a Company Pension Transfer Plan (or “Bulk S32”), designed to accept benefits from both defined benefit and defined contribution pension schemes which are winding up (ceasing to exist or being replaced by a new type of scheme). Prudential UK also has the facility to accept enhanced transfers from deferred members of a corporate’s defined benefit pensions scheme into the Prudential UK Personal Pension plan where the member has received advice from an independent financial adviser (often called an Enhanced Transfer Value exercise).

### *Pension annuities and other retirement products*

Prudential UK offers individual conventional immediate annuities that are either fixed or retail price indexed (referred to as “RPI”), where annuity payments are guaranteed from the outset, or with-profits annuities, where annuity payments are variable dependent on the investment performance of underlying assets. Prudential UK also offers products with an income drawdown option which allow customers greater flexibility in terms of the amount of income they take in retirement and the option to delay buying an annuity up to age 75. In 2009, Prudential UK sold £91 million of income drawdown products. A total of £2,189 million of individual annuities were sold in 2009. Of this total, £1,357 million were sold to existing Prudential UK customers with maturing pension policies. The other £832 million were sold to new customers, typically individuals with a pension maturing with another provider who chose Prudential UK to provide their annuity. Prudential UK also offers bulk annuities, whereby it manages the assets and accepts the liabilities of a company pension scheme, usually when it is being wound up by the employer. Due to the nature of the product, the volume of Prudential UK’s bulk annuity sales is unpredictable as it depends on the decision of scheme trustees. In 2009, Prudential UK sold £39 million of bulk annuities.

Prudential UK’s immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump sum capital payment. No surrender value is available under any of these products. The primary risks to Prudential UK from immediate annuity products, therefore, are mortality improvements and credit risk.

#### *Conventional annuities*

Prudential UK’s conventional annuities include level (non-increasing), fixed increase and RPI annuities. Prudential UK’s fixed increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder’s life. The RPI annuities provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK Retail Prices Index. In 2009, sales of RPI annuities were £493 million (including £19 million of bulk annuities). In 2009, sales of level and fixed increase annuities amounted to £1,445 million (including £20 million of bulk annuities and £43 million of unit-linked income drawdown products).

#### *With-profits annuities*

Prudential UK’s with-profits annuities combine the income features of annuity products with the investment smoothing features of with-profits products and enable policyholders to obtain equity-type returns over time. Through this product, Prudential UK brings its product development strengths to bear while also capitalising on people’s need for protection from inflation through increasingly long periods of retirement. Prudential is one of only a few companies in the United Kingdom in the with-profits annuities market and has been operating in this market since 1991. In 2009, Prudential UK’s premiums for this business were £382 million (including £48 million of with-profits income drawdown products). Prudential UK is now the market leader, with a market share of over 84% in the nine months to September 2009<sup>(57)</sup>.

In the first quarter of 2009, Prudential UK launched a new Income Choice Annuity which allows customers to choose an income between a defined maximum and minimum level, with the option of re-setting this every two years. It also provides an opportunity for pension income to grow because the product is backed by Prudential’s strong with-profits fund.

#### *Income drawdown*

Given the UK’s compulsory annuitisation age of 75, an increasingly sophisticated consumer population, and the rising incidence of second careers and semi-retirement as a result of increasing longevity, the market has seen good growth in the ‘bridge’ between pensions and annuities through income drawdown products. Prudential UK launched an income drawdown option as a part of the Flexible Retirement Plan in late 2007 and achieved premiums of £91 million in 2009 compared to £75 million in the previous year for this and the existing product, the Flexible Income Retirement Account. These products help customers manage their pensions through the various stages of retirement, and also offer flexibility while providing potential for capital growth.

#### *Lifetime mortgage*

In November 2009, Prudential UK announced the decision to close its equity release operation to new business. For this product, a significant cash expense is incurred up front in acquiring new business and the payback period on capital employed is long. Prudential UK management concluded that this is not sustainable and that cash and capital

(57) Source: ABI

can be deployed more effectively across other parts of the business. Prudential UK's existing lifetime mortgage customers are unaffected by this decision.

#### *Reinsurance*

In view of the size and spread of PAC's long-term insurance fund, there is little need for reinsurance to protect this business. Some limited reinsurance is maintained and treaties relating to critical illness, permanent health insurance, term insurance and certain unit-linked products are in place. In addition PMI policies issued by Pru Health are reinsured.

#### *Reserves*

In the United Kingdom, a life insurance company's reserve and other requirements are determined by its Board, with advice from its Actuarial Function Holder, subject to minimum reserve requirements. These minimum reserve requirements are established by the rules and guidance of the FSA.

The reserves are published in annual returns to the FSA. In practice, similar provisions are included in the life insurance company's statutory accounts with limited adjustments. The Actuarial Function Holder must pay due regard to the fair treatment of policyholders in making recommendations to the company's board. The Actuarial Function Holder is required to report directly to the FSA any serious concerns regarding the company's ability to treat its customers fairly.

Prudential UK's regulatory reserving for with-profits products, as required by UK regulation, takes into account annual bonuses/annual interest credited to policyholders because these are "attached" to the policies and are guaranteed. Realistic reserves are also calculated for with-profits products under UK regulation. These include an allowance for final bonuses based on the asset share or a prospective valuation of the policies and the cost of guarantees, smoothing and enhancements.

The Prudential Group reserves for unit-linked products on the basis of the value of the unit fund and additional reserves are held for expenses and mortality where this is required by the contract design.

As well as the reserves, the company's assets must also cover other capital requirements set out in the FSA Prudential Sourcebook. These comprise: a with-profits insurance capital component, which is a measure of the difference in the surplus assets on regulatory and realistic bases; a resilience capital requirement for entities other than PAC, which makes prudent allowance for potential future adverse movements in investment values; and the long-term insurance capital requirement, which must be held by all EU insurance companies. See "Financial Strength of PAC's Long-term Fund" for further information on solvency and "Realistic Financial Strength Reporting" for further information on realistic reporting.

#### *Financial strength of PAC's long-term fund*

As at 31 March 2010, the financial strength of PAC was rated Aa2 (negative outlook) by Moody's, AA (negative watch) by Standard & Poor's, and AA+ (negative watch) by Fitch.

PAC's with-profits fund is one of the largest and financially strongest in the UK, continuing to cover comfortably all of its regulatory solvency requirements. The fund is supported by an inherited estate of £6.4 billion (as at 31 December 2009) which provides the working capital required to support the fund for the long-term benefit of current and future policyholders.

The table below shows the change in the investment mix of PAC's main with-profits fund:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	%	%	%
UK equities . . . . .	35	34	25
International equities . . . . .	17	17	12
Property . . . . .	14	14	12
Fixed Interest . . . . .	28	29	40
Cash and other asset classes . . . . .	<u>6</u>	<u>6</u>	<u>11</u>
Total . . . . .	<u>100</u>	<u>100</u>	<u>100</u>

Despite difficult conditions in financial markets throughout 2008 and during the first half of 2009, the with-profits sub-fund performed strongly in 2009. With-profits, when invested in an actively managed and financially strong fund like PAC's, continues to be an attractive medium to long-term investment, offering annualised returns which compare favourably with other investment options. The with-profits sub-fund has delivered investment returns of

66.3% over ten years compared with the FTSE All-share index (total return) of 17.7% over the same period (figures are to 31 December 2009, before tax and charges). Much of this strong investment performance was achieved through the active asset allocation of the fund. As part of its asset allocation process, Prudential UK constantly evaluates prospects for different markets and asset classes. During the year, PAC's long-term fund reduced its exposure to equities and increased its exposure to fixed interest securities.

#### *Realistic financial strength reporting*

In accordance with the FSA Prudential Sourcebook, PAC has to demonstrate solvency on a "realistic" valuation basis as well as the regulatory basis. In the aggregate, the basis has the effect of placing a value on the liabilities of UK with-profits contracts that reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances.

This basis makes companies' financial health more transparent to policyholders, intermediaries and regulators alike, and enables more informed choices to be made by policyholders. The PAC long-term with-profits sub-fund is very strong with the inherited estate (free assets) measured on a realistic basis, valued at approximately £6.4 billion at the end of 2009 before deduction for the risk capital margin.

#### *Shareholders' interests in Prudential UK's long-term insurance business*

In common with other UK long-term insurance companies, the Prudential UK's products are structured as either with-profits products or non-participating (including unit-linked) products. For statutory and management purposes, PAC's long-term fund consists of a number of sub-funds in which shareholders and policyholders have varying interests.

#### *With-profits products*

With-profits products provide an equity-type return to policyholders through bonuses that are "smoothed". There are two types of bonuses: "annual" and "final". Annual bonuses, often referred to as reversionary bonuses, are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are only guaranteed until the next bonus declaration. Final bonuses are only credited on a product's maturity or surrender or on the death of the policyholder. Final bonuses can represent a substantial portion of the ultimate return to policyholders.

With-profits policies are supported by a with-profits fund. Prudential UK's primary with-profits fund is part of PAC's long-term fund. With-profits products provide benefits that are generally either the value of the premiums paid, less charges and fees and with the addition of declared bonuses, or the guaranteed death benefit with the addition of declared bonuses. Smoothing of investment returns is an important feature of with-profits products. It is designed to reduce the impact of fluctuations in investment return from year to year and is accomplished predominantly through the level of final bonuses declared.

The return to Prudential's shareholders in respect of with-profits business Prudential UK writes is an amount equal to up to one-ninth of the value of the bonuses the Prudential UK credits or declares to policyholders in that year. Prudential UK has a large block of in-force with-profits business with varying maturity dates that generates a relatively stable stream of shareholder profits from year to year.

PAC's board of directors, with the advice of its Actuarial Function Holder and its With-Profits Actuary, determines the amount of annual and final bonuses to be declared each year on each group of contracts.

When determining policy payouts, including final bonuses, PAC follows an actuarial practice of considering "asset shares" for specimen policies. Asset shares broadly reflect the value of premiums paid in respect of a policy accumulated at the investment return on the assets PAC notionally attributes to the policy. In calculating asset shares, PAC takes into account the following items:

- the cost of mortality risk and other guarantees (where applicable);
- the effect of taxation;
- management expenses, charges and commissions;
- the proportion of the amount determined to be distributable to shareholders; and
- the surplus arising from surrenders, non-participating business included in the with-profits fund and other miscellaneous sources.

However, Prudential UK does not take into account the surplus assets of the long-term fund, or their investment return, in calculating asset shares. Asset shares are used in the determination of final bonuses together with treating customers fairly, the need to smooth claim values and payments from year to year and competitive considerations.

Prudential UK is required by UK law and regulation to consider the fair treatment of its customers in setting bonus levels. The concept of treating customers fairly is established by statute but is not defined. In practice, it provides one of the guiding principles for decision-making in respect of with-profits products.

The overall return to policyholders is an important competitive measure for attracting new business. The ability to declare competitive bonuses depends, in part, on the financial strength of PAC's long-term fund, enabling it to maintain high levels of investment in equities and real estate, if it wishes to do so. Equities and real estate have historically over the long-term provided a return in excess of fixed interest securities.

In 2009, PAC declared a total surplus of £2,149 million from PAC's primary with-profits sub-fund, of which £1,935 million was added to with-profits policies and £214 million was distributed to shareholders. This includes annual bonus rates of 3.0% per annum for the Prudence Bond and 3.0% per annum for personal pensions. In 2008, PAC declared a total surplus of £3,029 million from PAC's primary with-profits sub-fund, of which £2,730 million was added to with-profits policies and £298 million was distributed to shareholders. This includes annual bonus rates of 3.5% for the Prudence Bond and 3.5% for personal pensions.

The closed Scottish Amicable Insurance Fund ("SAIF") declared total bonuses in 2009 of £533 million compared to £777 million in 2008. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business. For greater detail on the SAIF fund, see "The SAIF sub-fund and accounts" below.

#### *Surplus assets in PAC's long-term with-profits fund*

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

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

Prudential UK, of which PAC is part, announced in March 2006 that it had begun a process to determine whether it could achieve greater clarity as to the status of the inherited estate through reattribution. In June 2008, Prudential announced that it did not believe that it was in the interests of current or future policyholders or shareholders to continue the reattribution process. This announcement reflects PAC's overriding priority, which is to maintain the long-term financial security of the with-profits sub-fund and to continue delivering strong relative performance for the benefit of its policyholders.

#### *Depletion of surplus assets and shareholders' contingencies*

As a proprietary insurance company, PAC is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers (the excess assets) in the long-term funds, represented by the unallocated surplus of with-profits funds could be materially depleted over time by, for example, a significant or sustained equity market downturn, costs of significant fundamental strategic change or a material increase in mis-selling provisions. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Prudential Group's ability to treat its customers fairly was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

In 1998, Prudential UK stated that deducting personal pensions mis-selling costs from the inherited estate of the with-profits sub-fund would not impact Prudential UK's bonus or investment policy. Prudential UK gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged.

The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing. The mis-selling review was completed on 30 June 2002 and consequently the assurance has not applied to new business issued since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The maximum amount of capital support available under the terms of the assurance will reduce over time as claims are paid on the policies covered by it.

The bonus and investment policy for each type of with-profits policy is the same irrespective of whether or not the assurance applies. Hence removal of the assurance for new business has had no impact on policyholder returns and this is expected to continue for the foreseeable future.

During 2009, the FSA issued a policy statement confirming that certain payments of compensation and redress for events occurring after 31 July 2009 may only be paid from assets attributable to shareholders. As the pensions mis-selling review was concluded prior to this date, the requirements of the policy statement do not impact the pensions mis-selling provision met from the inherited estate described above.

#### *The SAIF sub-fund and accounts*

The SAIF sub-fund is a ring-fenced sub-fund of PAC's long-term fund and was formed following the acquisition of the mutual Scottish Amicable Life Assurance Society in 1997. No new business may be written in SAIF, although regular premiums are still being paid on policies in-force at the time of the acquisition and "top-ups" are permitted on these policies.

This fund is solely for the benefit of those Scottish Amicable Life Assurance Society policyholders whose policies were transferred to SAIF. Shareholders have no interest in the profits of this fund, although they are entitled to the investment management fees paid on this business. The brand name and rights to profit on new business were transferred to a new Prudential UK subsidiary, Scottish Amicable Life plc, which operated for the benefit of shareholders.

With the exception of certain guaranteed annuity products, referred to below, the majority of SAIF with-profits policies do not guarantee minimum rates of return to policyholders. Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency. Due to the quality and diversity of the assets in SAIF and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the Directors believe that the probability of either the PAC's long-term fund or Prudential UK's shareholders' funds having to contribute to SAIF is remote.

#### *Non-participating business*

The majority of Prudential-branded non-participating business is written in the non-profit sub-fund of PAC's long-term fund or in subsidiaries owned by Prudential UK. Since mid-2004, Prudential UK has written all of its new non-profit annuity business through Prudential Retirement Income Limited ("PRIL"), from which the profits are attributed solely to shareholders. Prior to that time, certain non-profit annuity business was written through Prudential Annuities Limited ("PAL"), which is wholly owned by PAC's with-profits fund. The profits on this business are attributable to the fund and not to shareholders, although indirectly shareholders get one-ninth of additional amounts paid to policyholders through the declaration of bonuses.

The unit-linked business written by PAC and Prudential International Assurance is written with capital provided by shareholders.

#### *Guaranteed annuities*

PAC used to sell guaranteed annuity products in the United Kingdom and held a provision of £31 million as at 31 December 2009, within the main with-profits fund to honour guarantees on these products. PAC's main exposure to guaranteed annuities in the United Kingdom is through SAIF and a provision of £284 million was held in SAIF as at 31 December 2009, to honour the guarantees. As SAIF is a separate sub-fund of PAC's long-term business fund, this provision has no impact on shareholders.

## **4.5 M&G**

M&G is the Prudential Group's fund management business in the United Kingdom and continental Europe and comprises retail, institutional and internal fund management activities. Its key metrics of performance are investment performance, net investment flows and profits.

## *Fund management*

M&G is an investment-led business which aims to deliver superior investment performance and maximise risk-adjusted returns in a variety of macro-economic environments. Through M&G, the Prudential Group seeks to add value by generating attractive returns on internal funds as well as growing profits from the management of third party assets. Such external funds now represent 40% of M&G's total FUM as at 31 December 2009.

In the retail market, M&G's strategy is to maximise the value of its centralised investment function through a multi-channel, multi-geography distribution approach. Key themes in recent years have included the growing proportion of business sourced from intermediated channels and the growth of cross-border products. M&G has benefited from having a diverse product portfolio during the recent financial turmoil as inflows were received throughout 2009 despite investors' appetite for bond funds switching to equity funds during the second half of the year.

M&G's institutional strategy centres on leveraging capabilities developed primarily for internal funds into higher margin external business opportunities. In recent years this has allowed M&G to operate at the forefront of a number of specialist fixed income strategies, including leveraged finance and infrastructure investment. The recent chaos in capital markets has resulted in a renewed focus on more traditional credit and equity mandates, again drawing on its core research and investment expertise.

### *Key initiatives and performance*

Delivering fund performance remains critical and is the key determinant of success for an active asset management business. M&G has continued to deliver market-leading investment performance in 2009 with strong results.

In the three years to December 2009, 38% of M&G's retail funds delivered top-quartile investment performance<sup>(58)</sup>. Over the same period, 89% of M&G's active institutional funds delivered returns ahead of their benchmarks. On the back of this strong investment performance M&G delivered record net third party fund inflows of £13.5 billion in 2009, an increase of 296% year-on-year.

Gross third party fund inflows rose 54% to £24.9 billion. These third party inflows and the recovery of equity markets in the latter half of 2009 led to a 23% increase in M&G's total funds under management to £174 billion. As at 31 December 2009, 40% of M&G's funds under management were for third party clients.

M&G's retail business had a strong year in 2009, seeing net inflows jump by 259% over the year to £7.5 billion. Gross fund sales were up 50% at £13.6 billion. Sales of M&G's top-performing fixed income funds accounted for most of the inflows for most of the year before investor appetite switched to M&G's equity and property funds during the second half of 2009 as sentiment turned more bullish.

Similarly, the institutional business attracted a high level of net new third party business. Net inflows were £6.0 billion, a rise of 354% on 2008. This included the award of a single fixed income mandate valued at £4 billion and £0.8 billion of net new money into M&G's leveraged loan funds. Gross fund sales were up 59% at £11.3 billion.

Net sales remained robust in the fourth quarter of 2009. The retail business attracted net new money of £1.8 billion, more than double the £0.7 billion taken in the same quarter in 2008. Gross retail sales were £3.8 billion. The institutional business took £0.6 billion of net new business over the final three months compared with an outflow of £1.4 billion for the same period a year ago. Gross sales were 93% higher year-on-year at £2.7 billion.

During 2009, M&G's cost/income ratio was 65%, increasing from 60% in 2008. The increase can largely be attributed to the reinstatement of costs associated with the long-term incentive plan ("LTIP") as the medium-term outlook for the business improved in light of strong fund inflows and recovering market levels. M&G remains focused on cost control.

The following table shows funds managed by M&G at the dates indicated.

	<u>31 December 2007</u>	<u>31 December 2008</u>	<u>31 December 2009</u>
	£ billion	£ billion	£ billion
Retail fund management . . . . .	22	19	31
Institutional fund management . . . . .	29	28	39
Internal fund management . . . . .	<u>116</u>	<u>94</u>	<u>104</u>
Total . . . . .	<u>167</u>	<u>141</u>	<u>174</u>

(58) Source: Morningstar

## **4.6 Prudential Capital**

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

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

## **5. Major customers**

None of the Prudential Group's customers, nor its top five major customers combined, accounted for 30% or more of its gross written premiums, policy fees and deposits from its insurance businesses in 2007, 2008, 2009.

## **6. Product development**

The Prudential Group believes that it can benefit from an operating model that helps enable each of its businesses to stay close to its customers and their needs when formulating product and distribution strategies, whilst seeking to achieve a consistent and disciplined group-wide approach to managing risk, capital and cash. This group oversight is achieved through the annual planning process and approval of changes to those plans. Details of the products sold and recent initiatives are included in the discussion of each business unit in Section 4 of this Part VII.

## **7. Distribution Channels**

Prudential is not aware of any material non-compliance with local laws and regulations in respect of the contractual relationship between the relevant member of the Prudential Group and its agents and employees in the jurisdictions where the Prudential Group has material operations.

The Prudential Group distributes its products through all major distribution channels, including tied agents, banks, direct marketing and brokers, some of which are employees of the Prudential Group.

## **8. Training and development activities**

The Prudential Group has an established range of training and development activities for employees, including:

- Groupwide development programmes (the Leadership Development Programme and the Management Development Programme) for senior and middle management. These programmes identify the development that individuals need to be credible successors to future leadership roles in the Prudential Group;
- The Momentum Programme, which was launched in 2007 and aims to identify high-potential individuals early in their career, providing them with the opportunities to develop the skills needed to succeed in an international business. This programme is open to people both within and outside the Prudential Group and individuals are part of the programme for 4-6 years; and
- The Executive Development Programme, due for launch in May 2010, which will target future CEOs in Asia, providing them with the skills to be credible successors within 5 years.

Each business unit also provides tailored training and development activities for their employees, including:

- Online training available to employees of M&G and Prudential UK;
- The Managing for Success Programme launched in 2008 by Prudential UK to provide managers with the knowledge, skills and tools they need to manage people effectively;
- The Academy and Cornerstone Programmes in M&G, targeting future senior managers within the asset management business; and

- PruUniversity, a structured range of courses available to all Asian employees, covering a range of subjects from management and leadership to technical and commercial skills. Courses are available in a number of languages.

The Prudential Group is also committed to supporting movement across the group, which will provide critical experiences and development for its best people.

## **9. Existing listings**

The Existing Shares are listed on the premium segment of the Official List and admitted to trading on the London Stock Exchange's main market for listed securities. Prudential's 4.54% notes due 11 June 2008, 6.50% perpetual subordinated capital securities, index linked notes due 10 July 2023, 5.75% floating rate subordinated notes due 19 December 2021, 5 7/8% bonds due 2029, 6.125% subordinated notes due 19 December 2031, 6 7/8% bonds due 2023, Tier 1 notes, floating rate notes due 16 April 2010, 3.375% senior notes due 28 January 2013 and callable dated Tier 2 notes due 29 May 2039 are each listed on the standard segment of the Official List and admitted to trading on the regulated market of the London Stock Exchange. Prudential is subject to the provisions of the Listing Rules and to the provisions of the City Code on Takeovers and Mergers. ADRs have been listed for trading on the New York Stock Exchange since 28 June 2000. In addition, application has been made in Hong Kong to the Hong Kong Stock Exchange Listing Committee for the listing of, and permission to deal in Prudential Shares. Application has also been made in Singapore to the SGX-ST for the listing and quotation of Prudential Shares on the Main Board of the SGX-ST.

Settlement of dealings on the London Stock Exchange takes place on the third business day following the date of transaction. Settlement of dealings on the New York Stock Exchange takes place on the third business day following the date of transaction.

## PART VIII

### INFORMATION ABOUT THE AIA GROUP

For the purposes of reading this Part of the prospectus, you should refer to the list of explanations set out in paragraph 15 of Part XIII (*Operating and Financial Review of the AIA Group*) which contains explanations of certain terms used only in this Part VIII and Part XIII (*Operating and Financial Review of the AIA Group*) of this prospectus. These terms and their meanings may not always correspond to standard industry meaning or usage of these terms.

Unless otherwise indicated, the financial data relating to the AIA Group in this Part VIII has been extracted without material adjustment from the historical financial information of the AIA Group as reported on by PricewaterhouseCoopers set out at Part XV (*Historical Financial Information for AIA Group*) of this prospectus or from AIA Group's unaudited accounting records, operating systems and other information prepared by AIA or Prudential.

#### 1. Overview

The AIA Group is a leading life insurance organisation in Asia Pacific that traces its roots in the region back more than 90 years. It provides individuals and businesses with products and services for their evolving insurance, protection, savings, investments and retirement needs in 15 geographical markets in the region: Hong Kong, Korea, Thailand, Singapore, China, Malaysia, the Philippines, Australia, Indonesia, Vietnam, Taiwan, New Zealand, India, Macau and Brunei. In FY 2009, the AIA Group had US\$11,632 million in total weighted premium income ("TWPI"). As of 30 November 2009, it had US\$91.5 billion in total assets and total equity attributable to shareholders of AIA of US\$15.3 billion.

As of 30 November 2009, the AIA Group (excluding AIA India, a joint venture in which the AIA Group has a 26% equity interest) had approximately 15,500 employees serving the holders of its approximately 21.3 million in-force policies and approximately 9 million participating members of its clients for group life, medical, credit life coverage and pension products.

The AIA Group derives substantially all of its premiums from its 15 geographical markets across the Asia Pacific region. The AIA Group's individual local operating units are significant businesses in their own right, with Hong Kong, Singapore and Thailand each contributing more than US\$350 million of operating profit in FY 2009. At the same time, in FY 2008 and FY 2009, no more than 25% of the AIA Group's TWPI came from any one geographical market.

The AIA Group's extensive book of in-force business has created (i) a stable operating profit base, with (ii) high renewal premiums (84.1% of its TWPI consisted of renewal premium in 2009). In FY 2009, the AIA Group had an operating profit of US\$1,835 million and an AIA operating margin of 15.8%. In addition, as of 30 November 2009, it had capital in excess of its requirements under relevant Hong Kong insurance regulatory guidance and it complied with relevant capital adequacy requirements in each of its geographical markets.

The AIA Group was a market leader in the Asia Pacific region based on life insurance premiums in 2008, according to regulatory and industry sources in the relevant market. Owing to its historic roots in the Asia Pacific region, the AIA Group has built a network made up almost entirely of wholly-owned businesses operating as branches or subsidiaries.

As of 30 November 2009, the AIA Group's tied agency force consisted of approximately 162,720 agents (excluding those who serve AIA India). In each of Hong Kong, Singapore, and Thailand, the AIA Group's agency force made up more than 15% of the total agents in that market in 2008.

More recently, the AIA Group has developed its other distribution channels, particularly bancassurance and direct marketing. Bancassurance relationships, in the AIA Group's geographical markets excluding India, provide potential access to approximately 12,000 of its partners' bank branches.

#### 2. History

##### 2.1 Origins and development

The AIA Group traces its roots in Asia to 1919 when Cornelius Vander Starr, a young American entrepreneur, established a fire and marine insurance agency in Shanghai.

In 1931, the AIA Group's principal operating subsidiary, AIA Co, was initially registered in Shanghai as a Hong Kong company under the name International Assurance Company, Limited (later changed to American International Assurance Company, Limited). Within 7 years, the business had expanded into several other markets

in Asia Pacific through the establishment of branches in Singapore (1931), Hong Kong (1931), Malaysia (1934) and Thailand (1938, in respect of life insurance business), all of which remain key markets for the AIA Group today.

In the late 1940s, events in China led to the transfer of AIA Co's regional office to Hong Kong and, in 1950, the suspension of operations in the PRC. AIA Co's new Hong Kong base became the platform for a programme of post-war expansion with the geographical footprint of the AIA Group companies and branches expanding to include Brunei (1957), Australia (1972, in respect of life insurance business), New Zealand (1981), Macau (1982), Indonesia (1984), Korea (1987), Taiwan (1990), Vietnam (2000) and India (2001). Hong Kong was also the gateway back to mainland China in 1992 when AIA Co became the first foreign insurer to receive a licence to sell life insurance in the PRC and opened a branch office in Shanghai. Today, the AIA Group operates in China with licensed sales offices in 2 provinces (Guangdong and Jiangsu) and 3 cities (Shanghai, Beijing and Shenzhen).

Today, the AIA Group's Hong Kong base is the hub of an insurance network that spans the following 15 geographical markets:

<u>Geographical Market</u>	<u>Commencement of Life Insurance Operations</u>	<u>Ownership Structure</u>
Singapore . . . . .	1931	Branch
Hong Kong . . . . .	1931	Branch
Malaysia . . . . .	1934	Wholly-owned subsidiary (transferred from a branch in 2008)
Thailand . . . . .	1938	Branch
Philippines . . . . .	1947	Subsidiary (owned 99.78%)
Brunei . . . . .	1957	Branch
Australia . . . . .	1972	Wholly-owned subsidiary
New Zealand . . . . .	1981	Branch
Macau . . . . .	1982	Branch
Indonesia . . . . .	1984	Joint venture*
Indonesia . . . . .	1999	Wholly-owned subsidiary**
Korea . . . . .	1987	Branch
Taiwan . . . . .	1990	Branch
China . . . . .	1992	Branches
Vietnam . . . . .	2000	Wholly-owned subsidiary
India . . . . .	2001	Joint venture

\* Initial operation was via a joint venture that was divested on 22 October 2009.

\*\* The current Indonesian business is operated through PT AIA Financial. See section 6 (Primary operating units) below.

## **2.2 The AIG Events**

In the second half of 2008, the AIA Group's parent, AIG, experienced an unprecedented strain on liquidity. The two principal causes of the liquidity strain were demands for the return of cash collateral under AIG's US securities lending programme and collateral calls on AIG Financial Product Corp.'s super senior multi-sector collateralised debt obligations ("CDO") credit default swap portfolio. Both of these liquidity strains were significantly exacerbated by the downgrades of AIG's long-term debt ratings by S&P, Moody's and Fitch on 15 September 2008.

As a result of AIG's liquidity requirements and certain other events (collectively, the "AIG Events") and AIG's inability to find a viable private sector solution to its liquidity issues, AIG entered into the FRBNY Credit Agreement with FRBNY on 22 September 2008.

In March 2009, AIG announced that it had agreed to transfer its equity ownership of AIA Co to a special purpose vehicle in return for a reduction of the debt owed by AIG under the FRBNY Credit Agreement.

In May 2009, AIG announced that it would take additional steps to position the AIA Group as a separate entity and seek a public listing.

## **2.3 Impact of the AIG Events on the AIA Group**

The impact of the AIG Events on AIA Co included reputational damage, a decline in the value of new business, an increase in surrendered policies and the adverse impact on its capitalisation resulting from the decline in the value of AIG stock owned by AIA Co. Throughout this period, AIA Co worked closely with its regulators to ensure that policyholders were not adversely impacted by the AIG Events and to comply with regulatory requirements (including regulatory orders designed to protect the AIA Group's assets in several of its geographical markets).

Subsequent to the AIG Events, AIA Group management took steps to enhance the capital adequacy of the AIA Group by unwinding certain arrangements with the AIG Group. For more information concerning the financial performance of the AIA Group, see Part XIII (Operating and Financial Review of the AIA Group).

## **2.4 Reorganisation**

In 2009, the AIA Group was reorganised in order to improve operational and financial efficiency, respond to the AIG Events and better position the AIA Group for a public offering or a sale (collectively, the “Reorganisation”). The Reorganisation consisted of three phases: (1) rationalisation of the AIA Group structure; (2) reorganisation driven by the AIG Events; and (3) preparation for a public offering or a sale.

### **Phase I — Rationalisation of the AIA Group Structure**

For historical reasons, a number of the life insurance businesses that worked closely with AIA Co, and now form part of the AIA Group, were held directly by AIRCO, rather than as subsidiaries of AIA Co, the principal operating entity within the AIA Group. To rationalise the group’s structure, and simplify corporate governance, regulatory management, tax planning and legal and compliance functions, a reorganisation was initiated to transfer legal ownership of these entities, and of the Taiwan branch of ALICO, to create the AIA Group. On 28 February 2009, pursuant to the terms of a series of share swap agreements, this reorganisation was completed and AIA-B, AIA Australia and AIA-PT were transferred by AIRCO to AIA Co. On 1 June 2009, AIA-B acquired the business of the Taiwan branch of ALICO (now known as American International Assurance Company (Bermuda) Limited — Taiwan Branch).

The first phase of the restructuring brought within a single corporate group the Asia Pacific business that had been historically managed together from a regional office in Hong Kong.

### **Phase II — Reorganisation Driven by the AIG Events**

As a consequence of the AIG Events, on 2 March 2009, AIG and the FRBNY announced their intention to enter into certain transactions that would reduce AIG’s obligations under the FRBNY Credit Agreement and more clearly separate the AIA Group from the AIG Group.

On 25 June 2009, AIG, AIRCO and FRBNY entered into a purchase agreement (the “June 09 Purchase Agreement”) relating to AIA Co and Philamlife. Pursuant to the June 09 Purchase Agreement, AIG agreed to contribute the equity of AIA Co to a special purpose vehicle, AIA Aurora LLC, in exchange for the common interests in AIA Aurora LLC, and the FRBNY agreed to receive preferred interests in AIA Aurora LLC. As a result of the transactions contemplated by the June 09 Purchase Agreement, AIRCO transferred 100% of the common stock of AIA Co to AIA, a newly formed holding company wholly-owned by AIA Aurora LLC, on 30 November 2009. The June 09 Purchase Agreement also provided for Philamlife to be transferred to AIA Co as further described in “ — Transfer of Philamlife” in this section.

### **Phase III — Preparation for a public offering or a sale**

In the second half of 2009, the AIA Group acquired certain AIG life insurance businesses that had previously worked closely with AIA Co and divested certain businesses that were owned by members of the AIA Group for historical reasons but were more aligned with other entities and business lines in the AIG Group. The key transactions resulting from this reorganisation were as follows:

#### ***Transfer of Philamlife***

In August 2009, ALICO and AIG entered into an agreement with AIA Co to transfer all of their legal and beneficial interests in Philamlife to AIA Co in exchange for an AIA Co promissory note equal to the net book value of Philamlife. In conjunction with the transactions carried out under the June 09 Purchase Agreement, this promissory note was indirectly contributed by AIG to AIA Co and cancelled.

#### ***Sale of AIGGIC(A)***

AIG determined that AIG Global Investment Corporation (Asia) Ltd. (“AIGGIC(A)”), the asset management business owned by AIA-B (but managed by the AIG Group separately from AIA-B’s life insurance business), would be consolidated with AIG’s global asset management business, which was in the process of being sold to a third party as part of AIG’s global restructuring plan. Consequently, on 13 August 2009, AIG and AIA-B entered into a purchase agreement to transfer AIGGIC(A) and its subsidiaries, consisting of asset management and related entities, from AIA-B to AIG in exchange for a promissory note from AIG to AIA-B of US\$86,660,000. Prior to

closing of that sale, AIGGIC(A) was renamed PineBridge Investments Asia Limited. At the closing of the sale transaction, which occurred on 25 November 2009, AIGGIC(A) and certain of its asset management affiliates (collectively, “AIGGIC”) on the one hand and AIA Co, on the other hand, entered into agreements providing for certain services and transitional arrangements including the provision of investment management services by AIGGIC to the AIA Group. On 29 March 2010, AIG announced that AIGGIC was sold by AIG to Bridge Partners, L.P., an entity affiliated with the Pacific Century Group.

### ***Sale of ALICO***

In March 2010, AIG and ALICO Holdings LLC (“ALICO Holdings”) entered into a definitive agreement with MetLife, Inc. (“MetLife”) for the sale of ALICO by ALICO Holdings to MetLife, and the sale of Delaware American Life Insurance Company by AIG to MetLife, for approximately US\$15.5 billion, including US\$6.8 billion in cash and the remainder in equity securities of MetLife, subject to closing adjustments. According to AIG’s public announcement dated 8 March 2010, the sale of ALICO is expected to be completed by the end of 2010. ALICO was transferred by AIG to ALICO Holdings as part of the reorganisation driven by the AIG Events and has historically operated as a separate group.

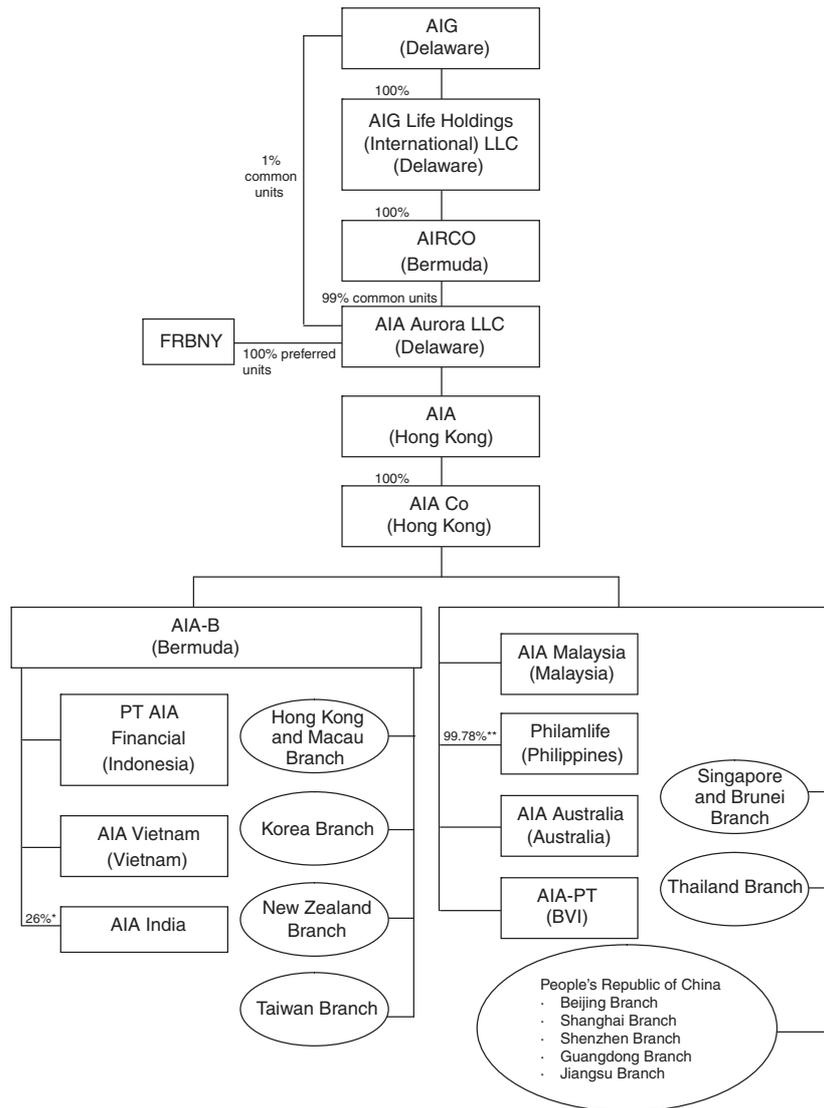
### ***2.5 The AIA Group’s next chapter***

The AIA Group’s profitable businesses have permitted the AIA Group to finance and construct an operating infrastructure in the region that permits it to operate on a largely standalone basis from AIG. The AIA Group has been engaged in a series of separation initiatives since 2007. In 2009, the AIA Group launched a new branding initiative throughout the Asia Pacific region to communicate its new identity and to transition branding in certain markets that have historically used the AIG brand.

### ***2.6 The Acquisition***

In March 2010, Prudential, AIA Aurora LLC and New Prudential entered into the Acquisition Agreement under which, subject to the terms and conditions of that agreement, New Prudential has agreed to acquire the entire issued share capital of AIA.

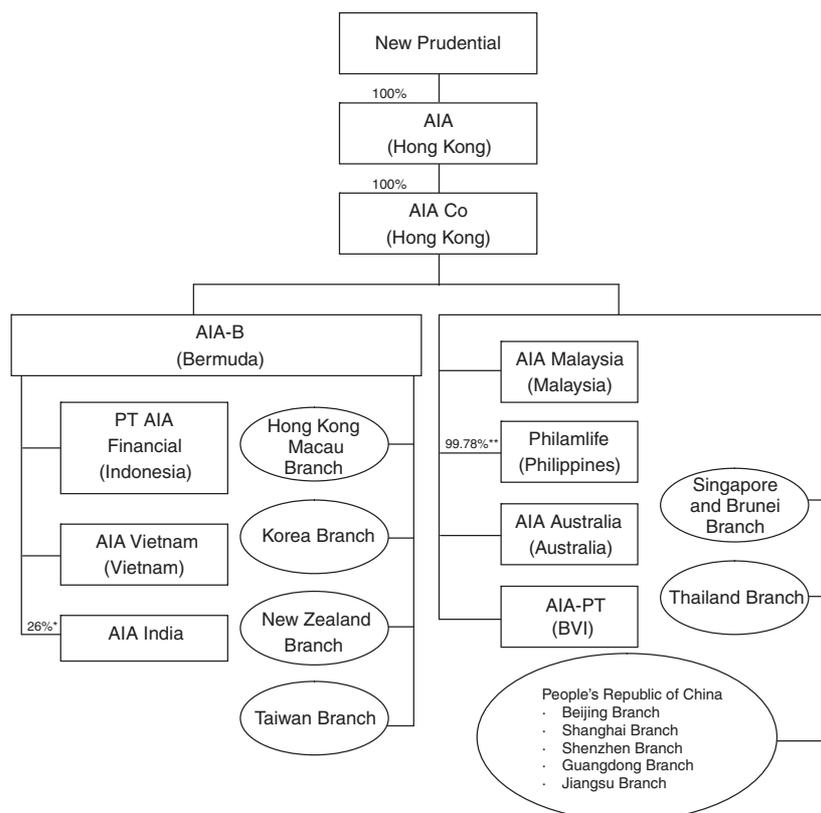
The following chart is a simplified representation of the principal operating subsidiaries and branches of the AIA Group following the Reorganisation but prior to the Acquisition. All subsidiaries are wholly-owned by AIA unless otherwise indicated.



\* The remaining interests in AIA India are held by Tata Sons Limited, AIA's joint venture partner.

\*\* Approximately 0.22% of Philamlife's shares are owned by 13 separate independent third parties consisting of 11 natural persons and the estate of two natural persons.

The following chart is a simplified representation of the principal operating subsidiaries and branches of the AIA Group following completion of the Acquisition. All subsidiaries are wholly-owned by AIA unless otherwise indicated.



\* The remaining interests in AIA India are held by Tata Sons Limited, AIA's joint venture partner.

\*\* Approximately 0.22% of Philamlife's shares are owned by 13 separate independent third parties consisting of 11 natural persons and the estate of two natural persons.

From completion of the Acquisition, AIA will no longer be a subsidiary of AIG, the agreements previously entered into by AIG and the FRBNY will cease to have effect in relation to the AIA Group and the FRBNY will cease to have any special rights with respect to AIA.

### 3. AIA Group strengths

The AIA Group's competitive strengths include:

#### *Deep and historic roots in the Asia Pacific region*

The AIA Group traces its roots in the Asia Pacific region back more than 90 years. It was among the first insurers to establish operations in many of its Key Geographical Markets and in certain cases played a role in the development of the life insurance industry in these markets. In Hong Kong, Singapore, Thailand and Malaysia, the AIA Group has sold life insurance products to its customers since the 1930s. It was also the first licensed foreign life insurer to establish operations in the PRC. The AIA Group's early entry into many of its geographical markets has given it a historic advantage in establishing a network made up almost entirely of wholly-owned businesses.

AIA has grown to become a household name with high brand recognition in its key geographical markets.

#### *A broad footprint across the Asia Pacific region*

Within the Asia Pacific region, the AIA Group has a broad geographical footprint, with a network stretching across 15 geographical markets. As of 30 November 2009, the AIA Group, excluding AIA India, had approximately 162,720 agents and approximately 15,500 employees serving the holders of its approximately 21.3 million in-force policies and its approximately 9 million participating members of its clients for group life, medical, credit life coverage and pension products.

Additional information on total weighted premium income and operating profits/(loss) by market is provided in Part XIII of this prospectus.

### ***An extensive tied agency network and an expanding multi-channel distribution platform***

The AIA Group had a large, long-standing tied agency force of approximately 162,720 agents, excluding those who serve AIA India, as of 30 November 2009, that is the cornerstone of its distribution platform. For many decades, the AIA Group's agents have provided it with significant reach and access in terms of face-to-face customer targeting and servicing capabilities, enabling it to build and maintain long-term relationships with its customers. The AIA Group's tied agency force spans the Asia Pacific region.

In each of Hong Kong, Singapore and Thailand, the AIA Group's tied agency force made up more than 15% of the total agents in that market in 2008. As of 1 August 2009, more than 1,300 of the AIA Group's agents, including those that serve AIA India, were members of the Million Dollar Round Table ("MDRT"), a global professional trade association that recognises significant sales achievements while working to develop professional and ethical sales practices.

In many of its geographical markets, the AIA Group has built and continues to develop other distribution channels to increase penetration and broaden its access to potential customers and to meet the evolving preferences of its current customers. For example, as of 30 November 2009, the AIA Group, excluding AIA India, has established approximately 80 bank relationships, giving it access to its partners' customers across approximately 12,000 bank branches. The AIA Group has also developed its direct marketing and IFA distribution channels across the region by drawing on well-established models in some of its key markets to capitalise on emerging direct marketing and IFA opportunities.

### ***A diversified suite of products and innovative product capabilities***

The AIA Group has a broad and diversified suite of products, ranging from traditional to investment-oriented products, that are designed to meet its customers' needs at different stages of their lives. This diversified product suite is intended to position the AIA Group to capture shifting demand across its geographical markets and cater to differences in such markets due to the varying stages of development of the life insurance industry. The AIA Group is continuing its focus on developing Takaful and Shariah-compliant products and services by actively pursuing Takaful opportunities in the region.

### ***Stable profitability and financial strength derived from a diversified base of geographical markets and products***

The AIA Group's extensive book of in-force business has created a stable profit base, with high renewal premiums (84.1% of the AIA Group's TWPI in FY 2009 consisted of renewal premiums). In FY 2009, the AIA Group had an operating profit of US\$1,835 million and an AIA operating margin of 15.8%.

The AIA Group derives its income from a diverse range of sources across its geographical markets. Three of the AIA Group's Key Markets, Hong Kong, Singapore and Thailand, each generated more than US\$350 million of operating profit in FY 2009, and Malaysia, China, Korea and its Other Markets produced US\$150 million, US\$89 million, US\$81 million and US\$191 million, respectively. At the same time, no more than 25% of TWPI in FY 2009 was derived from any one geographical market.

In addition, the AIA Group has a strong AIA solvency position on both a regional and individual geographical market basis. As of 30 November 2009, it had capital in excess of its requirements under relevant Hong Kong insurance regulatory guidance and it complied with relevant capital adequacy requirements in each of its geographical markets.

## **4. Products**

To serve the evolving needs of its customers, the AIA Group has developed and continues to expand a broad, diversified product suite that is designed to respond to its customers' needs at each stage of their lives. The AIA Group typically develops and launches numerous new products across its multi-channel distribution platform annually.

### ***4.1 Product strategy and development***

A key element of the AIA Group's product development strategy is to provide relevant product solutions that meet its clients' evolving insurance, protection, savings, investment and retirement needs. In addition, the AIA Group

varies its product offerings by geographical market in order to respond to both their varying stages of economic and regulatory development and specific market trends.

The AIA Group head office oversees a product development group consisting of three distinct teams: strategic marketing; target marketing and customer relationship management; and product management. The AIA Group head office is increasingly utilising sophisticated consumer research and analysis tools to identify trends and fill new product niches.

The AIA Group has an extensive proprietary information database accumulated over its long history in the Asia Pacific region. In addition, the AIA Group tests its products to ensure product features meet risk controls. The pricing of all products is overseen by the actuarial group which applies specific criteria so that all new products are vetted for profitability, capital efficiency and sustainability (i.e. that they remain profitable under various economic and market scenarios). Existing products are also reviewed annually to ensure that they continue to meet the AIA Group's profitability and capital efficiency requirements.

#### 4.2 Key product lines

TWPI and other information for the AIA Group's key products lines for the periods indicated is set forth in the table below:

	<u>Year Ended 30 November</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	(in US\$ millions)		
Ordinary individual life insurance . . . . .	7,216	7,439	7,285
AIA investment-linked products . . . . .	2,223	2,532	2,069
Standalone health and protection . . . . .	1,304	1,426	1,349
Group insurance . . . . .	502	704	877
Other . . . . .	113	102	52
<b>Total</b> . . . . .	<b><u>11,358</u></b>	<b><u>12,203</u></b>	<b><u>11,632</u></b>

#### *Ordinary individual life insurance*

The AIA Group offers a wide variety of life insurance products for individuals in four principal categories: term life; traditional basic participating; traditional basic non-participating; and universal life products. These products continue to be the major contributor to the AIA Group's TWPI, accounting for 63.5%, 61.0% and 62.6% in FY 2007, FY 2008 and FY 2009, respectively.

#### *Term life*

Term life insurance provides life insurance protection for a defined period. The sum assured under the policy is paid to the beneficiary if death occurs during the period of coverage.

#### *Traditional basic participating life insurance*

Participating policies are contracts of insurance where the policyholders have a contractual right to receive additional benefits based on investment return and/or other factors, as a supplement to any guaranteed benefits. In some markets, participating business is written in a participating fund that is distinct from the other assets of the insurer. In these markets, the allocation of benefits to participating policyholders from the assets held in the distinct participating fund is typically subject to minimum levels or other mechanisms established by applicable regulation. In markets where participating business is not written in a distinct fund, allocations to participating policyholders are based, at the insurer's discretion, on the investment performance of a group of assets or contracts and other factors. Whether participating policies are written in a distinct participating fund largely depends on local practice and regulation. The extent of policy participation may change over time.

#### *Traditional basic non-participating life insurance*

Traditional basic non-participating life insurance products are contracts of insurance where the policyholder has a guaranteed right to the benefit, which is not at the contractual discretion of the insurer.

### *Universal life products*

Universal life products are insurance products where the customer pays flexible premiums that are accumulated in an account and are credited with interest at a rate set by the insurer. The customer may vary the death benefit and the contract may permit the customer to withdraw the account balance, typically subject to a surrender charge.

### *AIA investment-linked products*

AIA investment-linked products, including variable universal life products, are insurance products where the surrender value of the policy is linked to the value of underlying investments (such as collective investment schemes, internal investment pools or other property) or fluctuations in the value of underlying investments or indices. Investment risk associated with the product is usually borne by the policyholder. Insurance coverage, investment and administration services are provided for which charges are deducted from the investment fund assets. Benefits payable will depend on the price of the units prevailing at the time of surrender, death or the maturity of the policy, subject to surrender charges. AIA investment-linked products are presented together with pension products for purposes of disclosure of financial information.

### *Health and protection*

The AIA Group offers health and protection and personal accident insurance products, which provide morbidity or sickness benefits and include health, disability, critical illness and accident cover. Health and protection insurance products are sold both as standalone policies and as riders that can be attached to the AIA Group's life insurance products. Health and protection riders are presented together with ordinary individual life insurance products for purposes of disclosure of financial information.

The market for health and protection is expected to grow as healthcare costs are shifted from governments to citizens in certain of the AIA Group's geographical markets. These products are key drivers of the AIA Group's profitability due to its extensive claims database; continuous experience tracking; proactive remedial actions; and economies of scale in operations.

### *Group insurance*

The group insurance business is operated through the Group Corporate Solutions division ("AIA GCS"), which provides employee benefits, credit insurance and pension products and services in the Asia Pacific region, serving approximately 99,000 corporate clients with approximately nine million participating members as of 30 November 2009, excluding corporate clients and participating members relating to AIA India's business. According to regulatory and industry sources in the relevant market, the AIA Group occupied the leading position in terms of market share of group life insurance premiums in 2008 in Hong Kong (17.9% of group medical insurance business) and Singapore (32%), for the year ended June 2009, in Thailand (23.5%) and for the year ended September 2009, in Australia (20.2%). The AIA Group distributes these products in all 15 of its geographical markets, generally by leveraging off its multi-channel distribution network. The AIA Group's most important geographical markets for these products and services, in terms of annual premiums, are Australia, Hong Kong, Malaysia, Singapore and Thailand.

One of the AIA Group's key strategies in this area is to leverage off its access to its participating members to distribute additional individual life insurance and health and protection insurance products that are tailored to improve the coverage provided by their employers. The AIA Group is increasing its agents' training on AIA GCS products to encourage greater sales, drive agency force productivity and explore alternative distribution models. For example, it is working to increase IFA sales of corporate products to smaller and medium-sized enterprises.

Group insurance, which is typically marketed to corporations, government entities and associations, has been a driver of both the AIA Group's product volume and profitability growth. Group insurance coverage is typically arranged by employers for employees of corporate or government entities. The employers typically pay premiums for basic policies, such as group term life and group medical coverage. Group credit life insurance products typically provide life insurance protection to the customers (borrowers) of financial lending institutions. The premium is usually built into the cost of the loans, which may cover mortgages, credit cards and auto loans. The AIA Group, excluding AIA India, has a significant in-force portfolio of group insurance policies with approximately 61,000 corporate policyholders and approximately eight million insured employees/members for group life insurance products, as well as approximately 1,500 corporate policyholders and approximately 1.8 million insured members for group credit life insurance products as of 30 November 2009.

### ***Corporate pension products***

The AIA Group's corporate pension products business is mainly operated by AIA Pension and Trustee Co. Ltd., a British Virgin Islands company ("AIA-PT") and American International Assurance Company (Trustee) Limited, a Hong Kong company ("AIA-T"). AIA-PT and AIA-T serve as trustees of a multi-investment manager platform offering more than 50 constituent funds under Hong Kong's Occupational Retirement Schemes Ordinance (Chapter 426 of the Laws of Hong Kong) ("ORSO") with respect to voluntary corporate pensions and Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong) ("MPFSO") with respect to defined contribution plans. These products are distributed across a range of distribution channels. AIA Pension also acts as the trustee of other collective investment schemes.

Since 2000, there has been a substantial increase in the AIA Group's pension business due to the Hong Kong government requiring mandatory provident funds for employees. As of 30 November 2009, AIA Pension had a combined US\$6.6 billion of assets under management for its pension management business that covers more than 1.1 million members of its approximately 38,000 ORSO and MPFSO clients in Hong Kong.

The AIA Group utilises mainly tied agency, brokerage and direct marketing channels to distribute pension products and its operations are supported by its proprietary Regional Pensions Administration System. The AIA Group uses a mixture of in-house managed funds and third party managed funds.

### ***Other products***

#### ***Annuity products***

The AIA Group's annuities products are savings products where the accumulated amount can be paid out to the customer in a variety of income streams. The purpose of these products is to fund retirement. The AIA Group generally has two main types of annuities product: a single premium product where a customer can invest money in a deferred annuity by paying a single lump sum or a flexible premium product where a customer can invest over a period of years. Customers can also generally purchase an immediate or income annuity with a single premium where annuity payments continue during the lifetime of the annuitant or for a fixed period.

#### ***General insurance (personal lines) products***

The AIA Group's personal lines insurance business comprises private motor insurance, buildings and household contents insurance, health and protection insurance, pet insurance, travel insurance and insurance for domestic helpers. It underwrites selected personal lines insurance in Hong Kong, Singapore and Malaysia. Key products include travel, home contents, private motor, domestic helper and personal liability insurance.

## **5. Distribution**

The AIA Group distributes its products through all major distribution channels, including tied agents, banks, direct marketing, IFAs and brokers.

Since 1931, the AIA Group has been developing a tied agency force that spans the Asia Pacific region. As of 30 November 2009, its tied agency force consisted of approximately 162,720 agents (excluding those who serve AIA India).

The AIA Group is expanding its other distribution channels to extend its exposure and reach. As of 30 November 2009, it had approximately 80 relationships with banks throughout the Asia Pacific region.

In Korea and Taiwan, the AIA Group has used sophisticated direct marketing distribution (such as database marketing) to expand its distribution platform. In addition, its products are also increasingly sold on a non-exclusive basis by IFAs and brokers, particularly in more developed markets such as Hong Kong, Singapore and Australia.

### ***Agency channel***

The AIA Group had agents accounting for more than 15% of the total tied agency force in Hong Kong, Singapore and Thailand in 2008. While these tied agents distribute almost all of the insurance products in the product range, they are a preferred distribution channel for many of the more complex, and generally more profitable, insurance products offered by the AIA Group, such as its universal life products. The tied agents are not employees of the AIA Group. The AIA Group's contractual arrangements with tied agents are reviewed by its legal and compliance departments to ensure that they comply in all material respects with the requirements of applicable law.

The tied nature of the agency model and the AIA Group's role in managing, training and motivating the agency force provides it with significant control over this distribution channel, allowing it to (i) drive the product strategy

and development process to meet specific customer segments and demands; (ii) anticipate the needs of customers and potential new customers; and (iii) create new products and disseminate best practice based on those needs.

In 2009, more than 1,300 of the AIA Group's tied agents, including those that serve AIA India, were rewarded for their productivity by membership in the MDRT, a global trade association that recognises significant sales achievements and works to develop professional and ethical sales practices. MDRT membership is an important measure of success in the life insurance industry. Fewer than 1% of life insurance agents industry-wide are registered MDRT members.

The following table shows the approximate size of the AIA Group's tied agency force in each of its 'Key Geographical Markets' and its 'Other Geographical Markets' as of 30 November 2009:

### Agency Size

<b>Geographical Market</b>	<b>Approximate Number of Tied Agents</b>
Hong Kong <sup>(1)</sup> . . . . .	8,600
Thailand . . . . .	80,780
Singapore <sup>(2)</sup> . . . . .	3,950
Malaysia . . . . .	10,710
China . . . . .	25,840
Korea . . . . .	4,370
Other Geographical Markets <sup>(3)</sup> . . . . .	<u>28,470</u>
<b>Total</b> . . . . .	<b><u>162,720</u></b>

(1) Amount includes Macau as of 31 October 2009.

(2) Amount includes Brunei.

(3) Amount excludes the agents that are part of the agency force of AIA India.

In its Key Geographical Markets, approximately 40.8% of the AIA Group's agency leaders and approximately 15.1% of the AIA Group's total tied agency force (which includes its agency leaders) have been AIA Group agents for more than 10 years as of 31 January 2010. In certain of the AIA Group's markets, tied agents have passed their agency businesses on to succeeding generations.

### **Agency management**

The AIA Group's tied agency force is led by a chief agency officer and a team of directors of agencies and agency executives. Each local operating unit has a team of employees dedicated to optimising that unit's agency force, which is structured as a hierarchy in which high achievers can advance to supervise and manage other agents. The agency executives supervise the agency leaders who, in turn, supervise the tied agents. As of 30 November 2009, there were approximately 400 agent trainers dedicated to the training of the tied agency force of the AIA Group, excluding AIA India. Agency staff monitor and audit the activities of the tied agency force. In order to supervise and motivate its agents, each local agency team has a wide range of responsibilities, including:

- developing and implementing strategic plans for agency expansion;
- providing advice to agency leaders on how to better manage their agencies;
- working with AIA Group agency to develop annual strategic plans and productivity goals;
- working with development teams to create agency incentive contests and award programmes; and
- overseeing training and development programmes for various levels of agents.

The AIA Group has developed an agency business strategy reflecting the varying nature of the markets in which it operates. In more developed markets, such as Hong Kong and Singapore, it is focusing on greater market and agent segmentation to serve better the high net worth population, improving agent compensation schemes to incentivise sales of more profitable products and developing a "needs-based" selling approach. In addition, it has taken steps to rationalise less productive agents in certain geographical markets. In faster growing markets, such as China, the priority is to expand the agency force by aligning manager compensation with recruiting success.

### ***Compensation***

The compensation system for tied agents aligns their incentives with the AIA Group's key objectives, such as sales of more profitable products, production and policy persistency. The core components of the agency compensation scheme are commissions, production bonuses and persistency bonuses. Reflecting the different operating environments in the Asia Pacific region, the specific terms and conditions regarding agent compensation vary from geographical market to market. For example, in many of the markets that the AIA Group has entered relatively recently, compensation is designed to drive agent recruitment and growth of the agency force, while arrangements in established markets place greater emphasis on sales of more complex and profitable products. The AIA Group constantly reviews its compensation arrangements in light of industry developments and has a well-defined internal approval process for any modifications to its compensation schemes.

### ***Training and development***

To enhance agent productivity and retention, the AIA Group has developed a training programme designed for new agents, experienced agents, new agency leaders and experienced agency leaders. At all levels, training focuses on compliance with local licensing requirements and the AIA Group's conduct guidelines, as well as productivity and profitability, with an emphasis on understanding the AIA Group's product suite so as to permit its agents to respond to customer needs with the relevant product solutions.

### ***Bancassurance channel***

The AIA Group has focused on extending its presence in bancassurance, which is an increasingly important distribution channel for its ordinary life and health and protection insurance products. As of 30 November 2009, the AIA Group, excluding AIA India, had approximately 80 bancassurance relationships, which range from exclusive agreements, which generally have a term of five years or more, to open architecture agreements. Open architecture agreements are non-exclusive and typically allow the AIA Group's partners to sell the insurance products of 2 to 4 insurance companies and have open-ended or one-year renewable terms. The AIA Group's (excluding AIA India) bancassurance partners have a network of approximately 12,000 bank branches, which provide the AIA Group with an opportunity to extend its reach and access its bancassurance partners' customers. In FY 2008, the AIA Group, excluding AIA India, entered into 15 new bank relationships, and in FY 2009, the AIA Group, excluding AIA India, added another 8 relationships, including an exclusive strategic joint venture in the Philippines in which Philamlife acquired a 51% stake in Ayala Life Insurance, Inc. ("Ayala Life"), the life insurance subsidiary of the Bank of the Philippine Islands ("BPI"), a leading bank in the Philippines, giving the AIA Group access to a distribution network with more than 750 branches.

Bancassurance is attractive because it provides access to the AIA Group's partners' client base and branch infrastructure, and extends the AIA Group's market reach and exposure. Bancassurance distribution is also responsive to the evolving needs of customers who prefer a single point of entry for banking, insurance and other financial services.

### ***Direct marketing channel***

Direct marketing is an increasingly important distribution channel for the AIA Group. The AIA Group employs direct marketing teams in Taiwan for both direct-to-consumer sales and for sponsor arrangements where it markets products to the customers of consumer lending partners. In Korea, the AIA Group utilises hybrid marketing, a distribution channel that relies on a phased sales approach consisting of telephone marketing followed by face-to-face meetings. It typically establishes sponsor partnerships on a market-by-market basis. The AIA Group's approach to direct marketing is diverse, leveraging several sub-channels such as broad media advertising; database marketing; outbound calling of affinity customers; and direct marketing agencies, which are external call centres that distribute its products. The AIA Group is developing additional direct marketing centres in Thailand, Australia and Indonesia. In Thailand, the AIA Group signed agreements with 5 new sponsor partners in 2008 and 2009. It also launched a broad marketing campaign in Thailand in the fourth quarter of 2008 for a guaranteed issue whole life product for senior citizens. In Indonesia, it set up a call centre in 2008 and extended a number of its bancassurance relationships to include a direct marketing component in 2009.

### ***IFA brokerage channel***

The AIA Group utilises IFA/brokerage distribution channels primarily in Hong Kong, Singapore and Australia. As of 30 November 2009, it had approximately 400 active relationships (i.e. the business partner regularly submits new business to the AIA Group) with business partners in this channel, including relationships with approximately 270 broker-dealerships in Australia, 123 IFAs in Hong Kong and 8 financial advisers in Singapore. Arrangements

between the AIA Group and its IFA/brokerage partners are typically non-exclusive and include commission-based payment terms. As of 30 November 2009, the average duration of AIA Group's IFA/brokerage relationships in Hong Kong, Australia and Singapore was approximately 10.6, 5.5 and 2.5 years, respectively.

IFA/brokerage distribution may become increasingly important in the AIA Group's more developed markets, to the extent that sophisticated customers, particularly high net worth individuals, seek independent advice from advisers. For this reason, the AIA Group has established a dedicated team of channel specialists at the AIA Group level to drive its "partnership model" to develop sustainable long-term and productive relationships in its existing markets. The establishment of a robust platform is designed to position it to expand this channel presence into new markets as prevailing conditions and regulations allow.

## **6. Primary operating units**

The AIA Group has local operating units in 15 geographical markets which gives it a broad geographic footprint in the Asia Pacific region and access to both high growth emerging markets and more developed markets like Hong Kong, Singapore and Malaysia. The AIA Group classifies Hong Kong, Korea, Thailand, Singapore, China and Malaysia as its Key Geographical Markets, and the Philippines, Australia, Indonesia, Vietnam, Taiwan, New Zealand, India, Macau and Brunei, taken together, as its Other Geographical Markets.

### **6.1 Key geographical markets**

#### *Hong Kong*

The AIA Group began conducting business in Hong Kong in 1931 when AIA Co established a branch in Hong Kong. The AIA Group has maintained a presence in Hong Kong for over 70 years, except for limited interruptions. Hong Kong is the location of the AIA Group's head office. The AIA Group occupied the leading position in the Hong Kong life insurance market with a reported 14.6% market share of total premiums (excluding certain retirement scheme-related group business classes) in 2008, based on data published by the OCI. AIA Hong Kong served more than 1 million individual customers as of 30 November 2009.

AIA Hong Kong maintains a multi-channel distribution network. Its primary distribution channel is its agency force. Based on data published by the Hong Kong Federation of Insurers, AIA Hong Kong had the largest agency force in the Hong Kong life insurance market with approximately 7,800 agents, which represents more than 25% of the total individual agents in the market as of 30 November 2009. AIA Hong Kong's agency force is characterised by both its stability (more than 2,500 agents had over 10 years of service with AIA Hong Kong as of 31 July 2009) and its professionalism and productivity (more than 660 agents, the highest number in the Hong Kong market, were MDRT members as of August 2009). Through its IFA/brokerage distribution channel, AIA Hong Kong has partnered with approximately 480 broker firms and established approximately 40 significant business relationships as of 30 November 2009.

#### *Thailand*

The AIA Group began conducting business in Thailand in 1938 when AIA Co established a branch there. AIA Co was one of the first international life insurance companies to operate in Thailand. The AIA Group occupied the leading position in Thailand's life insurance market with a reported 37.5% market share of total premiums in 2008, based on data published by the Thai Life Assurance Association. AIA Thailand had the largest number (approximately 6.4 million based on data published by the Thai Life Assurance Association) of in-force insurance policies for life and personal accident products among life insurance companies operating in the country as of 31 December 2008.

The cornerstone of AIA Thailand's distribution strategy is its large network of approximately 80,780 agents as of 30 November 2009. This distribution channel has historically accounted for a high proportion of AIA Thailand's business. In addition, AIA Thailand had 7 bancassurance relationships, giving it access to more than 1,300 bank branches, as of 30 November 2009. AIA Thailand also had approximately 8 active direct marketing relationships as of 30 November 2009.

#### *Singapore*

The AIA Group began conducting business in Singapore in 1931 when AIA Co established a branch in Singapore. It has maintained a presence in Singapore for nearly 80 years, except for limited interruptions, and was one of the first international insurers to operate in the country. The AIA Group occupied the leading position in Singapore's life insurance market with a reported 20.2% market share of total premiums in 2008, based on data published by the Monetary Authority of Singapore. AIA Singapore served more than 900,000 individual customers as of

30 November 2009, which represents approximately 25% of Singapore's residents (calculated as at 28 September 2009).

AIA Singapore's agency channel has historically been the major contributor to AIA Singapore's sales production, although bancassurance is a growing distribution channel. AIA Singapore had approximately 3,760 agents as of 30 November 2009. AIA Singapore had approximately 4 bancassurance relationships as of 30 November 2009. Among other purposes, AIA Singapore's bancassurance channel is used to access Singapore's high net worth customer segment and to distribute investment products.

### *Malaysia*

The AIA Group began conducting business in Malaysia in 1934 as a branch of AIA Co. In 2008, its Malaysian branch operations were converted to a locally incorporated company. In 2008, AIA Malaysia became the first life insurance company in Malaysia to receive an international Takaful operator licence, and is one of few life insurance companies in Malaysia offering Takaful products in international currencies. AIA Takaful International Bhd was then formed to focus on foreign currency denominated Takaful insurance and re-Takaful business. The AIA Group occupied the third position in Malaysia's life insurance market with a reported 13.3% market share of premiums in 2008, based on data published by the Life Insurance Association of Malaysia. AIA Malaysia had an in-force book of business in excess of 2 million policies as of 30 November 2009.

A number of channels within AIA Malaysia's multi-channel distribution network contribute to its sales, with its agency force constituting the majority of sales production. AIA Malaysia had the second largest agency force in the Malaysian life insurance market with approximately 10,710 agents as of 30 November 2009, based on data published by the Life Insurance Association of Malaysia. AIA Malaysia had approximately 6 bancassurance relationships as of 30 November 2009. AIA Malaysia's growing direct marketing distribution channel had over 20 direct marketing relationships as of 30 June 2009.

### *China*

The AIA Group returned to the PRC in 1992 when it opened a branch in Shanghai, but the AIA Group has roots in China dating back to 1919. AIA China currently operates in 2 provinces (Guangdong and Jiangsu) and 3 cities (Shanghai, Beijing and Shenzhen), representing a population of more than 200 million people. AIA China was the first foreign life insurance company to be licensed to operate in China.

The AIA Group occupied the leading market position among foreign life insurance companies, with approximately a 21% market share of total premiums earned by foreign life insurance companies in 2008, based on data published by the China Insurance Regulatory Commission ("CIRC"). The AIA Group had a reported 1.0% market share of life insurance premiums earned by both domestic and foreign life insurance companies in 2008, based on data published by the CIRC.

AIA China maintains a multi-channel distribution network. Agency is the core distribution channel and AIA China had approximately 25,840 agents as of 30 November 2009. AIA China has a growing presence in both bancassurance and the direct marketing channels. AIA China had approximately 17 bancassurance relationships, which provided it with access to more than 1,100 bank branches, as of 30 November 2009. AIA China's direct marketing channel is supported by a sales force of approximately 460 telesales representatives as of 30 November 2009.

### *Korea*

AIA Korea commenced operations in 1987, initially as a branch of ALICO. AIA Korea was reorganised as a branch of AIA-B in 1997, although ALICO continued to have some management and reporting oversight over AIA Korea through 2008. In 2000, AIA Korea began operating under the name "AIG Life Korea". In May 2009, AIA Korea initiated a re-branding campaign and currently operates under the name "AIA Life". The AIA Group occupied the third position among foreign life insurance companies (excluding those operating through joint venture arrangements), with an approximate 16.6% market share of total premiums earned by foreign life insurance companies for the year ended 31 March 2009, based on data published by the Korea Life Insurance Association. The AIA Group had a reported 3.5% market share of life insurance premiums earned by both domestic and foreign life insurance companies in 2008, based on data published by the Korea Life Insurance Association. AIA Korea served more than two million individual customers and had approximately 3.1 million in-force policies as of 30 November 2009.

A number of channels within AIA Korea's multi-channel distribution network contribute to its sales. AIA Korea's agency force had approximately 4,370 agents as of 30 November 2009, and is one of the most productive agency

forces in the AIA Group, with first year premiums of approximately 111 million Korean Won per agent in 2008. In the direct marketing distribution channel, AIA Korea has 15 dedicated call centres and total staff of approximately 620 telemarketers as of 30 November 2009. In September 2006, AIA Korea launched hybrid marketing, a distribution channel that relies on a phased sales approach consisting of telephone marketing followed by face-to-face meetings. This channel had more than 450 master planners (i.e. personnel that work in the hybrid marketing channel) as of 30 November 2009 and is an important distribution channel for AIA Korea. Bancassurance is also an important distribution channel, and AIA Korea had bancassurance relationships with approximately 17 banks and 7 securities companies as of 30 November 2009.

## **6.2 Other geographical markets**

### *Philippines*

Philamlife was formed in 1947 and is one of only three life insurers in the Philippines with a composite insurer's licence. Philamlife recently joined the AIA Group. Philamlife occupied the leading position in the Philippines' life insurance market with approximately a 24% market share of total premiums (as classified by the Philippine Insurance Commission) in 2008, based on data published by the Philippine Insurance Commission. Philamlife served more than one million individual customers and corporate clients as of 31 December 2008.

Philam Asset Management, Inc. ("PAMI"), established in 1992, provides asset management services. PAMI had more than US\$330 million assets under management, representing approximately 23%, or the second highest amount, of assets under management in the Philippines' asset management industry as of October 2009, based on data published by the Investment Company Association of the Philippines. PAMI leverages the distribution platform of Philamlife to distribute its broad line of investment products, including 6 PAMI-managed mutual funds.

Philamlife's agency force and bancassurance relationships constitute the majority of Philamlife's sales production. Philamlife had the largest agency force in the Philippines' life insurance market with approximately 5,920 agents as of 30 November 2009. Philamlife entered into a strategic exclusive bancassurance joint venture in the second half of 2009 with BPI, as part of which Philamlife acquired a 51% stake in Ayala Life Assurance Inc. (subsequently re-named BPI – Philam Life Assurance Corporation), the life insurance subsidiary of BPI and entered into a bancassurance distribution agreement with BPI. The total consideration payable by Philamlife was US\$39 million. This amount is subject to purchase price adjustment, estimated to be US\$7 million, based on the final adjusted net worth of Ayala Life as at the date of acquisition. Among other things, this strategic bancassurance joint venture provides Philamlife with access to BPI's network of over 750 bank branches.

### *Australia*

AIA Australia, a wholly-owned subsidiary of AIA Co, was formed in 1970 and registered under relevant Australian life insurance legislation in 1972. AIA Australia has historically operated under the "AIA" brand, although from 2004 to June 2009 it operated under the "AIG" and related brands. In June 2009, AIA Australia re-branded back to the "AIA" brand.

Based on data published by Plan for Life, AIA Australia occupied (i) the sixth position in Australia's life risk insurance segment, with a reported 8.4% market share of total premiums in the 12 months ended 30 June 2009; (ii) the second position in Australia's life risk insurance segment in terms of total new sales, with a reported 14.7% market share in the 12 months ended 30 June 2009; and (iii) the leading position in the group life risk insurance segment, with a reported 20.0% market share of total premiums in the 12 months ended 30 June 2009.

The life risk group insurance channel and IFA channel have historically been the most important to AIA Australia's sales production. AIA Australia's life risk group insurance channel distributes products through its approximately 20 contracts with regulated superannuation funds. AIA Australia had more than 2,200 IFA relationships as of 30 November 2009. AIA Australia served approximately 1.8 million customers as of 30 November 2009.

### *Indonesia*

The AIA Group entered Indonesia in 1984 via a joint venture, PT Asuransi AIA Indonesia. In order to simplify its operations in Indonesia and enable the AIA Group to focus on running one core, wholly-owned multi-channel life insurer under the AIA brand in Indonesia, the AIA Group exited this joint venture by selling its 60% interest to its joint venture partner on 22 October 2009. The AIA Group's current business in Indonesia is not related to its former joint venture and operates through PT AIA Financial. AIA Indonesia was granted a Shariah life insurance licence in August 2009. AIA Indonesia occupied third position in Indonesia's life insurance market with a reported approximate 12.6% market share of premiums (as classified by the Indonesian Life Insurance Association) in 2008, based on data published by the Indonesian Life Insurance Association.

AIA Indonesia maintains a multi-channel distribution network. AIA Indonesia had approximately 10,760 agents as at 30 November 2009 and approximately 8 bancassurance relationships that provided it with access to over 1,000 bank branches as of 30 November 2009. AIA Indonesia served approximately 600,000 in-force policies as of 30 November 2009. AIA Indonesia also utilises direct marketing and group distribution channels.

#### *Taiwan*

The AIA Group's branch in Taiwan commenced business in 1990. On 1 June 2009, AIA-B acquired the business of the Taiwan branch of ALICO and changed the legal name of that business to American International Assurance Company (Bermuda) Limited — Taiwan Branch. AIA Taiwan served more than 110,000 individual customers as of 30 November 2009.

AIA Taiwan's multi-channel distribution network consists of bancassurance, direct marketing and broad marketing, a channel that utilises mass marketing through television, newspapers and magazines. AIA Taiwan had 7 bancassurance relationships as of 30 November 2009 and, as of 31 October 2009, employed more than 200 direct marketers in charge of selling its products by phone.

#### *Vietnam*

AIA Vietnam, a wholly-owned subsidiary of AIA-B, was formed in 2000 and was one of the first foreign-owned life insurers to operate in the country. AIA Vietnam has historically operated under the "AIA" brand, although during a limited period between August 2008 and June 2009 it operated under the "AIG" brand. In June 2009, AIA Vietnam re-branded back to the "AIA" brand. AIA Vietnam occupied the fourth position in Vietnam's life insurance market with a reported 6.7% market share of total premiums in the 12 months ended 31 December 2009, based on data published by the Association of Vietnamese Insurers. AIA Vietnam had approximately 230,000 in-force policies as of 30 November 2009.

AIA Vietnam's agency channel has historically dominated its sales production. AIA Vietnam had the third largest individual agency force in the Vietnamese life insurance market with approximately 11,790 agents as of 30 September 2009, based on data published by the Association of Vietnamese Insurers. AIA Vietnam is focused on building multi-channel distribution capabilities and has entered into distribution agreements with 4 bank partners.

#### *New Zealand*

AIA New Zealand commenced business in 1981, initially as a branch of ALICO. Between 1993 and 1996, the business was transferred to AIA-B and began doing business under the "AIA New Zealand" brand. AIA New Zealand occupied the sixth position in New Zealand's life insurance market with a reported 6.2% market share of total premiums as of 30 June 2009, based on data published by the Investment Savings and Insurance Association of New Zealand. AIA New Zealand served more than 48,000 individual customers and corporate clients as of 30 November 2009. AIA New Zealand actively participates in the group insurance market.

AIA New Zealand's IFA channel has historically dominated AIA New Zealand's sales production. AIA New Zealand had over 2,500 IFA relationships as of 30 November 2009. This distribution channel has been supplemented by a modest bancassurance channel.

#### *Macau*

AIA Macau began its business in 1982. AIA Macau is managed and supported by AIA Hong Kong and is a branch of AIA-B. AIA Macau occupied the leading position in Macau's life insurance market with a reported 36.1% market share of premiums (as classified by the Monetary Authority of Macau) in 2008, based on data published by the Monetary Authority of Macau.

AIA Macau had the largest agency force in the Macau life insurance market with more than 800 agents, representing over 35% of the total individual agents in the market as of 31 October 2009, based on data published by the Monetary Authority of Macau.

#### *Brunei*

AIA Brunei was registered for business in 1957, and the AIA Group was one of the first international life insurance companies to operate in the country. AIA Brunei is managed and supported by AIA Singapore and is a branch of AIA Co. The AIA Group occupied the leading position in Brunei's life insurance market with an estimated 70%

market share of the life insurance market (excluding life Takaful products) as at October 2009, based on data published by Axco Insurance Information Services.

AIA Brunei's main distribution channel is its network of an estimated 190 agents as of 30 November 2009. Bancassurance is a growing distribution channel for AIA Brunei, and it currently has 3 distribution relationships with major financial institutions.

#### *AIA Pension*

AIA-PT was formed in 1992 and AIA-T was formed in 1987. AIA-PT and AIA-T serve as trustees of a multi-investment manager pension platform offering more than 50 constituent funds under Hong Kong's ORSO with respect to voluntary corporate pensions and Mandatory Provident Funds Scheme Ordinance with respect to defined contribution plans. AIA Pension also acts as the trustee of other collective investment schemes. AIA Pension strives to provide a comprehensive investment platform to satisfy the spectrum of individual member's risk appetites as well as investment management needs.

There are approximately 19 approved trustees in the mandatory provident fund market and AIA Pension (together with JF Asset Management, with which it formed a strategic alliance in 1999) occupied third position in the mandatory provident fund market with approximately a 10.1% market share of assets under management as of 30 June 2009, based on the Gadbury Group Limited report on MPF Market Shares and Estimated New Fund Inflows in the Mandatory Provident Fund System, Hong Kong. As of 30 November 2009, AIA Pension had a combined US\$6.6 billion of assets under management for its pension management business that covered more than 1.1 million members of its approximately 38,000 ORSO and mandatory provident fund clients. AIA Pension's products are distributed across a range of distribution channels, including registered mandatory provident fund intermediaries in AIA Hong Kong's tied agency force and brokers, IFAs, consultants and bank partners.

### **6.3 Joint ventures**

#### *India*

The AIA Group commenced operations in India in 2001 through a joint venture established with Tata Sons Limited under the name Tata AIG Life Insurance Company Limited. The AIA Group has a 26% equity interest in AIA India.

It is currently intended that the AIA Group's equity interest in AIA India will be disposed of at fair-market value either before or around the time of completion of the Acquisition.

## **7. Investments**

The carrying value of AIA total investment portfolio was US\$77 billion as of 30 November 2009, of which policyholder and shareholder investments (i.e. excluding investment-linked investments) ("Policyholder and Shareholder Investments") represented 82% and investments related to investment-linked and pension business ("Investment-linked Investments") represented 18% of AIA total investment portfolio. Investment return associated with investment-linked, including pension products, is generally passed through to policyholders. The AIA Group's investments and investment management functions are key aspects of the AIA Group's business and can create significant value for the AIA Group's customers and shareholders. The AIA Group's financial strength and ability to profitably underwrite insurance business depends significantly on the quality and performance of its investment portfolios. The AIA Group invests the premiums and other income generated from its insurance business with an objective of meeting the future liabilities associated with the insurance products that it underwrites, as well as to generate desired return for its business. The AIA Group's success in investment management contributes to the competitiveness of its products, its financial strength and business reputation.

The AIA Group's long-standing culture of disciplined investing, active management of investments and risk management have enabled it to maintain financial stability through many varied business and economic cycles, including the global economic downturn. The AIA Group has the investment expertise with which to manage its portfolios across its geographical markets. During the period of significant volatility and uncertainty which affected the markets in the second half of calendar year 2008 and the earlier part of calendar year 2009, the AIA Group preserved its capital and the value of its investments by reducing its exposure to riskier assets and increasing its fixed income investment allocation and cash balances.

## **7.1 Investment objectives and processes**

### *Policyholder and shareholder investments*

For the AIA Group's Policyholder and Shareholder Investments, the primary investment principle is to achieve optimal levels of risk-adjusted return for policyholders and shareholders over the long-term while: (i) preserving capital; (ii) maintaining adequate solvency and liquidity levels; (iii) remaining in line with risk management and asset-liability management objectives; and (iv) ensuring full compliance with applicable regulations and internal policies. The AIA Group's investment objective is to produce stable and consistent income and returns, mainly through investments in long duration fixed income instruments. The AIA Group also invests a portion of its portfolio in other asset classes, such as public equities, private equities and real estate, to generate higher returns.

To meet these objectives, the AIA Group has established a structured investment management framework including: (i) a liability-driven strategic asset allocation ("SAA") benchmark designed to match its long-term liability requirements (i.e. one to five year horizon); (ii) a market-driven tactical asset allocation ("TAA") overlay designed to reduce risk and benefit from market opportunities in the near term; and (iii) a combination of internal and external investment management for individual asset class management designed to create value from optimising the mix of managers.

### *Investment-linked investments*

AIA investment-linked products are insurance products where the surrender value of the policy is linked to the value of underlying investments (collective investment schemes, internal investment pools or other investment instruments). Investment return associated with the product is usually passed through to the policyholder. The AIA Group's pension business predominantly consists of employer-sponsored defined-contribution arrangements. Employers use the AIA Group as their service provider and either select specific funds for investment or allow participating employees to choose their own funds. The AIA Group's pension business provides fund analysis, risk profiling and prevailing market condition outlooks to policyholders from chosen third party fund managers.

## **7.2 Investment management**

The AIA Group manages its investment portfolio using a combination of internal and external managers. The AIA Group's Policyholder and Shareholder Investments are primarily managed internally, while Investment-linked Investments are primarily managed by third parties.

Historically, AIG Global Investment Corporation was the AIA Group's primary investment manager for certain fixed income, equity and real estate investments, providing both back office and front office functions. On 29 March 2010, AIG announced that AIGGIC(A) and certain of its affiliates had been sold to Bridge Partners, L.P., an affiliate of the Pacific Century Group. That business is now known as PineBridge Investments Asia Limited ("PineBridge"). AIG retained certain portions of the business through its subsidiary, AIG Asset Management (Asia) Limited ("AIG-AMG"). Certain front and back office services will continue to be provided to the AIA Group by PineBridge and AIG-AMG. PineBridge managed approximately 15% of AIA total investment portfolio as of 30 November 2009 relating to fixed income securities, public equities and private equities. AIG-AMG managed approximately 11% of AIA total investment portfolio as of 30 November 2009 primarily relating to non-Asian fixed income securities.

To ensure the quality of third party funds underlying AIA investment-linked products, the AIA Group has in place a set of quantitative and qualitative criteria that enables it to select as well as monitor the underlying investment fund on an ongoing basis. Other geographical markets where AIA investment-linked products are sold may adopt a different selection and monitoring framework due to specific local regulatory requirements and varied degree of product maturity.

The AIA Group's pension platform offers a wide range of funds managed by third parties where valuations are tied to the price of the unit of the underlying fund. The selection of asset management companies and their underlying funds is subject to a rigorous selection process and is reviewed in comparison to established benchmarks and relevant peer groups. The AIA Group puts underperforming funds on a closely monitored watch list and replaces those that do not demonstrate clear signs of improvement.

## **7.3 Investment portfolio**

### *Overview*

The AIA Group manages its financial investments in two distinct categories: Investment-linked Investments and Policyholder and Shareholder Investments. The investment risk in respect of Investment-linked Investments is generally borne by customers. Furthermore, investment-linked contract holders are responsible for allocation of

their policy values among investment options offered by the AIA Group. Policyholder and Shareholder Investments include all financial investments other than Investment-linked Investments. The investment risk in respect of Policyholder and Shareholder Investments is partially or wholly borne by the AIA Group.

The AIA Group's investment portfolio consists of two principal asset classes: (i) fixed income securities and (ii) equity securities and alternative investments. The following table sets forth the carrying value of the AIA Group's principal asset classes in its investment portfolio as of the dates indicated:

As of 30 November 2007					
	Policyholder and Shareholder Investments	% of Total Policyholder and Shareholder Investments	Investment- linked Investments	% of Total Investment- linked Investments	Total
(in US\$ millions)					
Fixed income securities . . . . .	49,184	82	2,202	17	51,386
Equity securities and alternative investments . . . . .	<u>10,557</u>	<u>18</u>	<u>11,040</u>	<u>83</u>	<u>21,597</u>
<b>Total</b> . . . . .	<b><u>59,741</u></b>	<b><u>100</u></b>	<b><u>13,242</u></b>	<b><u>100</u></b>	<b><u>72,983</u></b>
As of 30 November 2008					
	Policyholder and Shareholder Investments	% of Total Policyholder and Shareholder Investments	Investment- linked Investments	% of Total Investment- linked Investments	Total
(in US\$ millions)					
Fixed income securities . . . . .	46,845	91	2,691	32	49,536
Equity securities and alternative investments . . . . .	<u>4,475</u>	<u>9</u>	<u>5,682</u>	<u>68</u>	<u>10,157</u>
<b>Total</b> . . . . .	<b><u>51,320</u></b>	<b><u>100</u></b>	<b><u>8,373</u></b>	<b><u>100</u></b>	<b><u>59,693</u></b>
As of 30 November 2009					
	Policyholder and Shareholder Investments	% of Total Policyholder and Shareholder Investments	Investment- linked Investments	% of Total Investment- linked Investments	Total
(in US\$ millions)					
Fixed income securities . . . . .	56,640	89	2,598	19	59,238
Equity securities and alternative investments . . . . .	<u>6,690</u>	<u>11</u>	<u>11,080</u>	<u>81</u>	<u>17,770</u>
<b>Total</b> . . . . .	<b><u>63,330</u></b>	<b><u>100</u></b>	<b><u>13,678</u></b>	<b><u>100</u></b>	<b><u>77,008</u></b>

The AIA Group generally allocates a large proportion of its investment portfolio to fixed income securities, which represented 82%, 91% and 89% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. Equity securities and alternative investments, which totalled 18%, 9% and 11% of the carrying value of total Policyholder and Shareholder Investments as of 30 November, 2007, 2008 and 2009, respectively, declined in FY 2008 primarily as a result of the AIA Group de-risking its investment portfolio as a result of the global economic downturn and the AIG Events as well as the decline in fair value of AIG shares, which made up approximately 25% of its total equity portfolio as of 30 November 2007.

*Fixed income investment portfolio*

The following table sets forth the carrying value of the subcategories of fixed income securities in the AIA Group's investment portfolio as of the dates indicated.

As of 30 November 2007					
<u>Policyholder and Shareholder Investments</u>	<u>% of Total Policyholder and Shareholder Investments</u>	<u>Investment-linked Investments</u>	<u>% of Total Investment-linked Investments</u>	<u>Total</u>	
(in US\$ millions)					
<b>Debt securities:</b>					
Government bonds . . . . .	15,811	26	286	2	16,097
Government agency bonds . . . . .	6,862	12	164	1	7,026
Corporate bonds . . . . .	18,210	31	1,020	8	19,230
Structured securities . . . . .	<u>2,033</u>	<u>3</u>	<u>18</u>	<u>—</u>	<u>2,051</u>
Subtotal . . . . .	42,916	72	1,488	11	44,404
<b>Loans:</b>					
Policy loans . . . . .	1,327	2	—	—	1,327
Mortgage loans on residential real estate . . . . .	609	1	—	—	609
Mortgage loans on commercial real estate . . . . .	112	—	—	—	112
Inter-company loans to fellow subsidiaries of AIG . . . . .	1,589	3	—	—	1,589
Other loans . . . . .	120	—	62	—	182
Allowance for loan losses . . . . .	<u>(15)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(15)</u>
Subtotal . . . . .	3,742	6	62	—	3,804
Term deposits . . . . .	557	1	38	—	595
Cash and cash equivalents . . . . .	<u>1,969</u>	<u>3</u>	<u>614</u>	<u>5</u>	<u>2,583</u>
<b>Total fixed income securities . . . . .</b>	<b><u>49,184</u></b>	<b><u>82</u></b>	<b><u>2,202</u></b>	<b><u>16</u></b>	<b><u>51,386</u></b>

As of 30 November 2008					
<u>Policyholder and Shareholder Investments</u>	<u>% of Total Policyholder and Shareholder Investments</u>	<u>Investment-linked Investments</u>	<u>% of Total Investment-linked Investments</u>	<u>Total</u>	
(in US\$ millions)					
<b>Debt securities:</b>					
Government bonds . . . . .	14,663	29	261	3	14,924
Government agency bonds . . . . .	7,295	14	220	3	7,515
Corporate bonds . . . . .	17,956	35	971	12	18,927
Structured securities . . . . .	<u>942</u>	<u>2</u>	<u>15</u>	<u>—</u>	<u>957</u>
Subtotal . . . . .	40,856	80	1,467	18	42,323
<b>Loans:</b>					
Policy loans . . . . .	1,437	3	—	—	1,437
Mortgage loans on residential real estate . . . . .	587	1	—	—	587
Mortgage loans on commercial real estate . . . . .	105	—	—	—	105
Inter-company loans to fellow subsidiaries of AIG . . . . .	29	—	—	—	29
Other loans . . . . .	182	—	60	—	242
Allowance for loan losses . . . . .	<u>(7)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(7)</u>
Subtotal . . . . .	2,333	5	60	—	2,393
Term deposits . . . . .	608	1	48	1	656
Cash and cash equivalents . . . . .	<u>3,048</u>	<u>6</u>	<u>1,116</u>	<u>13</u>	<u>4,164</u>
<b>Total fixed income securities . . . . .</b>	<b><u>46,845</u></b>	<b><u>91</u></b>	<b><u>2,691</u></b>	<b><u>32</u></b>	<b><u>49,536</u></b>

As of 30 November 2009

	<u>Policyholder and Shareholder Investments</u>	<u>% of Total Policyholder and Shareholder Investments</u>	<u>Investment- linked Investments</u>	<u>% of Total Investment- linked Investments</u>	<u>Total</u>
(in US\$ millions)					
<b>Debt securities:</b>					
Government bonds . . . . .	17,690	28	280	2	17,970
Government agency bonds . . . . .	7,641	12	256	2	7,897
Corporate bonds . . . . .	24,147	38	1,170	9	25,317
Structured securities . . . . .	997	2	20	—	1,017
Subtotal . . . . .	50,475	80	1,726	13	52,201
<b>Loans:</b>					
Policy loans . . . . .	1,644	3	—	—	1,644
Mortgage loans on residential real estate . . . . .	527	1	—	—	527
Mortgage loans on commercial real estate . . . . .	48	—	—	—	48
Inter-company loans to fellow subsidiaries of AIG . . . . .	87	—	—	—	87
Other loans . . . . .	371	1	75	1	446
Allowance for loan losses . . . . .	(12)	—	—	—	(12)
Subtotal . . . . .	2,665	4	75	1	2,740
Term deposits . . . . .	859	1	33	—	892
Cash and cash equivalents . . . . .	2,641	4	764	6	3,405
<b>Total fixed income securities . . . . .</b>	<b><u>56,640</u></b>	<b><u>89</u></b>	<b><u>2,598</u></b>	<b><u>19</u></b>	<b><u>59,238</u></b>

Debt securities constitute the largest asset class in the AIA Group's Policyholder and Shareholder Investments, representing 72%, 80% and 80% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. The remaining asset classes within the fixed income investments portion of the AIA Group's investment portfolio include loans, term deposits and cash and cash equivalents.

A large proportion of the AIA Group's investments in debt securities are in the form of government bonds and government agency bonds. Government agency bonds comprise bonds issued by government-sponsored institutions such as state owned enterprises, provincial and municipal authorities and supranational financial institutions, such as the Asian Development Bank. This allocation is driven primarily by asset-liability and capital management purposes as these assets tend to be capital efficient and provide longer maturities to enable the AIA Group to better match its liability profiles. The AIA Group maintains currency matching between assets and liabilities to the extent appropriate. The AIA Group also holds a large portfolio of corporate bonds, comprising 31%, 35% and 38% of carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. The AIA Group's corporate bond investments are primarily investment grade issues in their respective geographical markets and generally offer yield enhancement as compared to government bonds, and also provide duration matching for the AIA Group's liabilities.

In conducting its credit risk assessment of potential investment opportunities, the AIA Group uses an internal risk rating system which is conceptually similar to systems used by external credit rating agencies, such as Moody's and S&P.

A portion of the AIA Group's investment in fixed income securities is composed of government agency bonds, corporate bonds and structured securities that are below investment grade or not rated by international credit rating agencies. These investments principally consist of:

- Government and government agency bonds whose ratings are capped by the sovereign debt rating ceiling issued by rating agencies and the AIA Group's internal rating system.
- Bonds and structured notes issued by infrequent issuers in local markets that do not seek credit ratings from international credit rating agencies.
- Bonds that were rated investment grade at time of purchase but have been subsequently downgraded. The AIA Group reassesses its holding of such securities upon a downgrade.
- Certain below investment grade or non-rated emerging market bonds that offer yield enhancement opportunities.

Below investment grade or non-rated securities typically carry risks. Complementing the AIA Group's investment framework described above in "Investment objectives and process" and the tools used in connection with its investment process, such as its internal risk rating system, certain aspects of its risk management framework help it to manage the risks associated with such investments.

#### Government bonds

Government bonds constituted 26%, 29% and 28% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively.

The following tables show the breakdown of government bonds issued in local and foreign currency by country. In order to diversify investment risk, the AIA Group maintains a portfolio of foreign currency denominated government bonds from a diverse range of countries outside its geographical markets which are set forth below, including a small portfolio of emerging markets debt securities.

As of 30 November 2007						
	<u>Rating</u>	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment-linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)						
<b>Government bonds — issued by governments in their local currency</b>						
Singapore . . . . .	AAA	1,846	14	51	24	1,897
Thailand . . . . .	A	5,826	44	—	—	5,826
Philippines . . . . .	BB	1,200	9	30	14	1,230
Malaysia . . . . .	A	1,374	10	1	—	1,375
China . . . . .	A	895	7	30	14	925
Indonesia . . . . .	BB	514	4	86	40	600
Korea . . . . .	A	1,399	10	16	8	1,415
Other . . . . .		313	2	—	—	313
<b>Total</b> . . . . .		<b>13,367</b>	<b>100</b>	<b>214</b>	<b>100</b>	<b>13,581</b>

As of 30 November 2008						
	<u>Rating</u>	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment-linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)						
<b>Government bonds — issued by governments in their local currency</b>						
Singapore . . . . .	AAA	1,713	13	69	32	1,782
Thailand . . . . .	A	6,377	50	—	—	6,377
Philippines . . . . .	BB	862	7	12	5	874
Malaysia . . . . .	A	1,482	12	3	1	1,485
China . . . . .	A	967	7	70	32	1,037
Indonesia . . . . .	BB	315	2	59	27	374
Korea . . . . .	A	857	7	6	3	863
Other . . . . .		244	2	—	—	244
<b>Total</b> . . . . .		<b>12,817</b>	<b>100</b>	<b>219</b>	<b>100</b>	<b>13,036</b>

As of 30 November 2009

	<u>Rating</u>	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment- linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)						
<b>Government bonds — issued by governments in their local currency</b>						
Singapore . . . . .	AAA	2,255	15	70	33	2,325
Thailand . . . . .	A	7,374	48	—	—	7,374
Philippines . . . . .	BB	1,309	8	22	10	1,331
Malaysia . . . . .	A	1,149	7	1	—	1,150
China . . . . .	A	1,107	7	3	1	1,110
Indonesia . . . . .	BB	494	3	115	54	609
Korea . . . . .	A	1,539	10	4	2	1,543
Other . . . . .		317	2	—	—	317
<b>Total . . . . .</b>		<b><u>15,544</u></b>	<b><u>100</u></b>	<b><u>215</u></b>	<b><u>100</u></b>	<b><u>15,759</u></b>

As of 30 November 2007

	<u>Rating</u>	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment- linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)						
<b>Government bonds — issued by governments in foreign currency</b>						
Mexico . . . . .	BBB	168	7	—	—	168
South Africa . . . . .	BBB	103	4	1	1	104
Philippines . . . . .	BB	632	26	39	54	671
Malaysia . . . . .	A	307	12	1	1	308
Indonesia . . . . .	BB	360	15	17	24	377
Korea . . . . .	A	365	15	1	1	366
China . . . . .	A	53	2	1	1	54
Other . . . . .		456	19	12	17	468
<b>Total . . . . .</b>		<b><u>2,444</u></b>	<b><u>100</u></b>	<b><u>72</u></b>	<b><u>100</u></b>	<b><u>2,516</u></b>

As of 30 November 2008

	<u>Rating</u>	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment- linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)						
<b>Government bonds — issued by governments in foreign currency</b>						
Mexico . . . . .	BBB	167	9	3	7	170
South Africa . . . . .	BBB	116	6	2	5	118
Philippines . . . . .	BB	465	25	18	43	483
Malaysia . . . . .	A	266	14	2	5	268
Indonesia . . . . .	BB	252	14	5	12	257
Korea . . . . .	A	67	4	2	5	69
China . . . . .	A	59	3	2	5	61
Other . . . . .		454	25	8	18	462
<b>Total . . . . .</b>		<b><u>1,846</u></b>	<b><u>100</u></b>	<b><u>42</u></b>	<b><u>100</u></b>	<b><u>1,888</u></b>

As of 30 November 2009

	<u>Rating</u>	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment- linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)						
<b>Government bonds — issued by governments in foreign currency</b>						
Mexico .....	BBB	159	7	2	3	161
South Africa .....	BBB	166	8	2	3	168
Philippines .....	BB	761	36	46	71	807
Malaysia .....	A	88	4	1	2	89
Indonesia .....	BB	268	13	—	—	268
Korea .....	A	222	10	2	3	224
China .....	A	46	2	2	3	48
Other .....		<u>436</u>	<u>20</u>	<u>10</u>	<u>15</u>	<u>446</u>
<b>Total .....</b>		<b><u>2,146</u></b>	<b><u>100</u></b>	<b><u>65</u></b>	<b><u>100</u></b>	<b><u>2,211</u></b>

*Government agency bonds*

Government agency bonds constituted 12%, 14% and 12% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. These securities are primarily issued by government-sponsored institutions largely in the geographical markets in which the AIA Group operates.

The following tables show the breakdown of the AIA Group's government agency bond holdings by credit rating. 97%, 96% and 95% of total government agency bonds were rated BBB or higher as of 30 November 2007, 2008 and 2009, respectively. The credit ratings of government agency bonds are capped at the ratings of the individual country, some of which are below investment grade (BB+ or below).

As of 30 November 2007

	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment- linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)					
<b>Government agency bonds:*</b>					
AAA .....	1,336	20	31	19	1,367
AA .....	290	4	35	21	325
A .....	3,165	46	63	38	3,228
BBB .....	1,884	28	16	10	1,900
Below investment grade .....	85	1	3	2	88
Not rated .....	<u>102</u>	<u>1</u>	<u>16</u>	<u>10</u>	<u>118</u>
<b>Total government agency bonds .....</b>	<b><u>6,862</u></b>	<b><u>100</u></b>	<b><u>164</u></b>	<b><u>100</u></b>	<b><u>7,026</u></b>

As of 30 November 2008

	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment- linked Investments</u>	<u>%</u>	<u>Total</u>
(in US\$ millions)					
<b>Government agency bonds:*</b>					
AAA .....	1,190	16	15	7	1,205
AA .....	395	5	65	30	460
A .....	3,069	42	100	45	3,169
BBB .....	2,377	33	6	3	2,383
Below investment grade .....	264	4	1	—	265
Not rated .....	<u>—</u>	<u>—</u>	<u>33</u>	<u>15</u>	<u>33</u>
<b>Total government agency bonds .....</b>	<b><u>7,295</u></b>	<b><u>100</u></b>	<b><u>220</u></b>	<b><u>100</u></b>	<b><u>7,515</u></b>

As of 30 November 2009

	Policyholder and Shareholder Investments		Investment-linked Investments		Total
		%		%	
					(in US\$ millions)
<b>Government agency bonds:*</b>					
AAA	1,236	16	64	25	1,300
AA	195	3	64	25	259
A	3,408	45	116	45	3,524
BBB	2,456	32	4	2	2,460
Below investment grade	346	4	—	—	346
Not rated	—	—	8	3	8
<b>Total government agency bonds</b>	<b>7,641</b>	<b>100</b>	<b>256</b>	<b>100</b>	<b>7,897</b>

\* For ease of reference, the AIA Group uses S&P ratings where available. For securities where S&P ratings are not immediately available, it uses Moody's ratings as an alternative. Where S&P and Moody's ratings are not readily available, the AIA Group's internal rating methodology is used. The following conventions have been adopted to conform with the various ratings.

Reported Above As:	S&P	Moody's	Internal Ratings
AAA	AAA	Aaa	1
AA	AA+ to AA-	Aa1 to Aa3-	2+ to 2-
A	A+ to A-	A1 to A3	3+ to 3-
BBB	BBB+ to BBB-	Baa1 to Baa3	4+ to 4-
Below investment grade	BB+ and below	Ba1 and below	5+ and below

#### Corporate bonds

Corporate bonds constituted 31%, 35% and 38% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. In each of the AIA Group's geographical markets, its corporate bond investments include both local and foreign currency denominated bonds. The AIA Group invests in US dollar denominated bonds primarily to match the US dollar liabilities of certain operating units, such as AIA Hong Kong, and to enhance yields of investment portfolios of certain operating units, such as AIA Singapore and AIA Thailand, where the supply of corporate debt in the local geographical markets in which they operate is limited. AIA Singapore and AIA Thailand use currency swaps and foreign exchange forwards to hedge the US dollar exposure under their US dollar bond investments.

AIA Group's corporate bond investments are diversified across markets, industries and issuers or obligors. During FY 2008 and 2009, it recognised impairment losses of US\$67 million and US\$3 million, respectively, relating to bonds issued by Lehman Brothers. Sale of the defaulted bonds in 2009 resulted in a gain of US\$19 million in 2009.

The table below shows the carrying value of the AIA Group's corporate bonds invested in various industries as of the dates indicated.

	As of 30 November					
	2007		2008		2009	
	Policyholder and Shareholder Investments	%	Policyholder and Shareholder Investments	%	Policyholder and Shareholder Investments	%
						(in US\$ millions)
Banks	5,470	30	6,090	34	6,864	28
Oil and Gas	1,859	10	2,168	12	3,089	13
Telecommunications	2,496	14	1,730	10	2,293	9
Diversified Financial Services	1,950	11	1,601	9	2,079	9
Electricity Power and Gas	1,288	7	1,329	7	2,359	10
Conglomerates	635	3	696	4	924	4
Real Estate	514	3	556	3	760	3
Insurance	580	3	440	3	543	2
Transport Marine	407	2	358	2	612	3
Mining	149	1	232	1	257	1
Others	2,862	16	2,756	15	4,367	18
<b>Total</b>	<b>18,210</b>	<b>100</b>	<b>17,956</b>	<b>100</b>	<b>24,147</b>	<b>100</b>

The banking sector represented the AIA Group's largest sector exposure in its Policyholder and Shareholder Investments corporate bond portfolio as of 30 November 2009, which includes bank hybrid capital securities. Bank hybrid capital securities generally provide better spreads as compared to senior debt securities, and also serve to enhance returns of the AIA Group's investment portfolio. A significant proportion of the AIA Group's holdings consists of securities issued by Asia Pacific banks and international banks whose business is largely focused on Asia.

The following tables show that 93%, 94% and 94% of total corporate bonds were rated BBB or higher as of 30 November 2007, 2008 and 2009, respectively.

As of 30 November 2007					
	Shareholder and Policyholder Investments	%	Investment- linked Investments	%	Total
	(in US\$ millions)				
<b>Corporate bonds:*</b>					
AAA	301	2	59	6	360
AA	3,496	19	281	28	3,777
A	8,096	44	292	28	8,388
BBB	5,064	28	200	20	5,264
Below investment grade	1,171	6	151	15	1,322
Not rated	82	1	37	3	119
<b>Total corporate bonds</b>	<b><u>18,210</u></b>	<b><u>100</u></b>	<b><u>1,020</u></b>	<b><u>100</u></b>	<b><u>19,230</u></b>

As of 30 November 2008					
	Policyholder and Shareholder Investments	%	Investment- linked Investments	%	Total
	(in US\$ millions)				
<b>Corporate bonds:*</b>					
AAA	225	1	78	8	303
AA	3,271	18	298	30	3,569
A	7,981	44	292	30	8,273
BBB	5,397	30	211	22	5,608
Below investment grade	997	6	45	5	1,042
Not rated	85	1	47	5	132
<b>Total corporate bonds</b>	<b><u>17,956</u></b>	<b><u>100</u></b>	<b><u>971</u></b>	<b><u>100</u></b>	<b><u>18,927</u></b>

As of 30 November 2009					
	Policyholder and Shareholder Investments	%	Investment- linked Investments	%	Total
	(in US\$ millions)				
<b>Corporate bonds:*</b>					
AAA	533	2	34	3	567
AA	3,233	13	253	22	3,486
A	11,297	47	454	39	11,751
BBB	7,730	32	198	17	7,928
Below investment grade	1,106	5	41	3	1,147
Not rated	248	1	190	16	438
<b>Total corporate bonds</b>	<b><u>24,147</u></b>	<b><u>100</u></b>	<b><u>1,170</u></b>	<b><u>100</u></b>	<b><u>25,317</u></b>

\* For ease of reference, the AIA Group uses S&P ratings where available. For securities where S&P ratings are not immediately available, it uses Moody's ratings as an alternative. Where S&P and Moody's ratings are not readily available, the AIA Group's internal rating methodology is used. The following conventions have been adopted to conform with the various ratings.

<u>Reported Above As:</u>	<u>S&amp;P</u>	<u>Moody's</u>	<u>Internal Ratings</u>
AAA . . . . .	AAA	Aaa	1
AA . . . . .	AA+ to AA-	Aa1 to Aa3-	2+ to 2-
A . . . . .	A+ to A-	A1 to A3	3+ to 3-
BBB . . . . .	BBB+ to BBB-	Baa1 to Baa3	4+ to 4-
Below investment grade . . . . .	BB+ and below	Ba1 and below	5+ and below

*Structured securities*

The AIA Group's fixed income investment asset class also includes structured securities, which consist of asset-backed securities, mortgage-backed securities and collateralised debt obligations, constituting 3%, 2% and 2% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. Structured securities issued by Asia Pacific entities represented 30%, 38% and 75% of the total carrying value of structured securities as of 30 November 2007, 2008 and 2009, respectively.

During 2008 and 2009, the AIA Group recognised impairment losses of US\$52 million and US\$9 million respectively relating to collateralised debt obligations.

The following tables show that 94%, 89% and 84% of the AIA Group's total structured securities were rated BBB or higher as of 30 November 2007, 2008 and 2009, respectively.

	<u>As of 30 November 2007</u>				
	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment-linked Investments</u>	<u>%</u>	<u>Total</u>
	<u>(in US\$ millions)</u>				
<b>Structured securities:*</b>					
AAA . . . . .	998	49	—	—	998
AA . . . . .	268	13	—	—	268
A . . . . .	440	22	—	—	440
BBB . . . . .	220	11	3	17	223
Below investment grade . . . . .	71	3	15	83	86
Not rated . . . . .	36	2	—	—	36
<b>Total structured securities</b> . . . . .	<b><u>2,033</u></b>	<b><u>100</u></b>	<b><u>18</u></b>	<b><u>100</u></b>	<b><u>2,051</u></b>

	<u>As of 30 November 2008</u>				
	<u>Policyholder and Shareholder Investments</u>	<u>%</u>	<u>Investment-linked Investments</u>	<u>%</u>	<u>Total</u>
	<u>(in US\$ millions)</u>				
<b>Structured securities:*</b>					
AAA . . . . .	479	51	—	—	479
AA . . . . .	72	8	—	—	72
A . . . . .	78	8	—	—	78
BBB . . . . .	218	23	1	7	219
Below investment grade . . . . .	95	10	14	93	109
Not rated . . . . .	—	—	—	—	—
<b>Total structured securities</b> . . . . .	<b><u>942</u></b>	<b><u>100</u></b>	<b><u>15</u></b>	<b><u>100</u></b>	<b><u>957</u></b>

As of 30 November 2009

	Policyholder and Shareholder Investments		Investment-linked Investments		Total (in US\$ millions)
		%		%	
<b>Structured securities:*</b>					
AAA	29	3	—	—	29
AA	—	—	—	—	—
A	463	46	—	—	463
BBB	357	36	5	25	362
Below investment grade	143	14	15	75	158
Not rated	5	1	—	—	5
<b>Total structured securities</b>	<b>997</b>	<b>100</b>	<b>20</b>	<b>100</b>	<b>1,017</b>

\* For ease of reference, the AIA Group uses S&P ratings where available. For securities where S&P ratings are not immediately available, it uses Moody's ratings as an alternative. Where S&P and Moody's ratings are not readily available, the AIA Group's internal rating methodology is used. The following conventions have been adopted to conform with the various ratings.

Reported Above As:	S&P	Moody's	Internal Ratings
AAA	AAA	Aaa	1
AA	AA+ to AA-	Aa1 to Aa3-	2+ to 2-
A	A+ to A-	A1 to A3	3+ to 3-
BBB	BBB+ to BBB-	Baa1 to Baa3	4+ to 4-
Below investment grade	BB+ and below	Ba1 and below	5+ and below

#### Loans

The AIA Group extends loans to enhance yields on its fixed income investments asset class. Loans represented 6%, 5% and 4% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. These loans principally consisted of policy loans, mortgage loans on residential and commercial real estate properties and intercompany loans to subsidiaries of AIG. The decrease in loans in FY 2008 is primarily due to the pay down of inter-company loans to subsidiaries of AIG.

The AIA Group follows lending policies that are based on a credit analysis process and underwriting guidelines that account for diverse factors, including market conditions, industry specific conditions, company cash flows and quality of collateral. It also has a monitoring programme in place whereby its credit teams review the status of the obligor on a regular basis to anticipate any credit issues. Policy loan amounts are restricted to the policy's cash surrender values and, as a result, the AIA Group is not exposed to credit risk on policy loans. The loss on residential mortgage loans and other loans was insignificant in each of FY 2007, 2008 and 2009.

#### Term deposits and cash and cash equivalents

The AIA Group's term deposits and cash and cash equivalents constituted 4%, 7% and 5% of the carrying value of total Policyholder and Shareholder Investments as of 30 November, 2007, 2008 and 2009, respectively. The increase in cash and cash equivalents in FY 2008 resulted from the AIA Group's de-risking of its investment portfolio as well as liquidity management initiative by shifting to cash, the results of operations and capital contributions from AIG.

#### Equity securities and alternative investments

The AIA Group allocates a portion of its investments to equity securities and alternative investments for yield-enhancement and risk-return optimisation purposes. A significant proportion of its equity securities are held to match AIA investment-linked products and products with participating features where investment returns are shared between it and policyholders. The asset allocation strategies used to match these products are generally consistent with the nature of the products.

In certain other Policyholder and Shareholder Investment portfolios that back other products and shareholder funds, the AIA Group invests in equity securities in order to enhance overall investment portfolio returns. These investments are subject to the SAA and TAA, which seeks to optimise risk and return on such portfolios.

The following table sets forth the carrying value of the subcategories of the AIA Group's equity securities and alternative investments in its investment portfolio as of the date indicated.

As of 30 November 2007					
	Policyholder and Shareholder Investments	%	Investment- linked		Total
			Investments	%	
(in US\$ millions)					
<b>Equity securities:</b>					
Private equities . . . . .	191	—	—	—	191
Public equities . . . . .	4,255	7	2,268	17	6,523
Ordinary shares <sup>(1)</sup> . . . . .	4,446	7	2,268	17	6,714
Securities held by consolidated mutual funds managed by AIG . . . . .	1,154	2	1,558	12	2,712
<b>Interests in investment funds:</b>					
Private equity and alternative asset classes . . . . .	288	—	—	—	288
Other . . . . .	691	1	7,214	55	7,905
Subtotal . . . . .	979	2	7,214	55	8,193
Shares in AIG . . . . .	2,520	4	—	—	2,520
Equity securities - total . . . . .	9,099	15	11,040	84	20,139
Investment property . . . . .	1,458	2	—	—	1,458
<b>Total equity securities and alternative investments . . . . .</b>	<b>10,557</b>	<b>17</b>	<b>11,040</b>	<b>84</b>	<b>21,597</b>

(1) Other than shares in AIG.

As of 30 November 2008					
	Policyholder and Shareholder Investments	%	Investment- linked		Total
			Investments	%	
(in US\$ millions)					
<b>Equity securities:</b>					
Private equities . . . . .	86	—	—	—	86
Public equities . . . . .	1,619	3	1,211	15	2,830
Ordinary shares <sup>(1)</sup> . . . . .	1,705	3	1,211	15	2,916
Securities held by consolidated mutual funds managed by AIG . . . . .	728	1	805	10	1,533
<b>Interests in investment funds:</b>					
Private equity and alternative asset classes . . . . .	287	1	—	—	287
Other . . . . .	258	1	3,666	44	3,924
Subtotal . . . . .	545	1	3,666	44	4,211
Shares in AIG . . . . .	87	—	—	—	87
Equity securities - total . . . . .	3,065	6	5,682	68	8,747
Investment property . . . . .	1,410	3	—	—	1,410
<b>Total equity securities and alternative investments . . . . .</b>	<b>4,475</b>	<b>9</b>	<b>5,682</b>	<b>68</b>	<b>10,157</b>

(1) Other than shares in AIG.

As of 30 November 2009

	<u>Policyholder and Shareholder Investments</u>	<u>% of Total Policyholder and Shareholder Investments</u>	<u>Investment- linked Investments</u>	<u>% of Total Investment- linked Investments</u>	<u>Total</u>
					(in US\$ millions)
<b>Equity securities:</b>					
Private equities . . . . .	69	—	—	—	69
Public equities . . . . .	<u>3,624</u>	<u>6</u>	<u>2,738</u>	<u>20</u>	<u>6,362</u>
Ordinary shares <sup>(1)</sup> . . . . .	3,693	6	2,738	20	6,431
Securities held by consolidated investment funds . . . . .	661	1	1,333	10	1,994
<b>Interests in investment funds:</b>					
Private equity and alternative asset classes . . .	151	—	—	—	151
Other . . . . .	<u>531</u>	<u>1</u>	<u>7,009</u>	<u>51</u>	<u>7,540</u>
Subtotal . . . . .	682	1	7,009	51	7,691
Shares in AIG . . . . .	<u>62</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>62</u>
Subtotal . . . . .	5,098	8	11,080	81	16,178
Investment property . . . . .	<u>1,592</u>	<u>3</u>	<u>—</u>	<u>—</u>	<u>1,592</u>
<b>Total equity and alternative investments . . .</b>	<b><u>6,690</u></b>	<b><u>11</u></b>	<b><u>11,080</u></b>	<b><u>81</u></b>	<b><u>17,770</u></b>

(1) Other than shares in AIG.

The AIA Group's equities and alternative investment portfolio includes investments in public equities, private equities and investment funds that may invest in public equities and other alternative asset classes. Its equities and alternative investment portfolio represented 17%, 9% and 11% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. The significant decrease in equities in FY 2008 was due to the implementation of the de-risking strategy and the reduction in the carrying value of AIG shares.

The AIA Group's portfolio of private equities is relatively small, constituting 0.2%, 0.2% and 0.1% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. The AIA Group has made investments in private equity in high growth economies, such as China and India, and diverse sectors, including manufacturing, services, retail and infrastructure.

The AIA Group's investment funds portfolio represented 4%, 3% and 2% of the carrying value of total Policyholder and Shareholder Investments as of 30 November 2007, 2008 and 2009, respectively. The AIA Group owns a portfolio of investment properties used strictly for investment purposes. It also owns real estate for operational use but these are not reflected in its investment portfolio. The AIA Group's investment property portfolio had a net book value of US\$1,458 million, US\$1,410 million and US\$1,592 million as of 30 November 2007, 2008 and 2009, respectively, excluding the carrying value of operating leases of leasehold land relating to long-term leaseholds.

### **Securities lending**

AIG established a global securities lending programme in the late 1990s, in which AIA-B, AIA Hong Kong and AIA Brunei participated to enhance portfolio return. AIG Global Securities Lending (Ireland) Ltd acted as an agent for AIG subsidiaries in this programme. The operating units that participated in the programme lent AIA Group assets in exchange for cash as collateral from the borrowers of the assets. The cash collateral was then used to reinvest generally in securities which were rated as investment grade at the date of purchase. Due to the deterioration of market conditions and liquidity issues in the securities lending programme at AIG, the AIA Group began to restructure and wind down its participation in this programme, which was largely completed by 30 November 2009. For further information, see Part XIII (*Operating and Financial Review of the AIA Group*) section headed "Significant events affecting FY 2009".

## **8. Operations**

The AIA Group's operations unit focuses on processing new business and servicing policies and policyholders across the group.

Operations are currently structured as three separate departments, representing various functional responsibilities:

- Underwriting and New Business;
- Claims Management; and
- Customer Service.

As part of an ongoing strategic initiative to rationalise the AIA Group's infrastructure and achieve greater operational efficiencies, the operations unit is currently engaged in several key strategic initiatives, including increasing automation, reducing the amount of paper-based processing and increasing the internet-based self-service capability that the AIA Group can offer customers in developed markets.

For markets where operational costs are higher, the AIA Group has constructed a low-cost shared services centre in Malaysia. The centre provides information technology, human resources, finance and administration support services.

### **8.1 Underwriting and new business**

The AIA Group's underwriting operations involve the evaluation of its insurance products by a professional staff of underwriters and actuaries who determine the type and the amount of risk that it is willing to accept. It also employs a certain level of automated rules-based systems in both medical and non-medical underwriting that is centrally managed by its regional AIA Group office. Underwriting is governed by detailed policies, guidelines and procedures to assist the AIA Group's underwriters to assess and quantify risks before issuing an insurance policy or contract to a qualified customer. The AIA Group's geographical reach also allows it to utilise its underwriting experience from more developed markets and apply it to developing markets with less historical underwriting data by sharing established best practice underwriting principles among markets.

The AIA Group's product pricing philosophy reflects its underwriting standards and is based on the expected payout of benefits, calculated through the use of assumptions for mortality, morbidity, AIA persistency, expenses and investment returns, as well as certain macroeconomic factors such as inflation. These assumptions include a margin for expected profitability and the possibility that actual experience deviates from anticipated experience, and are based on the AIA Group's own extensive experience and internal data as well as data published by external sources in each of the geographical markets in which it operates.

### **8.2 Claims management**

Claims that the AIA Group receives on its products are processed and investigated by the claims team in each of the geographical markets in which the AIA Group operates. Major and unusual claims are elevated to senior assessors and sometimes will be referred to the regional group office. Claims policies, procedures and controls are determined by the regional group office.

The AIA Group manages claims management risk through organisational and computer systems controls. These organisational controls include pre-established procedures, guidelines and authorisation limits for various operating levels as well as periodic and *ad hoc* inspections of the local operating units in each of the geographical markets in which it operates. Routine quality assurance control is part of its standard operating procedure to ensure that claim assessment quality and accuracy are in line with its expected loss ratio.

### **8.3 Customer service and contact centre**

The AIA Group seeks to provide quality services to its customers and potential customers and to be responsive to their needs, both before and after issuing a policy or contract, through an extensive customer service network. It delivers customer services primarily through its customer service units at each of its local operating units via its contact centres and offices, agency force, internet platform and telephone services based on guidelines established by group operations.

The AIA Group is a frequent recipient of various industry awards, including:

- Readers Digest Trust Brand Award for Insurance (Hong Kong 2004 - 2009; Singapore 2004 - 2009; Thailand 2004 - 2009; Malaysia 2006 - 2008); and
- Preferred Insurance Vendor of the Year 2008 - Singapore.

## **8.4 Reinsurance**

The AIA Group reinsures a portion of the risk that it assumes under its insurance products to reduce its exposure to loss and protect its capital resources. In addition, it makes use of reinsurance to obtain product pricing expertise when entering new lines of business, products or markets. The AIA Group's reinsurance includes both arrangements with third party reinsurers not affiliated with it (i.e. external reinsurance) and arrangements between and among businesses entirely within the AIA Group (i.e. internal reinsurance). A central component of the AIA Group's reinsurance strategy is to use internal reinsurance where applicable local regulations allow. As a result of its history and scale, the AIA Group has accumulated a substantial volume of experience and data which assists in its reinsurance strategy. Where it does not have adequate data, such as when it insures a new type of risk, it may reinsure a substantial portion or all of such risk. As it develops experience data related to such new risk, it may gradually retain more of the risk and reduce the use of related external reinsurance over time.

When the AIA Group uses reinsurance, it cedes to a reinsurer a portion of the risk that it assumes under its insurance products in exchange for a portion of the premiums it receives with respect to these products.

The AIA Group's criteria for selecting third party reinsurers include financial strength, service, terms of coverage, claims settlement efficiency and price. It monitors the financial condition of its third party reinsurers on an ongoing basis and reviews its reinsurance arrangements periodically. To reduce reinsurance concentration risk, it has established reinsurance programmes with various international third party reinsurers and limits exposure to any one third party reinsurer. In some geographical markets in which it operates, local insurance regulations require it to use local third party reinsurers for a portion of its reinsurance. The AIA Group has clearly defined risk limits, tailored to its products and the geographical markets in which it operates, related to both internal and external reinsurance.

When the AIA Group uses internal reinsurance, one of its operating subsidiaries or branches cedes to another member of the group a portion of the risk that operating subsidiary or branch assumes under the AIA Group's insurance products. Under the AIA Group's internal reinsurance strategy, the member of the group that acts as reinsurer will typically obtain external reinsurance in order to cede to a third party reinsurer risk above certain defined risk limits.

## **8.5 Information technology**

The AIA Group's information technology group plays a significant role in supporting its business growth and providing reliable service to its customers, agents and business partners. The AIA Group has adopted a shared services strategy and currently has 3 shared services centres to improve quality, service and cost-efficiency. The majority of its core application development and support is delivered through these shared services centres.

The AIA Group's systems include applications related to e-business processes, sales and management support, sales illustration, underwriting, imaging and workflow, policy administration, actuarial, financial management and analysis and human resources. The AIA Group is expanding its deployment of "straight through" process functions across the group to both expedite new business underwriting processes and significantly improve control, turnaround time and customer and business partner satisfaction. It is also in the process of implementing a uniform group-wide financial system with service providers through its financial transformation programme.

The AIA Group's digital strategy includes the expansion of self-service functions to provide additional convenience to customers, agents and business partners. The AIA Group is also expanding the usage of the internet and other digital platforms (e.g. cell phones, PDAs, etc.) to provide even more online functions.

To minimise the impact of a partial or complete failure of any of its information technology or communications systems, the AIA Group has implemented two programmes — the Business Continuity Plan and the Disaster Recovery Plan — which provide detailed processes and procedures to be applied in case of any such failure. In addition, it maintains a network of disaster recovery facilities designed to be activated in place of its primary facilities in case of failure and it has created a remote backup management system to limit potential losses of data resulting from system disruptions.

## 8.6 Employees

As of 30 November 2009, the AIA Group (excluding AIA India) had a total of approximately 15,500 employees. The following table shows an approximate breakdown of its employees by function as of 30 November 2009:

	<u>Number of Employees</u>	<u>% of Total</u>
Sales & Marketing . . . . .	5,760	37
Claims / Customer Services . . . . .	2,270	15
Finance and Accounting . . . . .	1,650	11
Business Acquisition . . . . .	1,440	9
General Services . . . . .	1,170	8
Information Technology . . . . .	1,020	6 <sup>(1)</sup>
Actuarial / Product Development . . . . .	440	3
Investment . . . . .	350	2
Human Resources . . . . .	290	2
Legal / Compliance / Internal Audit . . . . .	170	1
Executive Management . . . . .	170	1
Others . . . . .	<u>770</u>	<u>5</u>
<b>Total . . . . .</b>	<b><u>15,500</u></b>	<b><u>100</u></b>

(1) This figure has been rounded down — actual figure is 6.58%.

The AIA Group enters into employment agreements with individual employees covering matters such as salary, employee benefits, confidentiality obligations and termination of employment. It generally formulates its employees' compensation to include one or more elements such as salaries, allowances, bonuses, long-term incentives and benefits subject to applicable rules and regulations. The AIA Group's compensation programmes are designed to remunerate its employees based on their performance, roles and responsibilities, skills and competencies. The AIA Group also performs market benchmarking with respect to its compensation programmes.

## 8.7 Services provided to AIA

In addition to the ALICO reinsurance contract referenced at “— Group employee benefit reinsurance agreements with ALICO” in the “Connected transactions” section of this Part VIII, certain low value services (including management and back office services; insurance services (including an insurance marketing service); and reinsurance services) will be provided by the AIG Group to the AIA Group following completion of the Transactions. The majority of these services are provided on short or rolling one-year terms. In addition, certain IT services may also be provided by the AIG Group following completion of the Transactions if the planned transition to a third party provider does not occur on the envisaged timetable. Certain investment management/ advisory services and insurance services are currently provided to the AIA Group by the AIG Group and the strategy in respect of these services following completion of the Transactions has not yet been determined.

## 9. Intellectual property

Most of the AIA Group's branches and wholly-owned subsidiaries conduct their businesses primarily under the “AIA” brand name and its derivatives and variants, with the notable exception of the Philamlife business in the Philippines, which will continue to operate primarily under the “Philamlife” brand name. The AIA Group possesses an extensive portfolio of domain names and trade marks relating to its businesses in the geographical markets in which its subsidiaries and branches operate. However, until recently, certain of the AIA Group's branches and subsidiaries, including AIA Australia, AIA Indonesia, AIA Korea, AIA New Zealand, AIA Taiwan and AIA Vietnam, used primarily AIG derived trade marks in their businesses, and many of its businesses used AIG trade marks and domain names for certain products and purposes.

On 30 November 2009, AIG assigned and transferred to AIA Co substantially all of the trade marks and domain names owned by AIG that were used primarily in the businesses and operations of AIA Co and its subsidiaries, including without limitation, the AIA and AIA-related trade marks registered in its geographical markets. Around the same time, the AIA Group also rebranded certain of its subsidiaries' businesses and generally began to transition the AIA Group from the use of trade marks and domain names that incorporated the AIG trade marks to the use of trade marks and domain names derived exclusively from the “AIA” trade marks. This assignment agreement also contains provisions relating to the co-existence of the AIA and AIG brands. AIA is limited in its ability to adopt variations of the AIA initials and name and to object to AIG's name and certain other names based on “AI” initials.

Further, except to a limited extent, AIA cannot use the AIA initials or American International Assurance name in North America or US overseas territories.

AIA Co also entered into a licence agreement with AIG on 30 November 2009 in order to facilitate the AIA Group's smooth transition from using the AIG trade mark and certain derivative marks and domain names. The licence will remain in place until 30 November 2011 or, if later, it will expire one year from a change of control of AIA Co. The underlying AIG trade marks covered by the licence agreement were not transferred to the AIA Group because they are not principally used by the AIA Group. AIG may terminate the agreement unilaterally with respect to a particular intellectual property right only in the case of a non-cured material breach or on the occurrence of certain insolvency events, such rights to arise only after a change of control event.

On 30 November 2009, AIA Co also entered into a licence agreement with AIG pursuant to which it was granted rights to continue using certain intellectual property (other than trade marks) used by the AIA Group or its affiliates prior to the closing of the transactions contemplated by the June 09 Purchase Agreement on a perpetual, worldwide, royalty-free basis. This licence can be terminated by AIG with respect to a particular intellectual property right in the event of a non-cured material breach, such right to arise only after a change of control event.

## **10. Customers**

The AIA Group's five largest customers constituted in aggregate less than 30% of its total sales for each of FY 2007, FY 2008 and FY 2009.

## **11. Reserves**

In accordance with appropriate methodologies called for by applicable accounting and regulatory standards, the AIA Group establishes, and carries as liabilities, reserves which are actuarially determined amounts that are calculated to meet its obligations under its insurance products.

### **IFRS reserves**

In accordance with IFRS the reserves for AIA Group financial reporting purposes are based on actuarially recognised methods for estimating future benefits and claims.

The AIA Group establishes liabilities for obligations for future benefits and claims on its products based on assumptions that are formulated with reference to experience and economic variables. These assumptions include assumptions for mortality, morbidity, AIA persistency, expenses and investment returns, as well as macroeconomic factors. Actual experience may deviate from these assumptions and, as a result, AIA cannot determine precisely the amounts which it will ultimately pay to settle the liabilities on its products or when these payments will need to be made. See Part II (*Risk Factors*) of this prospectus. The AIA Group may experience sudden and unexpected claims and investment losses due to catastrophic events. Actual amounts may vary from the estimated amounts, particularly when payments may not occur until well into the future. The AIA Group values its liabilities regularly, based on applicable assumptions used to establish the liabilities, as well as its actual policy benefits and claims experience. The AIA Group expenses changes in its liabilities in the period the liabilities are established or re-estimated. To the extent that actual experience and trends are less favourable than the AIA Group's underlying assumptions used in establishing these reserves, it could be required to increase its reserves for such liabilities.

### **Statutory reserves**

The AIA Group is required to report local operating unit reserves for regulatory purposes in many of the geographical markets in which it operates. These reserves are reported in accordance with the statutory reserve standards applicable to each of these geographical markets.

## **12. Connected transactions**

The AIA Group has entered into certain transactions with parties who are its connected persons (as defined in the Hong Kong Listing Rules) and to the extent that these transactions continue following the Acquisition, they will constitute continuing connected transactions of Prudential under the Hong Kong Listing Rules.

The historical values disclosed for FY 2007, FY 2008 and FY 2009 in respect of the continuing connected transactions in this section that were effective during FY 2007 to FY 2009 constitute a portion of the values disclosed in respect of related party transactions for FY 2007, FY 2008 and FY 2009 at Note 41 of the historical financial information of the AIA Group set out in Part XV of this document.

A further portion of the amounts disclosed in respect of related party transactions for FY 2007, FY 2008 and FY 2009 at Note 41 of the historical financial information of the AIA Group set out in Part XV of this prospectus is attributable to: (i) those continuing connected transactions disclosed in this section that were effective during FY 2007, FY 2008, FY 2009, constitute shared administrative services exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33(2) of the Hong Kong Listing Rules and for which historical values have not been disclosed; and (ii) transactions between the AIA Group and members of the AIG Group that will not continue following the Acquisition and which therefore do not constitute continuing connected transactions requiring disclosure in this section. Further details of related party transactions are set forth in the historical financial information of the AIA Group set out in Part XV of this document.

### **Non-exempt continuing connected transactions**

Following the Acquisition (and subject (i) to AIA Aurora being a substantial shareholder of New Prudential and (ii) to ALICO being an associate of AIG), the following transactions will, unless terminated, be regarded as continuing connected transactions subject to the reporting and announcement requirements but exempt from the independent shareholders' approval requirements under Rule 14A.34(1) of the Hong Kong Listing Rules. As referenced in "Reorganisation — Phase III — Preparation for a public offering or sale — Sale of ALICO" in the "History" section of this document, AIG has announced that a sale of ALICO to MetLife is expected to be completed by the end of 2010.

#### ***Group employee benefit reinsurance agreements with ALICO***

The AIA Group has entered into reinsurance transactions with ALICO, a member of the AIG Group, under which ALICO will reinsure risks relating to group employee benefit insurance policies issued by branches or subsidiaries of the AIA Group in Hong Kong, Singapore, Australia and New Zealand in the ordinary and usual course of business of the AIA Group following the Acquisition. These transactions were intended to replace previous arrangements in place between the parties under which subsidiaries of the AIA Group in certain countries and other insurance companies in the AIG Group were introduced via ALICO's sales network to multinational corporate clients to whom they issued group employee benefit policies for each multinational's local operations in their respective countries, and the insured risks under these policies were then pooled and shared between ALICO and the insurance companies. These transactions are based on a reinsurance model under which ALICO commits to reinsure a fixed percentage of the risk under each group employee benefit policy written by the AIA Group. For Hong Kong and Singapore the percentage reinsured by ALICO is 90% and for Australia and New Zealand it is 100%. For each underlying group employee benefit policy, ALICO reinsures the risk up to an agreed claim limit. This will be continuing business between the AIA Group and ALICO replacing the previous arrangements. Such transactions will be conducted in the ordinary and usual course of the AIA Group's business on normal commercial terms.

As these reinsurance transactions were intended to replace the previous arrangements in place prior to the Reorganisation that involved the AIA Group and ALICO obtaining leverage from scale by combining the parties' respective insurance liabilities, rather than ALICO acting as a reinsurer, there is no comparable historical value information available for these transactions.

It is expected that the aggregate annual value of the commissions and fees payable by ALICO to the AIA Group under these reinsurance transactions will not exceed £10 million on a gross basis and therefore the highest percentage ratio under the Hong Kong Listing Rules will be, on an annual basis, less than 0.1%. Accordingly, payment of commissions and fees in these reinsurance transactions constitute in aggregate a de minimis continuing connected transaction exempt from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33(3) of the Hong Kong Listing Rules.

It is expected that the aggregate annual value of reinsurance premiums and fees payable by the AIA Group to ALICO under these transactions will be at least US\$52.4 million on a gross basis in each of financial year 2010, financial year 2011 and financial year 2012 and, therefore, the highest applicable percentage ratio calculated based on the latest audited financial statements of the Prudential Group under the Hong Kong Listing Rules will be, on an annual basis, more than 0.1% and less than 2.5%. Accordingly, payment of reinsurance premiums and fees in these transactions between the AIA Group and ALICO will constitute a continuing connected transaction subject to the reporting and announcement requirements but exempt from the independent shareholders' approval requirements under Rule 14A.34(1) of the Hong Kong Listing Rules.

To comply with Rules 14A.35(1) and 14A.35(2) of the Hong Kong Listing Rules and to document the relationship between the AIA Group and ALICO in relation to the ongoing payment of reinsurance premiums and fees in reinsurance transactions, the AIA Group entered into quota share reinsurance agreements in Hong Kong, Singapore, Australia and New Zealand with ALICO (the "ALICO Reinsurance Agreements"), which became effective on

1 January 2010. The ALICO Reinsurance Agreements were negotiated between the AIA Group and ALICO on arm's length terms with the advice of external counsel.

Pursuant to the ALICO Reinsurance Agreements, the AIA Group and ALICO have agreed on rates of reinsurance premiums which are comparable to those available under similar reinsurance contracts with independent third party reinsurers, and to conduct all reinsurance transactions in accordance with applicable normal market practices and on normal commercial terms.

The ALICO Reinsurance Agreements will be effective for a period of three years from 1 January 2010. The Enlarged Group will comply with the applicable provisions of the Hong Kong Listing Rules in respect of any renewal of these agreements.

*Annual Caps*

Pursuant to Rule 14A.35(2) of the Hong Kong Listing Rules, the AIA Group has set annual caps for the maximum aggregate amount of premiums, commissions and fees payable on a gross basis under the ALICO Reinsurance Agreements in financial year 2010, financial year 2011 and financial year 2012 as follows:

*Premiums and fees payable by the AIA Group to ALICO*

<b>Annual Cap for Year Ending 30 November</b>		
<u>2010</u>	<u>2011</u>	<u>2012</u>
US\$52.4m . . . . .	US\$64.3m	US\$80.8m

The annual caps above have been estimated primarily on the basis of: (i) the AIA Group's projection of the normal rate of growth in premium income from its group employee benefit insurance business in each of the countries covered by the agreements; and (ii) the AIA Group's expectation that it will continue to reinsure the same portion of this new business to ALICO throughout the term of the ALICO Reinsurance Agreements as it does at present. Due to the fact that a fixed share of premiums will be paid by the AIA Group to ALICO, and a fixed proportion of those premiums will be paid as commission by ALICO to the AIA Group during the full term of the ALICO Reinsurance Agreements, the total amounts that will be payable by the parties is directly determined by insurance premium growth.

***Waiver application for non-exempt continuing connected transactions***

In respect of the non-exempt continuing connected transactions described in "Connected transactions — Non-exempt continuing connected transactions" in this section, as the highest applicable ratio as set out in Rule 14A.07 of the Hong Kong Listing Rules is, on an annual basis, in each case expected to be more than 0.1% but less than 2.5%, such transactions are exempt from the independent shareholders' approval requirements but are subject to the reporting and announcement requirements as set out in Rules 14A.45 to 14A.47 of the Hong Kong Listing Rules.

As described above, it is expected that these non-exempt continuing connected transactions to be carried out on a continuing and recurring basis and to extend over a period. Strict compliance with the announcement requirements under the Hong Kong Listing Rules would, accordingly, be impractical, unduly burdensome and would create unnecessary administrative costs.

Accordingly, Prudential has applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the announcement requirement relating to continuing connected transactions under Rule 14A.35 of the Hong Kong Listing Rules in respect of the non-exempt continuing connected transactions.

The Enlarged Group will, however, comply at all times with the applicable provisions under Rules 14A.35(1), 14A.35(2), 14A.36, 14A.37, 14A.38, 14A.39 and 14A.40 of the Hong Kong Listing Rules in respect of these non-exempt continuing connected transactions.

In the event of any future amendments to the Hong Kong Listing Rules imposing more stringent requirements than those as of the date of this prospectus on the continuing connected transactions referred to in this section, the Enlarged Group will take immediate steps to ensure compliance with such new requirements.

***Confirmation from the Sponsor***

The sponsor to Prudential's listing application with the Hong Kong Stock Exchange is of the view that the above transactions are in the ordinary and usual course of business of AIA, on normal commercial terms and are fair and reasonable and will upon completion of the Transactions be in the interests of the shareholders of Prudential as a whole, and that the proposed annual caps for the transactions set out above are fair and reasonable.

### ***Investments in the AIG Products***

The Prudential Group, through its subsidiaries, runs a number of funds on behalf of its clients. The funds invest in a variety of financial products. As part of this, the funds may, from time to time, hold financial products of the AIG Group including debt securities in the form of bonds or notes (including convertible bonds, exchangeable bonds, fixed or floating rate notes or structured notes such as credit or equity linked notes) (the “AIG Products”). These investments are documented and the term of the AIG Products may be longer than 3 years.

As AIA will, at completion of the Acquisition, become a connected person of the Prudential Group, investments in the AIG Products may constitute connected transactions under Rule 14A.13(1) of the Hong Kong Listing Rules. The value of the AIG Products held by the Prudential Group’s funds as at 31 December 2009 constituted less than 0.1% of the total assets of the Prudential Group as at 31 December 2009. The aggregate value of this percentage may be further reduced when the Prudential Group completes the Acquisition. The investments in the AIG Products would constitute an exempt connected transaction under Rule 14A.31(2) of the Hong Kong Listing Rules and from the reporting, announcement and independent shareholders’ approval requirements.

Prudential will continue to discuss with the Hong Kong Stock Exchange the implications of such transactions under the Hong Kong Listing Rules with a view to seeking any necessary waivers in respect of such.

### ***Related party transactions after FY 2009***

Transactions after 30 November 2009 which, had they occurred in FY 2009, would have been within the scope of the transactions referred to in Note 41 of the historical financial information of the AIA Group set out in Part XV of this document, relate to (i) payments and receipts under arrangements that were in existence as at 30 November 2009 (including payments made in connection with the termination of certain of such arrangements with members of the AIG Group as part of the ongoing separation of the AIA Group from the AIG Group); (ii) new arrangements entered into since 30 November 2009 of a similar type of those in existence as at 30 November 2009; and (iii) obligations contracted to directors after 30 November 2009 (in an amount, including the amounts referred to in the note within Note 40 of the historical financial information of the AIA Group set out in Part XV of this document, not greater than US\$6.1 million).

## **13. Risk management**

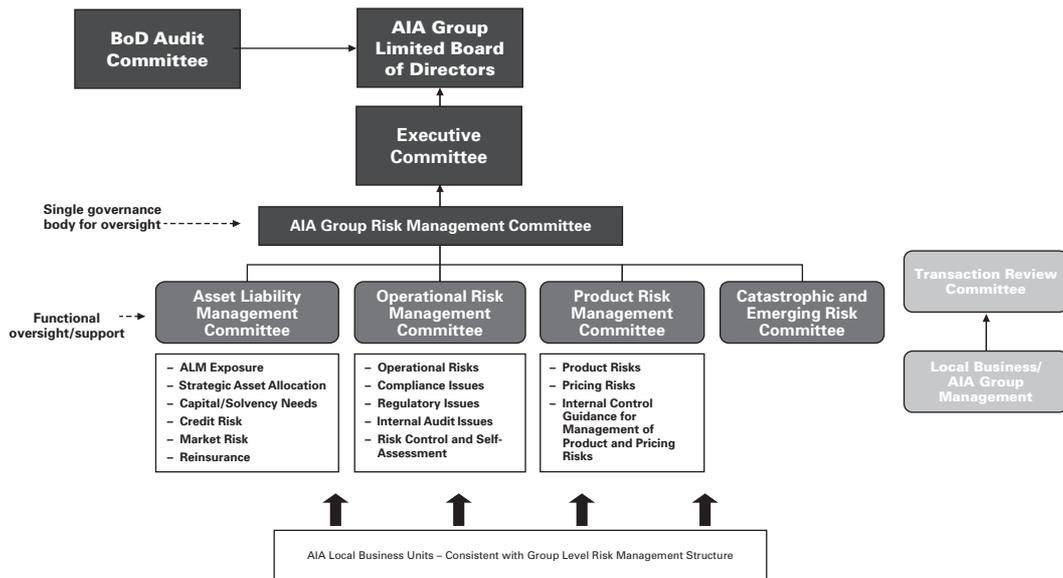
### ***Overview***

AIA’s risk management framework is managed by a dedicated enterprise risk management team and includes a variety of risk management committees and control procedures at both a regional AIA Group level and local operating unit level. The risk management framework seeks to deliver:

- a consolidated risk oversight structure;
- enhanced reporting lines for functional aspects of enterprise risk management;
- embedded risk management at local operating units;
- promotion of effective oversight and internal controls; and
- effective allocation of resources.

### ***Risk management framework***

The AIA Group’s enterprise risk management team consists of a group of professionals that focus on comprehensive AIA Group risk management and oversight and a group of professionals that focus on risk management matters at local operating units. These professionals report, through the head of enterprise risk management, to the chief risk officer of the AIA Group. The enterprise risk management team manages various risk management committees and control procedures at both a regional AIA Group level and local operating unit level. The chart below outlines AIA Group’s primary risk management committees as of 14 May 2010 (the latest practicable date prior to publication of this document).



The AIA Group’s primary risk management committee is the AIA Group risk management committee (the “Risk Management Committee”). This committee oversees four principal supporting subcommittees: the asset-liability management committee (the “ALM Committee”); the operational risk management committee (the “ORM Committee”); the product risk management committee (the “PRM Committee”); and the catastrophic and emerging risk committee (the “CERC Committee”). Complementing these principal risk management committees is a transaction review committee (the “TR Committee”).

In addition to the regional AIA Group level risk management committees outlined above, each local operating unit has a local risk management framework that is consistent with the regional AIA Group level risk management framework. Operating units in larger markets, including in each of the Key Geographical Markets, have their own local risk management committees overseeing local asset-liability management subcommittees, operational risk management subcommittees and product risk management subcommittees. Some operating units in smaller markets do not require dedicated subcommittees and so have a single risk management committee.

### ***Risk management committee***

The Risk Management Committee is the AIA Group’s primary risk management body and focuses on managing the AIA Group’s overall risk exposure and overseeing the 4 principal subcommittees described below. The Risk Management Committee reports directly to the Executive Committee, which is a subcommittee of the AIA Group’s Board.

### ***ALM Committee***

The ALM Committee focuses on asset-liability management exposure, major asset-liability proposals, solvency and capital management, strategic asset allocation, credit risk management, market risk management, financial mitigation programmes and reinsurance strategies. The objective of the AIA Group’s asset-liability management is to manage the risk exposures of assets to liabilities and to ensure that the AIA Group’s obligations arising from its liabilities are met.

### ***ORM Committee***

The purpose of the ORM Committee is to provide oversight of the operational risk management activities within the AIA Group and ensure the related operational risk management policies and programmes are implemented appropriately and consistently within local operating units. The ORM Committee is responsible for establishing priorities and coordination across the AIA Group’s functional operational risk management activities, monitoring operational risk exposures and the status of action plans, developing guidelines for reporting on key operational risks, key risk indicators and risk event data capture. The ORM Committee is also responsible for the review and monitoring of the most significant operational deficiencies identified by the AIA Group’s internal audit and

compliance functions or through self assessments and internal controls testing to ensure appropriate management focus is being directed toward risk mitigation activities and the successful implementation of remediation measures.

### ***PRM Committee***

The PRM Committee focuses on the pricing of risks, the risk exposure of existing products and guidance for internal controls. The PRM Committee reviews and approves product pricing policies and guidelines, monitors product risks and develops product approval authority limits.

### ***CERC Committee***

The CERC Committee provides oversight and guidance with respect to catastrophic and emerging risks and their potential impact on the AIA Group.

### ***TR Committee***

The TR Committee complements the AIA Group's risk management structure and plays an important role in due diligence of certain business transactions. The TR Committee reviews the AIA Group's products and transactions with a business partner or among members of the AIA Group that may expose the AIA Group to heightened legal, regulatory, accounting or reputational risk.

## ***Principal risk exposures***

### ***Insurance risk***

Life insurance risk can be described as a combination of the following component risks: (i) inadequate or inappropriate product design; (ii) inappropriate underwriting or pricing of policies; (iii) lapse risk; and (iv) variability of claims experience. The AIA Group manages its exposure to insurance risk in many ways. It has significant underwriting and actuarial personnel resources and has implemented well-defined underwriting and actuarial guidelines and practices. The AIA Group has accumulated a substantial volume of experience and data which assists it in the evaluation, pricing and underwriting of its products.

### ***Product design risk***

Product design risk refers to potential defects in the development of a particular insurance product. The AIA Group's product development process is overseen by the PRM Committee, which provides direction on pricing guidelines, as well as a separate committee, the product development committee. The AIA Group seeks to manage this risk by completing pre-launch reviews of a new product by regional AIA Group and local operating unit functional departments, including product development and approval, actuarial, legal and underwriting.

### ***Pricing and underwriting risk***

Pricing and underwriting risk refers to the possibility of product-related income being inadequate to support future obligations arising from a product. The AIA Group seeks to manage pricing and underwriting risk by adhering to regional AIA Group underwriting guidelines. Each local operating unit maintains a team of professional underwriters who review and select risks that are consistent with the risk appetite and underwriting strategy of the AIA Group. A second layer of underwriting review is conducted at the regional AIA Group for complex and large risks.

### ***Claims risk***

Claims risk refers to the possibility that the frequency or severity of claims arising from insurance products exceeds the levels assumed when the products were priced. The AIA Group seeks to mitigate claims risk by conducting regular experience studies, including reviews of mortality and morbidity experience, reviewing internal and external data and considering the impact of such information on reinsurance needs and product design and pricing.

Claims risk also includes risk related to the possibility of significant financial losses arising from a lack of diversification, either geographical or by product type, of the risks insured. The AIA Group has a broad geographical footprint across the Asia Pacific region, providing a natural diversification of geographic concentrations of claims and other (such as political) risks. The broad product offering and in-force product portfolio of the AIA Group also reduces exposure to risks associated with claims concentration risk. In addition, the AIA Group uses catastrophe insurance to help minimise concentration risk.

### *Lapse risk*

Lapse risk refers to the possibility of actual lapse experience that diverges from the anticipated experience that was assumed when products were priced, as well as financial loss due to early termination of policies or contracts where the acquisition cost incurred may not be recoverable from future revenue. The AIA Group carries out regular studies of persistency experience and the results are assimilated into new and in-force product management.

### *Concentration of insurance risk*

Concentration of insurance risk refers to the possibility of significant financial losses arising from a lack of diversification, either geographical or by product type, of the AIA Group's portfolio. Certain events, such as viral pandemics, may give rise to higher levels of mortality or morbidity experience and exhibit geographical concentrations. The AIA Group has a broad geographical footprint across Asia and its results are not substantially dependent upon any one geographical market. This breadth provides a natural diversification of geographic concentrations of insurance and other risks (such as political risks). However, given the AIA Group's exposure to Asia, it may be relatively more exposed to pandemics localised in Asia than insurance groups with a worldwide presence.

### *Credit risk*

Credit risk arises from the possibility of financial loss arising from default by borrowers and transactional counterparties and the decrease in value of financial instruments due to deterioration in credit quality. The key areas where the AIA Group is exposed to credit risk include repayment risk in respect of cash and cash equivalents; investments in debt securities; loans and receivables (including insurance receivables); and reinsurance receivables.

The AIA Group's approach to managing credit risk is a bottom-up process based on fundamental research. A team of analysts analyses each obligor's financial and competitive position, typically including a review of macroeconomic outlooks, industry trends and financial information, an analysis of issuer credit fundamentals, dialogue with issuers, third party checks and ongoing monitoring of fixed income and equity values.

### *Market risk*

Market risk arises from the possibility of financial loss caused by changes in financial instruments' fair values or future cash flows due to fluctuations in key variables, including interest rates, foreign exchange rates, equity market prices and real estate property market prices. The AIA Group seeks to manage its market risk exposure in a variety of ways. The ALM Committee oversees activities to evaluate market risk exposure and considers each component of market risk when formulating the SAA. AIA Group enterprise risk management uses various quantitative models to assess market risks. These models include sensitivity analyses, value-at-risk models and stress test scenarios, which are common tools in the investment and insurance industries.

### *Interest rate risk*

The AIA Group's exposure to interest rate risk predominantly arises from the AIA Group's investments in long-term fixed income debt securities, which are exposed to fluctuations in interest rates.

The AIA Group seeks to manage its interest rate risk by generally investing in fixed income assets in the same currencies as those of its liabilities as well as investing in financial instruments with tenors that broadly match the duration of its liabilities.

The AIA Group also considers the effect of interest rate risk in its overall product strategy. Certain products such as investment-linked, universal life and participating business, inherently have lower interest rate risk as their design provides flexibility as to crediting rates and policyholder dividend scales.

### *Foreign exchange rate risk*

At the AIA Group level, foreign exchange rate risk arises mainly from operations in multiple geographical markets in the Asia Pacific region and the translation of multiple currencies to US dollars for financial reporting purposes.

On a local operating unit level, to the extent possible and appropriate, investments are made in assets denominated in currencies that match the relevant liabilities to avoid currency mismatches. In certain portfolios, investments are made in currencies that are different from the underlying liabilities in order to achieve yield as well as diversification benefits. The related foreign exchange risk is hedged through standard derivatives such as swaps, futures and forwards.

### *Equity risk*

Equity price risk arises from changes in the market value of equity securities and equity funds. Equity securities form a small portion of the AIA Group's investment portfolio and SAA, and therefore the AIA Group has relatively limited exposure to equity risk.

### *Property price risk*

Property price risk arises from the AIA Group's interests in real estate assets which form a part of its investment portfolios and are subject to increases or decreases in market value. The AIA Group's real estate investment subcommittee reviews and oversees all major real estate investment activity. Real estate assets form a small portion of the AIA Group's investment portfolio and SAA, and therefore, it has relatively limited exposure to property price risk.

### *Liquidity risk*

Liquidity risk primarily refers to the possibility that the AIA Group has insufficient cash available to meet its payment obligations to counterparties as they become due. The AIA Group is subject to liquidity risk on insurance products that permit surrender, withdrawal or other forms of early termination for a cash surrender value.

The AIA Group seeks to manage liquidity risk by emphasising flexible insurance product design and by matching, to the extent possible and appropriate, the duration of its investment assets with the duration of its insurance policies. Most of the AIA Group's assets are in the form of marketable securities, which can typically be converted to cash quickly should unexpected cash payment obligations arise. The AIA Group develops cash flow forecasts and maturity gap analyses to quantify and monitor liquidity needs to minimise the risk that unexpected cash obligations arise.

For a detailed liquidity risk analysis, see note 37 to the AIA Group historical financial information set out in Part XV to this prospectus.

### *Operational risk*

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, personnel and systems or from external events.

The primary tool to manage operational risk is risk and control self assessment. The objective of risk and control self assessment is to identify, evaluate, measure and monitor operational risks. This assessment is performed by each member of the AIA Group and is subject to oversight by each local business unit's operational risk management subcommittees and the ORM Committee. Other tools utilised to manage operational risks are risk event data capture and analysis and key risk indicators. The ORM Committee and other operational risk management personnel share lessons learned as a result of operational incidents and losses, fraud and internal audit reporting issues with all local operating units to increase overall AIA Group risk awareness and proactively strengthen the AIA Group's control environment.

## PART IX

### TERMS AND CONDITIONS OF THE RIGHTS ISSUE

#### 1. Introduction

Prudential is proposing to raise proceeds of approximately £13.8 billion (net of Rights Issue and Transaction-related expenses) by way of a Rights Issue of 13,964,557,750 Rights Issue Shares. The net proceeds of the Rights Issue will be used (along with other sources of financing) to finance the Acquisition. Subject to the fulfilment of the conditions set out below, the Rights Issue Shares will be provisionally allotted to all Qualifying Shareholders (including, for the avoidance of doubt, all Overseas Shareholders) and will be offered by way of rights at 104 pence per Rights Issue Share, payable in full on acceptance to all Qualifying Shareholders (other than, subject to certain exceptions, Excluded Shareholders), on the basis of:

#### 11 Rights Issue Shares for every 2 Existing Shares

held on the Record Date (and so in proportion for any other number of Existing Shares held) and otherwise on the terms and conditions set out in this document (and, in the case of Qualifying Non-CREST Shareholders and Qualifying Non-CCASS Shareholders (together with HKSCC Nominees), the Provisional Allotment Letters and, in the case of Qualifying CDP Shareholders, the Singapore Application Form).

The Issue Price for UK Shareholders of 104 pence per Rights Issue Share represents a 80.8% discount to the Closing Price of 542.5 pence per Prudential Share on 14 May 2010, being the last business day before the announcement of the terms of the Rights Issue and a 39.3% discount to the theoretical ex-rights price based on that Closing Price.

The Issue Price for HK Shareholders and Singapore Shareholders is HK\$11.78 per Rights Issue Share, which was calculated using the £/HK\$ exchange rate of 11.3277, the noon buying rate on 14 May 2010 (being the last business day prior to the announcement of the terms of the Rights Issue).

The entitlements arising from the provisional allotment of Rights Issue Shares to UK Shareholders are rights to acquire Rights Issue Shares to be registered on the UK Register only, and the entitlements arising from the provisional allotment of Rights Issue Shares to HK Shareholders are rights to acquire Rights Issue Shares to be registered on the HK Register only.

Qualifying Shareholders who do not take up their entitlements to Rights Issue Shares will have their proportionate shareholdings in Prudential diluted by approximately 84.6% following the issue of the Rights Issue Shares and by approximately 86.3% as a result of both the Rights Issue, and assuming the Transactions complete, the issue of New Prudential Shares to AIA Aurora as part of the consideration for the Acquisition (assuming (i) the issue of Prudential Shares that are expected to be issued on 27 May 2010 to shareholders who have elected to receive the scrip dividend alternative for the 2009 final dividend; (ii) no options granted under the Prudential Share Schemes are exercised; and (iii) no other Prudential Shares or New Prudential Shares are issued between the date of this prospectus and completion of the Transactions and without taking into account any conversion of the MCNs). Those Qualifying Shareholders who take up their rights in full will, subject to fractions, have the same proportionate voting and distribution rights as held on the Record Date after the completion of the Rights Issue. However, even if a Qualifying Shareholder takes up the offer of Rights Issue Shares in full, his or her proportionate shareholding will be diluted by approximately 10.9% if the Transactions complete because of the issue of New Prudential Shares to AIA Aurora as part of the consideration for the Acquisition (on the basis of the assumptions referred to above).

The Nil Paid Rights (also described as Rights Issue Shares, nil paid) are entitlements to acquire the Rights Issue Shares, subject to payment of the Issue Price. In relation to Rights Issue Shares to be issued to acquirers on the UK Register only, Fully Paid Rights are entitlements to acquire Rights Issue Shares for which payment of the Issue Price has already been made.

Holdings of Existing Shares in certificated and uncertificated form and holdings in different accounts and on different registers will be treated as separate holdings for the purpose of calculating entitlements under the Rights Issue. Entitlements to Rights Issue Shares will be rounded down to the nearest whole number and resulting fractions of Rights Issue Shares will not be allotted to Qualifying Shareholders. Such fractions will be aggregated ultimately for the benefit of Prudential and treated in the same way as Rights Issue Shares not taken up.

**The attention of Overseas Shareholders and any person (including, without limitation, custodians, nominees and trustees) who has a contractual or other legal obligation to forward this document or a Provisional Allotment Letter into a jurisdiction other than the United Kingdom, Hong Kong or Singapore is drawn to section 7 of this Part IX. In particular, subject to certain exceptions, Qualifying Shareholders with registered addresses or who are otherwise located in the United States or any of the other Excluded Territories will not be sent Provisional Allotment Letters and will not have their CREST stock accounts, CCASS stock accounts or CDP securities accounts (as the case may be) credited with Nil Paid Rights.**

Application has been made to the UKLA for the Rights Issue Shares (nil and fully paid) to be admitted to the premium segment of the Official List and to the London Stock Exchange for the Rights Issue Shares (nil and fully paid) to be admitted to trading on the London Stock Exchange's main market for listed securities. Application has been made to the Hong Kong Stock Exchange, and will be made to the SGX-ST, for the listing of and permission to deal in the Rights Issue Shares (nil and fully paid) on the Hong Kong Stock Exchange and the Main Board of the SGX-ST, respectively. It is expected that UK Admission will become effective and that dealings in the Rights Issue Shares will commence on the London Stock Exchange, nil paid, at 8.00 a.m. (London time) on Tuesday 8 June 2010. It is also expected that HK Admission will become effective and that dealings in the Rights Issue Shares will commence on the Hong Kong Stock Exchange, nil paid, at 9.30 a.m. (Hong Kong time) on Thursday 10 June 2010. Further, it is expected that Singapore Admission will be effective and that dealings in the Rights Issue Shares, nil paid, will commence on the SGX-ST at 9.00 a.m. (Singapore time) on Wednesday 9 June 2010.

The Existing Shares are already admitted to CREST and application has been made for the Existing Shares to be admitted to CCASS. Applications have been made for the Nil Paid Rights and the Fully Paid Rights to be admitted to CREST. Applications have also been made for the Nil Paid Rights and the Rights Issue Shares to be admitted to CCASS. Prudential has also entered into a depository services agreement with CDP for all dealing in and transactions of the Existing Shares and the Nil Paid Rights executed on the SGX-ST to be cleared and settled through CDP. Euroclear requires Prudential to confirm to it that certain conditions are satisfied before Euroclear will admit any security to CREST. As soon as practicable after UK Admission, Prudential will confirm this to Euroclear. It is expected that these conditions will be satisfied on UK Admission.

The ISIN for the Rights Issue Shares will be the same as that of the Existing Shares, being GB0007099541. The ISIN for the Nil Paid Rights is GB00B64R3G57 and for the Fully Paid Rights is GB00B64H9B24.

The Rights Issue has been fully underwritten by the Underwriters and is conditional upon, among other things:

- (i) the passing, without material amendment, of the Rights Issue Resolution (which itself is conditional upon the passing of the Scheme Resolutions) at the General Meeting;
- (ii) the Acquisition Agreement remaining in full force and effect, not having lapsed and not having been terminated in accordance with its terms prior to UK Admission, and no condition to which the Acquisition Agreement is subject having become incapable of satisfaction and, if capable of waiver, not having been waived prior to UK Admission;
- (iii) UK Admission of the Rights Issue Shares (nil paid) occurring on Tuesday 8 June 2010 (or such later time and date as the Joint Global Co-ordinators may agree with Prudential); and
- (iv) the Underwriting Agreement having become unconditional in all respects save for the conditions relating to UK Admission and not having been terminated in accordance with its terms prior to UK Admission.

The Underwriting Agreement may be terminated by the Joint Global Co-ordinators prior to UK Admission upon the occurrence of certain specified events, in which case the Rights Issue will not proceed. The Underwriting Agreement is not capable of termination following UK Admission. The Joint Global Co-ordinators may arrange sub-underwriting for some, all or none of the Rights Issue Shares. A summary of the terms and conditions of the Underwriting Agreement is contained in paragraph 16.2 of Part XIX (*Additional Information*).

Prudential reserves the right to decide not to proceed with the Rights Issue at any time prior to UK Admission and commencement of dealings in the Rights Issue Shares (nil paid) on the London Stock Exchange.

Subject, among other things, to the above conditions being satisfied and save as provided in section 7 of this Part IX in respect of Overseas Shareholders, it is intended that:

- (i) Provisional Allotment Letters in respect of Nil Paid Rights will be despatched to Qualifying Non-CREST Shareholders (other than, subject to certain exceptions, such Qualifying Non-CREST Shareholders with registered addresses in the Excluded Territories) on Monday 7 June 2010;

- (ii) Provisional Allotment Letters in respect of Nil Paid Rights will be despatched to Qualifying Non-CCASS Shareholders and HKSCC Nominees on Tuesday 8 June 2010;
- (iii) Singapore Application Forms will be despatched to Qualifying CDP Shareholders on Wednesday 9 June 2010;
- (iv) the Registrar will instruct Euroclear to credit the appropriate stock accounts of Qualifying CREST Shareholders (other than, subject to certain exceptions, such Qualifying CREST Shareholders with registered addresses in the Excluded Territories) with such Qualifying CREST Shareholders' entitlements to Nil Paid Rights, with effect from 8.00 a.m. (London time) on Tuesday 8 June 2010;
- (v) HKSCC will credit the appropriate stock accounts of CCASS Participants (other than, subject to certain exceptions, such CCASS Participants with registered addresses in the Excluded Territories) with such CCASS Participants' entitlements to Nil Paid Rights, with effect from Tuesday 8 June 2010;
- (vi) CDP will credit the appropriate securities accounts of Qualifying CDP Shareholders with such Qualifying CDP Shareholders' entitlements to Nil Paid Rights on Wednesday 9 June 2010;
- (vii) the Nil Paid Rights and the Fully Paid Rights will be enabled for settlement by Euroclear on Tuesday 8 June 2010, as soon as practicable after Prudential has confirmed to Euroclear that all the conditions for admission of such rights to CREST have been satisfied;
- (viii) the Nil Paid Rights will be enabled for settlement by HKSCC on Thursday 10 June 2010;
- (ix) Rights Issue Shares will be credited to the appropriate stock accounts of relevant Qualifying CREST Shareholders (or their renounees) who validly take up their rights by 8.00 a.m. (London time) on Thursday 24 June 2010;
- (x) share certificates for the Rights Issue Shares will be despatched by Thursday 1 July 2010 to relevant Qualifying Non-CREST Shareholders (or their renounees) who validly take up their rights at their own risk;
- (xi) share certificates for the Rights Issue Shares will be despatched by Friday 25 June 2010 to relevant Qualifying Non-CCASS Shareholders and HKSCC Nominees (or their renounees) who validly take up their rights at their own risk;
- (xii) Rights Issue Shares will be credited to the appropriate securities accounts of the relevant Qualifying CDP Shareholders (or their Singapore Renounees) who validly take up their rights after 5.00 p.m. (Singapore time) on Friday 25 June 2010; and
- (xiii) Rights Issue Shares will be credited to the appropriate stock accounts of relevant CCASS Participants (or their renounees) who validly take up their rights through HKSCC Nominees by Friday 25 June 2010.

All documents, including Provisional Allotment Letters (which constitute temporary documents of title), Singapore Application Forms and cheques and certificates posted to, by or from Qualifying Shareholders and/or their transferees (or their agents, as appropriate), will be posted at their own risk.

The Rights Issue Shares will, when issued and fully paid, rank *pari passu* in all respects with the Existing Shares, including the right to receive all dividends or other distributions declared with a record date falling after the date of issue of the Rights Issue Shares. Accordingly, the final 2009 dividend, for which the record date was 9 April 2010, will not be paid in respect of any Rights Issue Shares.

Qualifying Shareholders taking up their rights by completing a Provisional Allotment Letter or by sending a Many-To-Many ("MTM") instruction to Euroclear will be deemed to have given the representation and warranties set out in paragraph 2.2.2 of this Part IX, unless such requirement is waived by Prudential.

## **2. Action to be taken by UK Shareholders**

**The action to be taken by HK Shareholders and Singapore Shareholders is set out in sections 3 and 4 respectively of this Part IX. The action to be taken by UK Shareholders in respect of the Rights Issue Shares depends on whether, at the relevant time, the Nil Paid Rights or the Fully Paid Rights in respect of which action is to be taken are in certificated form (that is, are represented by Provisional Allotment Letters) or are in uncertificated form (that is, are in CREST). Such Nil Paid Rights or Fully Paid Rights are rights with respect to Rights Issue Shares to be issued to acquirers on the UK Register only.**

If you are a Qualifying Non-CREST Shareholder and do not have a registered address in and are not located in the United States or any other Excluded Territory, please refer to paragraph 2.1 and Section 5 of this Part IX.

If you hold your Existing Shares in CREST and do not have a registered address in and are not located in the United States or any other Excluded Territory, please refer to paragraph 2.2 and Section 5 of this Part IX and to the CREST Manual for further information on the CREST procedures referred to below.

CREST sponsored members should refer to their CREST sponsors, as only their CREST sponsors will be able to take the necessary actions specified below to take up the entitlements or otherwise to deal with the Nil Paid Rights or Fully Paid Rights of CREST sponsored members.

**All enquires in relation to the Provisional Allotment Letters should be addressed to the Shareholder Helpline on 0871 384 2035 (from inside the United Kingdom) or +44 121 415 7026 (from outside the United Kingdom). The Shareholder Helpline is available from 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday (except bank and other public holidays) and will remain open until 21 August 2010. Calls to the 0871 384 2035 number from inside the United Kingdom are charged at ten pence per minute (including amounts in respect of VAT) from a BT landline. Other service providers' charges may vary. Calls to the +44 121 415 7026 number from outside the United Kingdom are charged at applicable international rates. Different charges may apply to calls made from mobile telephones and calls may be recorded and monitored for security and training purposes. Please note that, for legal reasons, the Shareholder Helpline is only able to provide information contained in this document and information relating to Prudential's register of members and is unable to give advice on the merits of the Rights Issue or to provide legal, financial, tax or investment advice.**

## **2.1 Action to be taken by Qualifying Non-CREST Shareholders in relation to the Nil Paid Rights represented by the Provisional Allotment Letters**

### **2.1.1 General**

Subject to the passing of the Rights Issue Resolution (without material amendment) at the General Meeting, Provisional Allotment Letters are expected to be despatched to Qualifying Non-CREST Shareholders, other than, subject to certain exceptions, to shareholders in Excluded Territories, on Monday 7 June 2010. Each Provisional Allotment Letter will set out:

- (A) in box 1, the holding at the Record Date of Existing Shares in certificated form on which a Qualifying Non-CREST Shareholder's entitlement to Rights Issue Shares has been based;
- (B) in box 2, the aggregate number of Rights Issue Shares which have been provisionally allotted to such Qualifying Non-CREST Shareholder;
- (C) in box 3, the amount payable on acceptance of all the Rights Issue Shares provisionally allotted to such Qualifying Non-CREST Shareholder at the Issue Price;
- (D) the procedures to be followed if a Qualifying Non-CREST Shareholder wishes to dispose of all or part of his entitlement or to convert all or part of his entitlement into uncertificated form;
- (E) instructions regarding acceptance and payment, consolidation, splitting and registration of renunciation; and
- (F) the procedure to be followed if a Qualifying Non-CREST Shareholder wishes to effect a Cashless Take Up or dispose of his Nil Paid Rights through the Equiniti Dealing Facility.

The latest time and date for requesting a Cashless Take Up or a disposal of Nil Paid Rights through the Equiniti Dealing Facility will be 5.00 p.m. on Thursday 17 June 2010.

**Assuming that the Provisional Allotment Letters are posted on Monday 7 June 2010 and that dealings in Nil Paid Rights commence at 8.00 a.m. on Tuesday 8 June 2010:**

- **the latest time and date for acceptance and payment in full is 11.00 a.m. on Wednesday 23 June 2010; and**
- **the recommended latest time and date for splitting a Provisional Allotment Letter, nil paid or fully paid, is 3.00 p.m. on Monday 21 June 2010.**

If the Rights Issue is delayed so that Provisional Allotment Letters cannot be despatched on Monday 7 June 2010, the expected timetable, as set out at the front of (and referred to in) this document, will be adjusted accordingly and the revised dates will be set out in the Provisional Allotment Letters and announced through a Regulatory Information Service. All references in this Part IX should be read as being subject to such adjustment.

### **2.1.2 Procedure for acceptance and payment**

- (i) Qualifying Non-CREST Shareholders who wish to accept in full

Holders of Provisional Allotment Letters who wish to take up all of their entitlements should complete the Provisional Allotment Letter in accordance with its instructions. The Provisional Allotment Letter must be returned, together with the cheque or banker's draft in pounds sterling, made payable to "Equiniti Limited re: PRUDENTIAL PLC Rights Issue" and crossed "A/C payee only", for the full amount payable on acceptance, in accordance with the instructions printed on the Provisional Allotment Letter, by post or (during business hours only) by hand to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA so as to be received as soon as possible and, in any event, not later than 11.00 a.m. on Wednesday 23 June 2010. The Provisional Allotment Letter does not need to be signed by a holder who wishes to take up all of his rights. A reply-paid envelope will be enclosed with the Provisional Allotment Letter for use within the United Kingdom only. Qualifying Non-CREST Shareholders who post their Provisional Allotment Letter within the United Kingdom by first-class post are recommended to allow at least four working days for delivery. Payments via CHAPS, BACS or electronic transfer will not be accepted. Once Qualifying Non-CREST Shareholders have posted their Provisional Allotment Letter, duly completed with payment cheque or banker's draft as described above, such Qualifying Non-CREST Shareholders will be treated as having accepted the offer to acquire their entitlement to Rights Issue Shares. Equiniti Limited will hold any cleared application monies on behalf of Credit Suisse, which is acting as principal, but subject to the requirement that such monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX.

(ii) Qualifying Non-CREST Shareholders who wish to accept in part

Holders of Provisional Allotment Letters who wish to take up some but not all of their Nil Paid Rights should refer to paragraph 2.1.6 of this Part IX.

(iii) Qualifying Non-CREST Shareholders who wish to effect a Cashless Take Up through the Equiniti Dealing Facility

Qualifying Non-CREST Shareholders who wish to effect a Cashless Take Up through the Equiniti Dealing Facility should tick the box under Option D "Cashless Take Up" on page 1 of the Provisional Allotment Letter, sign and date the bottom of page 1 of the Provisional Allotment Letter, and return their Provisional Allotment Letter by post or (during business hours only) by hand to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA, so as to be received as soon as possible and, in any event, by no later than 5.00 p.m. on Thursday 17 June 2010, the latest time and date for requesting a Cashless Take Up. A reply-paid envelope will be enclosed with the Provisional Allotment Letter for use within the United Kingdom only. Qualifying Non-CREST Shareholders who post their Provisional Allotment Letter within the United Kingdom by first-class post are recommended to allow at least four working days for delivery. The terms and conditions of the Equiniti Dealing Facility will be set out in a rights issue guide accompanying the Provisional Allotment Letter and are also available from Equiniti Limited on request. Shareholders using such service should note that they will be clients of Equiniti Financial Services Limited and not of Prudential or any of the Underwriters. Equiniti Financial Services Limited, rather than Prudential or any of the Underwriters will therefore be responsible for providing the protections afforded by the UK regulatory regime to clients for whom such services are provided. Neither Prudential nor any of the Underwriters is providing advice to shareholders on dealing in Prudential Shares.

(iv) Qualifying Non-CREST Shareholders who wish to dispose of all of their Nil Paid Rights through the Equiniti Dealing Facility

Qualifying Non-CREST Shareholders who wish to dispose of all of their Nil Paid Rights through the Equiniti Dealing Facility should tick the box under Option C "Sell all your rights" on page 1 of the Provisional Allotment Letter, sign and date the bottom of page 1 of the Provisional Allotment Letter, and return their Provisional Allotment Letter by post or (during business hours only) by hand to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA, so as to be received as soon as possible and, in any event, by no later than 5.00 p.m. Thursday 17 June 2010, the latest time and date for requesting disposals of Nil Paid Rights through the Equiniti Dealing Facility. A reply-paid envelope will be enclosed with the Provisional Allotment Letter for use within the United Kingdom only. Qualifying Non-CREST Shareholders who post their Provisional Allotment Letter within the United Kingdom by first-class post are recommended to allow at least four working days for delivery. The terms and conditions of the Equiniti Dealing Facility will be set out in a rights issue guide accompanying the Provisional Allotment Letter and are also available from Equiniti Limited on request. Shareholders using such service should note that they will be clients of Equiniti Financial Services Limited and not of Prudential or any of the Underwriters when using this service. Equiniti Financial Services Limited, rather than Prudential or any of the Underwriters will therefore be responsible for providing the protections afforded by the UK regulatory regime to clients for whom such services are provided. Neither Prudential nor any of the Underwriters is providing advice to shareholders on dealing in Prudential Shares.

(v) Discretion as to validity of acceptances

If payment is not received in full by 11.00 a.m. on Wednesday 23 June 2010, the provisional allotment will be deemed to have been declined and will lapse. However, with the agreement of the Joint Global Co-ordinators, Prudential may, but shall not be obliged to, treat as valid acceptances in respect of which remittances for the full amount are received prior to 11.00 a.m. on Wednesday 23 June 2010 from an authorised person (as defined in section 31(2) of FSMA 2000) specifying the number of Rights Issue Shares to be acquired and an undertaking by that person to lodge the relevant Provisional Allotment Letter, duly completed, in due course.

Prudential may also (in its absolute discretion and with the agreement of the Joint Global Co-ordinators) treat a Provisional Allotment Letter as valid and binding on the person(s) by whom or on whose behalf it is lodged even if it is not completed in accordance with the relevant instructions or is not accompanied by a valid power of attorney where required.

Prudential and/or the Joint Global Co-ordinators reserve the right to treat as invalid any acceptance or purported acceptance of the Rights Issue Shares that appear to Prudential and/or the Joint Global Co-ordinators to have been executed in, despatched from or that provides an address for delivery of share certificates for Rights Issue Shares in an Excluded Territory.

A Qualifying Non-CREST Shareholder who makes a valid acceptance and payment in accordance with this paragraph is deemed to request that the Rights Issue Shares to which he will become entitled be issued to him on the terms set out in this document and subject to the Articles.

(vi) Payments

All payments made by Qualifying Non-CREST Shareholders (but not Qualifying Non-CCASS Shareholders or Qualifying CCASS Shareholders) must be made in pounds sterling by cheque or banker's draft made payable to "Equiniti Limited re: PRUDENTIAL PLC Rights Issue" and crossed "A/C payee only". Third party cheques may not be accepted except building society cheques or banker's drafts where the building society or bank has confirmed the name of the account holder by stamping or endorsing the cheque or banker's draft to such effect. Cheques or banker's drafts must be drawn on an account at a branch (which must be in the United Kingdom, the Channel Islands or the Isle of Man) of a bank or building society which either is a settlement member of the Cheque and Credit Clearing Company Limited or the CHAPS Clearing Company Limited or which has arranged for its cheques and banker's drafts to be cleared through facilities provided by either of these companies. Such cheques and banker's drafts must bear the appropriate sort code in the top right hand corner. Post-dated cheques will not be accepted. Payments via CHAPS, BACS or electronic transfer will not be accepted.

Cheques and banker's drafts will be presented for payment on receipt. No interest will be paid on payments made before they are due and any interest on such payments ultimately will accrue for the benefit of Prudential. It is a term of the Rights Issue that cheques shall be honoured on first presentation, and Prudential and the Joint Global Co-ordinators may elect to treat as invalid any acceptances in respect of which cheques are not so honoured. If Rights Issue Shares have already been allotted to Qualifying Shareholders prior to any payment not being so honoured or such Qualifying Shareholders' acceptances being treated as invalid, the Joint Global Co-ordinators may (in their absolute discretion as to manner, timing and terms) make arrangements for the sale of such shares on behalf of those Qualifying Shareholders and hold the proceeds of sale (net of Prudential's reasonable estimate of any loss that it has suffered as a result of the same and of the expenses of sale including, without limitation, any stamp duty or SDRT payable on or in relation to the transfer of such shares, and of all amounts payable by such Qualifying Shareholders pursuant to the provisions of this Part IX in respect of the acquisition of such shares) on behalf of such Qualifying Shareholders. None of Prudential, the Underwriters or any other person shall be responsible for, or have any liability for, any loss, expense or damage suffered by Qualifying Shareholders as a result of any such action undertaken by or on behalf of Prudential and/or the Underwriters.

If a cheque or banker's draft sent by a Qualifying Non-CREST Shareholder is drawn for an amount different from that set out on that Qualifying Non-CREST Shareholder's Provisional Allotment Letter, that shareholder's application shall be treated as an acceptance in respect of such whole number of Rights Issue Shares that could be acquired at the Issue Price with the amount for which that cheque or banker's draft is drawn (and not the amount set out in the Provisional Allotment Letter). Any balance from the amount of the cheque will be retained for the benefit of Prudential.

### 2.1.3 Money Laundering Regulations

To ensure compliance with the Money Laundering Regulations, the Receiving Agent may require, at its absolute discretion, verification of the identity of the person by whom or on whose behalf the Provisional Allotment Letter is

lodged with payment (which requirements are referred to below as the “verification of identity requirements”). If an application is made by a UK regulated broker or intermediary acting as agent and which is itself subject to the Money Laundering Regulations, any verification of identity requirements are the responsibility of such broker or intermediary and not of the Receiving Agent. In such case, the lodging agent’s stamp should be inserted on the Provisional Allotment Letter. The person lodging the Provisional Allotment Letter with payment (the “applicant”), including any person who appears to the Receiving Agent to be acting on behalf of some other person, shall thereby be deemed to agree to provide the Receiving Agent with such information and other evidence as the Receiving Agent may require to satisfy the verification of identity requirements.

**Submission of a Provisional Allotment Letter will constitute a warranty that the Money Laundering Regulations will not be breached by the acceptance of the remittance and an undertaking by the applicant to provide promptly to the Receiving Agent such information as may be specified by the Receiving Agent as being required for the purpose of the Money Laundering Regulations.**

If the Receiving Agent determines that the verification of identity requirements apply to any applicant or application, the relevant Rights Issue Shares (notwithstanding any other term of the Rights Issue) will not be issued to the relevant applicant unless and until the verification of identity requirements have been satisfied in respect of that applicant or application. The Receiving Agent is entitled, in its absolute discretion, to determine whether the verification of identity requirements apply to any applicant or application and whether such requirements have been satisfied, and none of the Receiving Agent, Prudential or the Underwriters will be liable to any person for any loss or damage suffered or incurred (or alleged), directly or indirectly, as a result of the exercise of such discretion.

If the verification of identity requirements apply, failure to provide the necessary evidence of identity within a reasonable time may result in delays and potential rejection of an application. If, within a reasonable period following a request for verification of identity, the Receiving Agent has not received evidence satisfactory to it as aforesaid, Prudential may, in its absolute discretion, treat the relevant application as invalid, in which event the application monies will be returned (at the applicant’s risk) without interest to the account of the bank or building society on which the relevant cheque or banker’s draft was drawn.

The verification of identity requirements will not usually apply if:

- (i) the applicant is an organisation required to comply with the EU Money Laundering Directive (No. 91/308/EEC);
- (ii) the applicant is a regulated UK broker or intermediary acting as agent and is itself subject to the Money Laundering Regulations;
- (iii) the applicant (not being an applicant who delivers his application in person) makes payment by way of a cheque drawn on an account in the name of such applicant; or
- (iv) the aggregate price for taking up the relevant Rights Issue Shares is less than Euro 15,000 (approximately £12,770 as at 14 May 2010).

In other cases, the verification of identity requirements may apply. Satisfaction of these requirements may be facilitated in the following ways:

- (A) if payment is made by building society cheque (not being a cheque drawn on an account of the applicant) or banker’s draft, the building society or bank endorsing the cheque or banker’s draft should write the applicant’s full name and the number of the account held in the applicant’s name at such building society or bank, such endorsement being validated by a stamp and an authorised signature and the applicant should write his name and address on the back of the building society cheque or banker’s draft and, in the case of an individual, record his date of birth against his name; or
- (B) if the Provisional Allotment Letter is lodged with payment by an agent which is an organisation of the kind referred to in sub-paragraph (i) above or which is subject to anti-money laundering regulations in a country which is a member of the Financial Action Task Force (the non-EU members of which are Argentina, Australia, Brazil, Canada, Gibraltar, Hong Kong, Iceland, Mexico, Luxembourg, New Zealand, Norway, the Russian Federation, Singapore, South Africa, Switzerland, Turkey and the United States), the agent should provide with the Provisional Allotment Letter(s) written confirmation that it has that status and written assurance that it has obtained and recorded evidence of the identity of the person for whom it acts and that it will on demand make such evidence available to the Receiving Agent and/or any relevant regulatory or investigatory authority; or

- (C) if the Provisional Allotment Letter(s) is/are in respect of taking up Rights Issue Shares with an aggregate price of Euro 15,000 or more (approximately £12,770 as at 14 May 2010) and is/are lodged by hand by the applicant in person, or if the Provisional Allotment Letter(s) in respect of Rights Issue Shares is lodged by hand by the applicant and the accompanying payment is not the applicant's own cheque, the applicant should ensure that they have evidence of identity bearing their photograph (for example, a valid full passport) and separate evidence of their address.

#### *2.1.4 Dealings in Nil Paid Rights*

Subject to the Rights Issue becoming unconditional, dealings on the London Stock Exchange in the Nil Paid Rights are expected to commence at 8.00 a.m. on Tuesday 8 June 2010. A transfer of Nil Paid Rights can be made by renunciation of the Provisional Allotment Letter in accordance with the instructions printed on it and delivery of the Provisional Allotment Letter to the transferee. Shareholders should contact their stockbroker, bank or other authorised independent financial adviser if they wish to renounce all or part of their Nil Paid Rights. The latest time and date for registration of renunciation of Provisional Allotment Letters, nil paid, is 11.00 a.m. on Wednesday 23 June 2010.

#### *2.1.5 Dealings in Fully Paid Rights*

After acceptance of the provisional allotment and payment in full in accordance with the terms and conditions of the Rights Issue as set out in this document and the Provisional Allotment Letter, the Fully Paid Rights may be transferred by renunciation of the relevant fully paid Provisional Allotment Letter and lodging of the same, by post or (during normal business hours only) by hand to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA so as to be received not later than 11.00 a.m. on Wednesday 23 June 2010. To do this, a Qualifying Non-CREST Shareholder will need to have his fully paid Provisional Allotment Letter returned to him after the acceptance has been effected by the Receiving Agent. However, fully paid Provisional Allotment Letters will not be returned to Qualifying Non-CREST Shareholders unless their return is requested by crossing box 4 on the Provisional Allotment Letter.

From Thursday 24 June 2010, it is expected that the Rights Issue Shares will be in registered form and transferable in the usual way.

#### *2.1.6 Renunciation and splitting of Provisional Allotment Letters*

Qualifying Non-CREST Shareholders who wish to transfer all (and not some only) of their Nil Paid Rights represented by a Provisional Allotment Letter or, after acceptance of the provisional allotment and payment in full, Fully Paid Rights comprised in a Provisional Allotment Letter, and neither they nor any proposed transferee of those rights has a registered address, or is resident or located, in an Excluded Territory, may (save as required by the laws of certain overseas jurisdictions) renounce such allotment by completing and signing Form X on the Provisional Allotment Letter (if it is not already marked 'Original Duly Renounced') and passing the entire Provisional Allotment Letter to their stockbroker or bank or other appropriate authorised independent financial adviser or to the proposed transferee. Once a Provisional Allotment Letter has been renounced, it will become a negotiable instrument in bearer form. **The latest time and date for registration of renunciation of Provisional Allotment Letters is 11.00 a.m. on Wednesday 23 June 2010.**

If a holder of a Provisional Allotment Letter wishes to take up some, but not all, of his rights to the Rights Issue Shares provisionally allotted in his name and to transfer some or all of the remainder, or wishes to transfer all of those Nil Paid Rights or (if relevant) Fully Paid Rights, but to different persons, and neither he nor any transferee of those rights has a registered address, or is resident or located, in an Excluded Territory, he should first apply to have the Provisional Allotment Letter split by completing, signing and dating Form X on the Provisional Allotment Letter, and returning it by post or (during normal business hours only) by hand to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA so as to be received as soon as possible and, in any event, by **not later than 3.00 p.m. on Monday 21 June 2010**, with a covering letter.

The number of split Provisional Allotment Letters required and the number of Nil Paid Rights or (as appropriate) Fully Paid Rights to be comprised in each split Provisional Allotment Letter should be stated in the covering letter. The Provisional Allotment Letter will then be cancelled and exchanged for split Provisional Allotment Letters. Form X on split Provisional Allotment Letters will be marked 'Original Duly Renounced'. The split Provisional Allotment Letter representing the rights the shareholder wishes to take up should be delivered together with the cheque or banker's draft for the appropriate amount, made payable to "Equiniti Limited re: PRUDENTIAL PLC Rights Issue" and crossed "A/C payee only" **by 11.00 a.m. on Wednesday 23 June 2010**, the latest date and time for acceptance. Equiniti Limited will hold such monies on behalf of Credit Suisse, which is acting as principal, on

receipt of such monies but subject to the requirement that the monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX. The further split Provisional Allotment Letter(s) representing the rights that a holder does not wish to take up should be delivered to the renounee(s) or the stockbroker or bank or other agent through whom the sale or transfer was effected for delivery to the renounee.

Alternatively, Qualifying Non-CREST Shareholders who wish to take up some, but not all, of the rights to the Rights Issue Shares provisionally allotted to them, without transferring the remainder, should complete Form X on the Provisional Allotment Letter and return it by post or (during normal business hours only) by hand to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA, together with a covering letter confirming the number of Nil Paid Rights to be taken up and a cheque or banker's draft for the appropriate amount in pounds sterling made payable to "Equiniti Limited re: PRUDENTIAL PLC Rights Issue" and crossed "A/C payee only" and with the Shareholder Reference Number, which appears on page 1 of the Provisional Allotment Letter, written on the reverse of the cheque or banker's draft to pay for this number of rights. In this case, the Provisional Allotment Letter and payment must be received by Equiniti Limited **by 11.00 a.m. on Wednesday 23 June 2010**. Equiniti Limited will hold such monies on behalf of Credit Suisse, which is acting as principal, on receipt of such monies but subject to the requirement that the monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX.

Prudential and/or the Joint Global Co-ordinators reserve the right to refuse to register any renunciation or transfer in favour of any person in respect of which Prudential and the Joint Global Co-ordinators believes such renunciation or transfer may violate applicable legal or regulatory requirements, including (without limitation) any renunciation or transfer in the name of any person with an address in an Excluded Territory.

#### *2.1.7 Registration in names of Qualifying Shareholders*

A Qualifying Shareholder who wishes to have all the Rights Issue Shares to which he is entitled registered in his name must accept and make payment for such allotment in accordance with the provisions set out in this document and (in the case of Qualifying Non-CREST Shareholders) the Provisional Allotment Letter.

#### *2.1.8 Registration in names of persons other than Qualifying Shareholders originally entitled*

To register Nil Paid Rights or Fully Paid Rights in certificated form in the name of someone other than the Qualifying Shareholder(s) originally entitled, provided that, subject to certain exceptions, neither the Qualifying Shareholder nor any renounee has a registered address, or is resident or located, in an Excluded Territory, the renounee or his agent(s) must complete Form Y on the Provisional Allotment Letter (unless the renounee is a CREST member who wishes to hold such Rights Issue Shares in uncertificated form, in which case Form X and the CREST Deposit Form on the Provisional Allotment Letter must be completed —see paragraph 2.1.9 of this Part IX) and send the entire Provisional Allotment Letter by post or by hand (during normal business hours only) to Equiniti Limited at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA so as to be received by not later than 11.00 a.m. on Wednesday 23 June 2010.

The Rights Issue Shares comprised in several Provisional Allotment Letters (duly renounced where applicable) may be registered in the name of one holder (or joint holders). To consolidate the rights attached to two or more Provisional Allotment Letters, Form Y on page 4 of one of the Provisional Allotment Letters (the "Principal Letter") should be completed and a letter attached which details each Provisional Allotment Letter allotment number (as shown on page 1 of each Provisional Allotment Letter), the number of Rights Issue Shares represented by each Provisional Allotment Letter, the total number of Provisional Allotment Letters to be consolidated and the total number of Rights Issue Shares represented by all the Provisional Allotment Letters to be consolidated. All the Provisional Allotment Letters to be consolidated must be lodged in one batch together. Each Provisional Allotment Letter so lodged (including the Principal Letter) must bear the allotment number of the Principal Letter in the box provided in Form Y on page 4.

#### *2.1.9 Deposit of Nil Paid Rights or Fully Paid Rights into CREST*

The Nil Paid Rights or Fully Paid Rights represented by a Provisional Allotment Letter may be converted into uncertificated form, that is, deposited into CREST (whether such conversion arises as a result of a renunciation of those rights or otherwise). Similarly, Nil Paid Rights or Fully Paid Rights held in CREST may be converted into certificated form, that is, withdrawn from CREST. Subject as provided in the following paragraph 2.2 below or in the Provisional Allotment Letter, normal CREST procedures and timings apply in relation to any such conversion. Qualifying Non-CREST Shareholders are recommended to refer to the CREST Manual for details of such procedures.

The procedure for depositing the Nil Paid Rights or Fully Paid Rights represented by a Provisional Allotment Letter into CREST, whether such rights are to be converted into uncertificated form in the name(s) of the person(s) whose name(s) and address(es) appear on page 1 of the Provisional Allotment Letter or in the name of a person or persons to whom the Provisional Allotment Letter has been renounced, is as follows:

- (A) Form X and the CREST Deposit Form on the Provisional Allotment Letter will need to be completed and the Provisional Allotment Letter deposited with the CCSS. In addition, the normal CREST Stock Deposit procedures will need to be carried out, except that (i) it will not be necessary to complete and lodge a separate CREST Transfer Form (prescribed under the Stock Transfer Act 1963) with the CCSS; and (ii) only the whole of the Nil Paid Rights or Fully Paid Rights represented by the Provisional Allotment Letter may be deposited into CREST; and
- (B) Qualifying Non-CREST Shareholders who wish to deposit some only of their Nil Paid Rights or Fully Paid Rights represented by the Provisional Allotment Letter into CREST must first apply for split Provisional Allotment Letters — see paragraph 2.1.6 of this Part IX for details of how to do this. If the rights represented by more than one Provisional Allotment Letter are to be deposited, the CREST Deposit Form on each Provisional Allotment Letter must be completed and deposited.

A holder of the Nil Paid Rights (or, if appropriate, the Fully Paid Rights) represented by a Provisional Allotment Letter who is proposing to convert those rights into uncertificated form (whether following a renunciation of such rights or otherwise) is recommended to ensure that the conversion procedures are implemented in sufficient time to enable the person holding or acquiring the Nil Paid Rights (or, if appropriate, the Fully Paid Rights) in CREST following the conversion to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on Wednesday 23 June 2010. **In particular, having regard to processing times in CREST and on the part of the Receiving Agent, the latest recommended time for depositing a renounced Provisional Allotment Letter (with Form X and the CREST Deposit Form on the Provisional Allotment Letter duly completed), with the CCSS to enable the person acquiring the Nil Paid Rights (or, if appropriate, the Fully Paid Rights) in CREST as a result of the conversion to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on Wednesday 23 June 2010 is 3.00 p.m. on Friday 18 June 2010.**

When Form X and the CREST Deposit Form on the Provisional Allotment Letter have been completed, the title to the Nil Paid Rights or the Fully Paid Rights represented by the Provisional Allotment Letter will cease forthwith to be renounceable or transferable by delivery and for the avoidance of doubt any entries in Form Y on the Provisional Allotment Letter will not be recognised or acted upon by the Receiving Agent. All renunciations or transfers of the Nil Paid Rights or Fully Paid Rights must be effected by means of the CREST system once such rights have been deposited into CREST.

CREST sponsored members should contact their CREST sponsor as only their CREST sponsor will be able to take the necessary actions to take up the entitlements or otherwise to deal with the Nil Paid Rights or Fully Paid Rights of CREST sponsored members.

#### *2.1.10 Issue of Rights Issue Shares in definitive form*

Share certificates in respect of the Rights Issue Shares to be held in certificated form are expected to be despatched by post by Thursday 1 July 2010, at the risk of persons entitled thereto, to accepting Qualifying Non-CREST Shareholders or to persons entitled thereto at their registered address. After despatch of share certificates, Provisional Allotment Letters will cease to be valid for any purpose whatsoever. Pending despatch of share certificates, instruments of transfer of the Rights Issue Shares will be certified by the Registrar against the register.

## **2.2 Action to be taken by Qualifying CREST Shareholders in relation to Nil Paid Rights and Fully Paid Rights in CREST**

### *2.2.1 General*

Except for shareholders in Excluded Territories and subject as provided in section 7 of this Part IX in relation to Overseas Shareholders, each Qualifying CREST Shareholder is expected to receive a credit to his CREST stock account of his entitlement to Nil Paid Rights as soon as practicable after 8.00 a.m. on Tuesday 8 June 2010. The CREST stock account to be credited will be an account under the participant ID and member account ID that apply to the Existing Shares held at the Record Date by the Qualifying CREST Shareholder in respect of which the Nil Paid Rights are provisionally allotted.

The maximum number of Rights Issue Shares that a Qualifying CREST Shareholder may take up is that which has been provisionally allotted to that Qualifying CREST Shareholder and for which he receives a credit of entitlement

into his stock account in CREST. The minimum number of Rights Issue Shares a Qualifying CREST Shareholder may take up is one.

The Nil Paid Rights constitute a separate security for the purposes of CREST and can accordingly be transferred, in whole or in part, by means of CREST in the same manner as any other security that is admitted to CREST.

If for any reason it is impracticable to credit the stock accounts of Qualifying CREST Shareholders or to enable the Nil Paid Rights, Provisional Allotment Letters shall, unless the Prudential and the Joint Global Co-ordinators determine otherwise, be sent out in substitution for the Nil Paid Rights which have not been so credited or enabled and the expected timetable as set out in this document may, with the consent of the Joint Global Co-ordinators, be adjusted as appropriate. Prudential will make an appropriate announcement to a Regulatory Information Service giving details of the revised dates but Qualifying CREST Shareholders may not receive any further written communication.

**CREST members who wish to take up all or part of their entitlements in respect of, or otherwise to transfer all or part of, their Nil Paid Rights or Fully Paid Rights held by them in CREST should refer to the CREST Manual for further information on the CREST procedures referred to below. If you are a CREST sponsored member, you should consult your CREST sponsor if you wish to take up your entitlement as only your CREST sponsor will be able to take the necessary action to take up your entitlement or otherwise to deal with your Nil Paid Rights or Fully Paid Rights.**

#### *2.2.2 Procedure for acceptance and payment*

##### *(i) MTM instructions*

CREST members who wish to take up all or part of their entitlement in respect of Nil Paid Rights in CREST must send (or, if they are CREST sponsored members, procure that their CREST sponsor sends) an MTM instruction to Euroclear which, on its settlement, will have the following effect:

- (A) the crediting of a stock account of the Receiving Agent under the participant ID and member account ID specified below, with the number of Nil Paid Rights to be taken up;
- (B) creation of a settlement bank payment obligation (as defined in the CREST Manual), in accordance with the RTGS payment mechanism (as defined in the CREST Manual), in favour of the RTGS settlement bank of the Receiving Agent in respect of the full amount payable on acceptance in respect of the Nil Paid Rights referred to in (A) above; and
- (C) the crediting of a stock account of the accepting CREST member (being an account under the same participant ID and member account ID as the account from which the Nil Paid Rights are to be debited on settlement of the MTM instruction) of the corresponding number of Fully Paid Rights to which the CREST member is entitled on taking up his Nil Paid Rights referred to in (A) above.

##### *(ii) Contents of MTM instructions*

The MTM instruction must be properly authenticated in accordance with Euroclear's specifications and must contain, in addition to the other information that is required for settlement in CREST, the following details:

- (A) the number of Nil Paid Rights to which the acceptance relates;
- (B) the participant ID of the accepting CREST member;
- (C) the member account ID of the accepting CREST member from which the Nil Paid Rights are to be debited;
- (D) the participant ID of the Receiving Agent, in its capacity as a CREST receiving agent. This is 2RA12;
- (E) the member account ID of the Receiving Agent, in its capacity as a CREST receiving agent. This is RA014401;
- (F) the number of Fully Paid Rights that the CREST member is expecting to receive on settlement of the MTM instruction. This must be the same as the number of Nil Paid Rights to which the acceptance relates;
- (G) the amount payable by means of the CREST assured payment arrangements on settlement of the MTM instruction. This must be the full amount payable on acceptance in respect of the number of Nil Paid Rights to which the acceptance relates;
- (H) the intended settlement date (which must be on or before 11.00 a.m. on Wednesday 23 June 2010);
- (I) the ISIN for Nil Paid Rights, which is GB00B64R3G57;

- (J) the ISIN for Fully Paid Rights, which is GB00B64H9B24;
- (K) the Corporate Action Number for the Rights Issue. This will be available by viewing the relevant corporate action details in CREST;
- (L) a contact name and telephone number (in the free format shared note field); and
- (M) a priority of at least 80.
- (iii) Valid acceptance

An MTM instruction complying with each of the requirements as to authentication and contents set out in (B) below will constitute a valid acceptance where either:

- (A) the MTM instruction settles by not later than 11.00 a.m. on Wednesday 23 June 2010; or
- (B) at the discretion of Prudential and the Joint Global Co-ordinators:
  - (i) the MTM instruction is received by Euroclear by not later than 11.00 a.m. on Wednesday 23 June 2010;
  - (ii) the number of Nil Paid Rights inserted in the MTM instruction is credited to the CREST stock member account of the accepting CREST member specified in the MTM instruction at 11.00 a.m. on Wednesday 23 June 2010; and
  - (iii) the relevant MTM instruction settles by 2.00 p.m. on Wednesday 23 June 2010 (or such later time and/or date as Prudential has determined).

An MTM instruction will be treated as having been received by Euroclear for these purposes at the time at which the instruction is processed by the Network Provider's Communications Host (as defined in the CREST Manual) at Euroclear of the network provider used by the CREST member (or by the CREST sponsored member's CREST sponsor). This will be conclusively determined by the input time stamp applied to the MTM instruction by the Network Provider's Communications Host.

- (iv) Representations, warranties and undertakings of CREST members

A CREST member or CREST sponsored member who makes a valid acceptance in accordance with this paragraph 2.2 represents, warrants and undertakes to Prudential and the Underwriters that it has taken (or procured to be taken), and will take (or will procure to be taken), whatever action is required to be taken by him or by his CREST sponsor (as appropriate) to ensure that the MTM instruction concerned is capable of settlement before 11.00 a.m. on Wednesday 23 June 2010 and remains capable of settlement at all times after that until 2.00 p.m. on Wednesday 23 June 2010 (or until such later time and date as Prudential and the Joint Global Co-ordinators may determine). In particular, the CREST member or CREST sponsored member represents, warrants and undertakes that at 11.00 a.m. on Wednesday 23 June 2010 and at all times thereafter that until 2.00 p.m. on Wednesday 23 June 2010 (or until such later time and date as Prudential and the Joint Global Co-ordinators may determine) there will be sufficient Headroom within the Cap (as those terms are defined in the CREST Manual) in respect of the cash memorandum account to be debited with the amount payable on acceptance to permit the MTM instruction to settle. CREST sponsored members should contact their CREST sponsor if they are in any doubt.

If there is insufficient Headroom within the Cap (as those terms are defined in the CREST Manual) in respect of the cash memorandum account of a CREST member or CREST sponsored member for such amount to be debited or the CREST member's or CREST sponsored member's acceptance is otherwise treated as invalid and Rights Issue Shares have already been allotted to such CREST member or CREST sponsored member, the Joint Global Co-ordinators may (in its absolute discretion as to manner, timing and terms) make arrangements for the sale of such shares on behalf of that CREST member or CREST sponsored member and hold the proceeds of sale (net of Prudential's reasonable estimate of any loss that they have suffered as a result of the acceptance being treated as invalid and of the expenses of sale including, without limitation, any stamp duty or SDRT payable on or in relation to the transfer of such shares, and of all amounts payable by the CREST member or CREST sponsored member pursuant to the provisions of this Part IX in respect of the acquisition of such shares) on behalf of such CREST member or CREST sponsored member. Neither Prudential, the Underwriters nor any other person shall be responsible for, or have any liability for, any loss, expense or damage suffered by such CREST member or CREST sponsored member as a result.

- (v) CREST procedures and timings

CREST members and CREST sponsors (on behalf of CREST sponsored members) should note that Euroclear does not make available special procedures in CREST for any particular corporate action. Normal system timings and

limitations will therefore apply in relation to the input of an MTM instruction and its settlement in connection with the Rights Issue. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST sponsored member, to procure that his CREST sponsor takes) the action necessary to ensure that a valid acceptance is received as stated above by 11.00 a.m. on Wednesday 23 June 2010. In this regard, CREST members and (where applicable) CREST sponsors are referred in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

(vi) CREST member's undertaking to pay

A CREST member or CREST sponsored member who makes a valid acceptance in accordance with the procedures set out in this paragraph 2.2.2: (a) undertakes to pay to Credit Suisse, or procure the payment to Credit Suisse of, the amount payable in pounds sterling on acceptance in accordance with the above procedures or in such other manner as Credit Suisse may require (it being acknowledged that, where payment is made by means of the RTGS payment mechanism (as defined in the CREST Manual) the creation of a RTGS settlement bank payment obligation in pounds sterling in favour of the Receiving Agent's RTGS settlement bank (as defined in the CREST Manual), in accordance with the RTGS payment mechanism shall, to the extent of the obligation so created, discharge in full the obligation of the CREST member (or CREST sponsored member) to pay to Credit Suisse the amount payable on acceptance); and (b) requests that the Fully Paid Rights and/or Rights Issue Shares, to which they will become entitled, be issued to them on the terms set out in this document and subject to the Articles. Any amount so paid will be held on behalf of Credit Suisse, which is acting as principal, but subject to the requirement that such monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX.

If the payment obligations of the relevant CREST member in relation to such Rights Issue Shares are not discharged in full and such Rights Issue Shares have already been allotted to the CREST member or CREST sponsored member, the Joint Global Co-ordinators may (in their absolute discretion as to the manner, timing and terms) make arrangements for the sale of such shares on behalf of that CREST member or CREST sponsored member and hold the proceeds of sale (net of expenses including, without limitation, any stamp duty or SDRT payable on the transfer of such shares, and all amounts payable by the CREST member or CREST sponsored member pursuant to the provisions of this Part IX in respect of the acquisition of such shares) or an amount equal to the original payment of the CREST member or CREST sponsored member (whichever is lower) on trust for such CREST member or CREST sponsored member. In these circumstances neither Prudential, the Underwriters nor any other person shall be responsible for, or have any liability for, any loss, expense or damage suffered by the CREST member or CREST sponsored member arising as a result.

(vii) Discretion as to rejection and validity of acceptances

Prudential and the Joint Global Co-ordinators may:

- (A) reject any acceptance constituted by an MTM instruction, which is otherwise valid, in the event of breach of any of the representations, warranties and undertakings set out or referred to in this paragraph 2.2.2 of this Part IX. Where an acceptance is made as described in this paragraph 2.2.2 of this Part IX which is otherwise valid, and the MTM instruction concerned fails to settle by 2.00 p.m. on Wednesday 23 June 2010 (or by such later time and date as Prudential and the Joint Global Co-ordinators may determine), Prudential and the Joint Global Co-ordinators shall be entitled to assume, for the purposes of their right to reject an acceptance as described in this paragraph 2.2.2 of this Part IX, that there has been a breach of the representations, warranties and undertakings set out or referred to in this paragraph 2.2.2 of this Part IX;
- (B) treat as valid (and binding on the CREST member or CREST sponsored member concerned) an acceptance which does not comply in all respects with the requirements as to validity set out or referred to in this paragraph 2.2.2 of this Part IX;
- (C) accept an alternative properly authenticated dematerialised instruction from a CREST member or (where applicable) a CREST sponsor as constituting a valid acceptance in substitution for, or in addition to, an MTM instruction and subject to such further terms and conditions as Prudential and the Joint Global Co-ordinators may determine;
- (D) treat a properly authenticated dematerialised instruction (in this sub-section the "first instruction") as not constituting a valid acceptance if, at the time at which the Receiving Agent receives a properly authenticated dematerialised instruction giving details of the first instruction, either Prudential or the Receiving Agent has received actual notice from Euroclear of any of the matters specified in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001 in relation to the first instruction. These matters include notice

that any information contained in the first instruction was incorrect or notice of lack of authority to send the first instruction; and

- (E) accept an alternative instruction or notification from a CREST member or (where applicable) a CREST sponsor, or extend the time for acceptance and/or settlement of an MTM instruction or any alternative instruction or notification if, for reasons or due to circumstances outside the control of any CREST member or CREST sponsored member or (where applicable) CREST sponsor, the CREST member or CREST sponsored member is unable validly to take up all or part of his Nil Paid Rights by means of the above procedures. In normal circumstances, this discretion is only likely to be exercised in the event of any interruption, failure or breakdown of CREST (or of any part of CREST) or on the part of facilities and/or systems operated by the Receiving Agent in connection with CREST.

### *2.2.3 Money Laundering Regulations*

If you hold your Nil Paid Rights in CREST and apply to take up all or part of your entitlement as agent for one or more persons and/or you are not a UK or EU regulated person or institution (e.g. a UK financial institution), then, irrespective of the value of the application, the Receiving Agent is required to take reasonable measures to establish the identity of the person or persons on whose behalf you are making the application. You must therefore contact the Receiving Agent before sending any MTM instruction or other instruction so that appropriate measures may be taken.

Submission of an MTM instruction which constitutes, or which may on its settlement constitute, a valid acceptance as described above constitutes a warranty and undertaking by the applicant to provide promptly to the Receiving Agent any information the Receiving Agent may specify as being required for the purposes of the Money Laundering Regulations or FSMA 2000. Pending the provision of evidence satisfactory to the Receiving Agent as to identity, the Receiving Agent, having consulted with Prudential and the Joint Global Co-ordinators, may take, or omit to take, such action as it may determine to prevent or delay settlement of the MTM instruction. If satisfactory evidence of identity has not been provided within a reasonable time, then the Receiving Agent will not permit the MTM instruction concerned to proceed to settlement but without prejudice to the right of Prudential and/or the Underwriters to take proceedings to recover any loss suffered by it/them as a result of failure by the applicant to provide satisfactory evidence.

### *2.2.4 Dealings in Nil Paid Rights in CREST*

Subject to the Rights Issue becoming unconditional, dealings in the Nil Paid Rights on the London Stock Exchange are expected to commence at 8.00 a.m. on Thursday 24 June 2010. Dealings in Nil Paid Rights can be made by means of CREST in the same manner as any other security that is admitted to CREST. The Nil Paid Rights are expected to be disabled in CREST after the close of CREST business on Wednesday 23 June 2010.

### *2.2.5 Dealings in Fully Paid Rights in CREST*

After acceptance of the provisional allotment and payment in full in accordance with the provisions set out in this document, the Fully Paid Rights may be transferred (in whole or in part) by means of CREST in the same manner as any other security that is admitted to CREST. The last time for settlement of any transfer of Fully Paid Rights in CREST is expected to be 11.00 a.m. on Wednesday 23 June 2010. The Fully Paid Rights are expected to be disabled in CREST after the close of CREST business on Wednesday 23 June 2010.

### *2.2.6 Withdrawal of Nil Paid Rights or Fully Paid Rights from CREST*

Nil Paid Rights or Fully Paid Rights held in CREST may be converted into certificated form, that is, withdrawn from CREST. Normal CREST procedures (including timings) apply in relation to any such conversion. The recommended latest time for receipt by Euroclear of a properly authenticated dematerialised instruction requesting withdrawal of Nil Paid Rights or, if appropriate, Fully Paid Rights, from CREST is 4.30 p.m. on Wednesday 16 June 2010, so as to enable the person acquiring or (as appropriate) holding the Nil Paid Rights or, if appropriate, Fully Paid Rights, following the conversion to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on Wednesday 23 June 2010. It is recommended that Qualifying CREST Shareholders refer to the CREST Manual for details of such procedures.

### *2.2.7 Issue of Rights Issue Shares in CREST*

Fully Paid Rights in CREST are expected to be disabled in CREST after the close of CREST business on Wednesday 23 June 2010 (the latest date for settlement of transfers of Fully Paid Rights in CREST). Rights Issue Shares will be

issued in uncertificated form to those persons registered as holding Fully Paid Rights in CREST at the close of business on the date on which the Fully Paid Rights are disabled. The Receiving Agent will instruct Euroclear to credit the appropriate stock accounts of those persons (under the same participant ID and member account ID that applied to the Fully Paid Rights held by those persons) with their entitlements to Rights Issue Shares as soon as practicable after 8.00 a.m. on the following business day (expected to be Thursday 24 June 2010).

#### *2.2.8 Right to allot/issue in certificated form*

Despite any other provision of this document, Prudential reserves the right to allot and/or to issue any Nil Paid Rights, Fully Paid Rights or Rights Issue Shares in certificated form. In normal circumstances, this right is only likely to be exercised in the event of an interruption, failure or breakdown of CREST (or of any part of CREST) or of a part of the facilities and/or systems operated by the Receiving Agent in connection with CREST, or otherwise if it has first obtained the Joint Global Co-ordinators' written consent.

### **3. Action to be taken by HK Shareholders**

The action to be taken by UK Shareholders and Singapore Shareholders is set out in sections 2 and 4 respectively of this Part IX.

The action to be taken by HK Shareholders in respect of the Rights Issue Shares depends on whether, at the relevant time, the Nil Paid Rights in respect of which action is to be taken are in certificated form in the name of the relevant Qualifying Non-CCASS Shareholder (that is, are represented by a Provisional Allotment Letter) or held in the name of HKSCC Nominees on the HK Register and deposited directly into CCASS.

#### *3.1 Action to be taken by Qualifying Non-CCASS Shareholders*

##### *3.1.1 General*

Subject to the passing of the Rights Issue Resolution (without material amendment) at the General Meeting, this prospectus and the Provisional Allotment Letters are expected to be despatched to Qualifying Non-CCASS Shareholders and HKSCC Nominees on Tuesday 8 June 2010. The Provisional Allotment Letters will entitle Qualifying Non-CCASS Shareholders to whom they are addressed and HKSCC Nominees to take up the number of Rights Issue Shares shown therein.

**The latest time and date for acceptance and payment in full is 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010.**

##### *3.1.2 Procedure for acceptance and payment*

###### *(i) Qualifying Non-CCASS Shareholders who wish to accept in full*

If a Qualifying Non-CCASS Shareholder wishes to accept all Nil Paid Rights provisionally allotted to such shareholder as specified in the Provisional Allotment Letter, such shareholder must lodge the Provisional Allotment Letter in accordance with the instructions printed thereon, together with a remittance for the full amount payable on acceptance, with the HK Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, so as to be received as soon as possible, and in any event by no later than 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010. All remittances must be made in Hong Kong dollars and cheques must be drawn on a bank account with, or cashier orders must be issued by, a licensed bank in Hong Kong and made payable to "PRUDENTIAL PLC Rights Issue" and crossed "Account Payee Only". A reply-paid envelope will be enclosed with the Provisional Allotment Letter for use within Hong Kong only. Qualifying Non-CCASS Shareholders who lodge their Provisional Allotment Letter within Hong Kong by post are recommended to allow at least four working days for delivery. Computershare Hong Kong Investor Services Limited will hold any application monies on behalf of Credit Suisse, which is acting as principal, but subject to the requirement that such monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX.

It should be noted that unless the Provisional Allotment Letter, together with the appropriate remittance, has been lodged with Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong by 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010, whether by the original allottee or any person in whose favour the rights have been validly transferred, that provisional allotment and all rights thereunder will be deemed to have been declined and will lapse.

(ii) Qualifying Non-CCASS Shareholders who wish to accept in part

Qualifying Non-CCASS Shareholders who wish to take up some but not all of their Nil Paid Rights should refer to paragraph 3.1.4 of this Part IX.

(iii) Discretion as to validity of acceptances

If payment is not received in full by 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010, the provisional allotment will be deemed to have been declined and will lapse.

Prudential may also (with the agreement of the Joint Global Co-ordinators) treat a Provisional Allotment Letter as valid and binding on the person(s) by whom or on whose behalf it is lodged even if it is not completed in accordance with the relevant instructions or is not accompanied by a valid power of attorney (where required).

Rights Issue Shares can only be registered on the HK Register if the allottee has an address in Hong Kong. Prudential and/or the Joint Global Co-ordinators reserve the right to treat as invalid any acceptance or purported acceptance of the Rights Issue Shares that appears to Prudential and/or the Joint Global Co-ordinators to have been executed in, despatched from or that provides an address for delivery of share certificates for Rights Issue Shares outside Hong Kong.

A Qualifying Non-CCASS Shareholder who makes a valid acceptance and payment in accordance with this paragraph is deemed to request that the Rights Issue Shares to which he will become entitled be issued to him on the terms set out in this document and subject to the Articles.

(iv) Payments

All payments made by Qualifying Non-CCASS Shareholders must be in Hong Kong dollars and made by cheque drawn on a bank account with, or by cashier order issued by, a licensed bank in Hong Kong and in either case made payable to "PRUDENTIAL PLC Rights Issue" and crossed "Account Payee Only". Qualifying Non-CCASS Shareholders should write their name and Shareholder Reference Number (indicated at the top of Form A of the Provisional Allotment Letter) on the back of the cheque or cashier's order. Computershare Hong Kong Investor Services Limited will hold such monies on behalf of Credit Suisse, which is acting as principal, but subject to the requirement that such monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX. All cheques and cashier orders in Hong Kong dollars for the Rights Issue Shares will be presented for payment on receipt. No interest will be paid on payments made before they are due and any interest on such payments ultimately will accrue for the benefit of Prudential. It is a term of the Rights Issue that cheques or cashier orders shall be honoured on first presentation, and Prudential and the Joint Global Co-ordinators may elect to treat as invalid any acceptances in respect of which the cheques or cashier orders are not so honoured. If Rights Issue Shares have already been allotted to Qualifying Non-CCASS Shareholders prior to any payment not being so honoured or such Qualifying Non-CCASS Shareholders' acceptances being treated as invalid, the Joint Global Co-ordinators may, in their absolute discretion as to manner, timing and terms, make arrangements for the sale of such shares on behalf of those Qualifying Non-CCASS Shareholders and hold the proceeds of sale (net of Prudential's reasonable estimate of any loss that it has suffered as a result of the same and of the expenses of sale including, without limitation, any stamp duty or SDRT payable on or in relation to the transfer of such shares, and of all amounts payable by such Qualifying Non-CCASS Shareholders pursuant to the terms of this Part IX in respect of the acquisition of such shares) on behalf of such Qualifying Non-CCASS Shareholders. None of Prudential, the Underwriters or any other person shall be responsible for, or have any liability for, any loss, expense or damage suffered by Qualifying Non-CCASS Shareholders as a result.

If a cheque or cashier order sent by a Qualifying Non-CCASS Shareholder is drawn for an amount different from that set out on that HK Shareholder's Provisional Allotment Letter, that shareholder's application shall be treated as an acceptance in respect of such whole number of Rights Issue Shares that could be acquired at the Issue Price with the amount for which that cheque or cashier order is drawn (and not the amount set out in the Provisional Allotment Letter). Any balance from the amount of the cheque will be retained for the benefit of Prudential.

### 3.1.3 Dealings in Nil Paid Rights

Assuming the Rights Issue becomes unconditional, dealings on the Main Board of the Hong Kong Stock Exchange in the Nil Paid Rights are expected to commence at 9.30 a.m. (Hong Kong time) on Thursday 10 June 2010 and will cease at 4.00 p.m. (Hong Kong time) on Friday 18 June 2010. A transfer of Nil Paid Rights can be made by a renunciation of the Provisional Allotment Letter in accordance with the instructions printed thereon and delivery of the Provisional Allotment Letter to the transferee or broker. The latest time and date for registration of renunciation of Provisional Allotment Letters, nil paid, is 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010.

### *3.1.4 Transfer and splitting of Provisional Allotment Letters*

If a Qualifying Non-CCASS Shareholder wishes to take up only part of his Nil Paid Rights under the Provisional Allotment Letter or transfer a part of his rights to take up the Rights Issue Shares provisionally allotted to him/ her under the Provisional Allotment Letter or to transfer all or part of his rights to more than one person, he should arrange for splitting of the Provisional Allotment Letter. In order to split the Provisional Allotment Letter, the original Provisional Allotment Letter must be surrendered and lodged in person for cancellation together with a covering letter stating clearly the number of split Provisional Allotment Letters required and the number of Nil Paid Rights to be comprised in each split Provisional Allotment Letter (which, in aggregate, should be equal to the number of Rights Issue Shares provisionally allotted to such holder as stated in Box B on Form A of the Provisional Allotment Letter) by no later than 4.30 p.m. (Hong Kong time) on Monday 14 June 2010 with Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, who will cancel the original Provisional Allotment Letter and issue split Provisional Allotment Letters in the denominations required. The split Provisional Allotment Letters will be available for collection from Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong from 9.00 a.m. (Hong Kong time) on the second HK Business Day after the surrender of the original Provisional Allotment Letter.

If a Qualifying Non-CCASS Shareholder wishes to transfer all of his/her Nil Paid Rights under the Provisional Allotment Letter (or the split Provisional Allotment Letter, as the case may be) to another person, he/she should complete and sign Form B on page 4 of the Provisional Allotment Letter and hand the Provisional Allotment Letter to the person to or through whom he/she is transferring his/her Nil Paid Rights. The transferee must then complete and sign Form C on page 4 of the Provisional Allotment Letter and lodge the Provisional Allotment Letter intact together with a remittance for the full amount payable on acceptance with Computershare Hong Kong Investor Services Limited to effect the transfer by not later than 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010. Computershare Hong Kong Investor Services Limited will hold such monies on behalf of Credit Suisse, which is acting as principal, but subject to the requirement that such monies can only be applied in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited as provided in section 10 of this Part IX.

Prudential and/or the Joint Global Co-ordinators reserve the right to refuse to register any transfer in favour of any person in respect of which Prudential and the Joint Global Co-ordinators believe such transfer may violate applicable legal or regulatory requirements, including (without limitation) any transfer to any person who is resident outside the United Kingdom, Hong Kong or Singapore. Rights Issue Shares can only be registered on the HK Register if the allottee has an address in Hong Kong.

### *3.1.5 Registration in names of Qualifying Non-CCASS Shareholders*

A Qualifying Non-CCASS Shareholder who wishes to have all the Rights Issue Shares to which he is entitled registered in his name must accept and make payment for such allotment in accordance with the provisions set out in this document and the Provisional Allotment Letter.

## **3.2 Action to be taken by Qualifying CCASS Shareholders**

Qualifying CCASS Shareholders should contact their broker or custodian for further details.

## **3.3 Application for listing on the Hong Kong Stock Exchange**

Application has been made to the Hong Kong Stock Exchange for the listing of, and permission to deal in, the Rights Issue Shares, in both nil-paid and fully-paid forms. The Rights Issue Shares do not constitute a new class of securities to be listed on the Hong Kong Stock Exchange.

Subject to the granting of listing of, and permission to deal in, the Rights Issue Shares in their nil-paid and fully-paid forms on the Hong Kong Stock Exchange as well as compliance with the stock admission requirements of HKSCC, the Rights Issue Shares in their nil-paid and fully-paid forms will be accepted as eligible securities by HKSCC for deposit, clearance and settlement in CCASS with effect from the respective commencement date of dealings in the Rights Issue Shares in their nil-paid and fully-paid forms or such other dates as determined by HKSCC. Settlement of transactions between participants of the Hong Kong Stock Exchange on any trading day is required to take place in CCASS on the second trading day thereafter. All activities under CCASS are subject to the General Rules of CCASS and CCASS Operational Procedures in effect from time to time.

Nil Paid Rights are expected to be traded in board lots of 500 Prudential Shares (as the Existing Shares will be traded on the Hong Kong Stock Exchange from Tuesday 25 May 2010 in board lots of 500 Prudential Shares). Dealings in the nil-paid and fully-paid Rights Issue Shares will be subject to the payment of stamp duty in Hong Kong.

#### **4. Action to be taken by Singapore Shareholders**

The action to be taken by UK Shareholders and HK Shareholders is set out in sections 2 and 3 respectively of this Part IX.

Singapore Shareholders who wish to be eligible to participate in the Rights Issue and who presently do not maintain with CDP an address in Singapore for the service of notices and documents should provide such an address by notifying CDP in writing at:

**The Central Depository (Pte) Limited  
4 Shenton Way  
#02-01, SGX Centre 2  
Singapore 068807**

no later than three Singapore Business Days prior to the Record Date.

Details on the terms and conditions as well as the procedures for the application for Rights Issue Shares by Qualifying CDP Shareholders will be set out in the Singapore Application Form which is expected to be sent to Qualifying CDP Shareholders on Wednesday 9 June 2010.

#### **5. Procedures in respect of rights not taken up (whether certificated or in CREST) and withdrawal**

##### **5.1 Procedure in respect of Rights Issue Shares not taken up**

If an entitlement to Rights Issue Shares is not validly taken up by 11.00 a.m. (London time) on Wednesday 23 June 2010 in respect of UK Shareholders; by 4.00 p.m. (Hong Kong time) on Wednesday 23 June 2010 in respect of HK Shareholders; and by 5.00 p.m. (Singapore time) on Thursday 17 June 2010 in respect of Singapore Shareholders accepting via Singapore Application Forms and 9.30 p.m. (Singapore time) on Thursday 17 June 2010 for acceptances via ATM, in accordance with the procedure laid down for acceptance and payment, then that provisional allotment will be deemed to have been declined and will lapse. The Joint Global Co-ordinators (as agents of Prudential) will use reasonable endeavours to procure, by not later than 4.30 p.m. (London time) on the second business day after Wednesday 23 June 2010, acquirers for all (or as many as possible) of those Rights Issue Shares not taken up if a price per Rights Issue Share at least equal to the total of the Issue Price (in pounds sterling) and the expenses of procuring such acquirers (including any applicable brokerage, commissions, currency conversion costs and amounts in respect of VAT which are not recoverable) can be obtained.

Notwithstanding the above, the Joint Global Co-ordinators may at any time cease or decline to endeavour to procure any such acquirers if, in the opinion of the Joint Global Co-ordinators, it is unlikely that any such acquirers can be so procured at such a price by such time. If and to the extent that acquirers cannot be procured on the basis outlined above, the Rights Issue Shares not taken up will be acquired by the Underwriters as principals pursuant to the Underwriting Agreement (or by sub-underwriters procured by the Joint Global Co-ordinators), in each case, at the Issue Price (in pounds sterling).

Any premium over the aggregate of the Issue Price (in pounds sterling) and the expenses of procuring acquirers (including any applicable brokerage, commissions, currency conversion costs and amounts in respect of VAT which are not recoverable) shall be paid (subject as provided in this Part IX):

- (i) where the Nil Paid Rights were, at the time they lapsed, represented by a Provisional Allotment Letter (including those held by Qualifying Non-CCASS Shareholders and HKSCC Nominees on behalf of Qualifying CCASS Shareholders), to the person whose name and address appeared on page 1 of the Provisional Allotment Letter;
- (ii) where the Nil Paid Rights were, at the time they lapsed, in uncertificated form, to the person registered as the holder of those Nil Paid Rights at the time of their disablement in CREST; and
- (iii) where an entitlement to Rights Issue Shares was not taken up by an Overseas Shareholder (and (i) and (ii) do not apply to that Overseas Shareholder), to that Overseas Shareholder.

Rights Issue Shares for which acquirers are procured on this basis will be re-allotted to such acquirers and the aggregate of any premiums (being the amount paid by such acquirers after deducting the Issue Price and the expenses of procuring such acquirers, including any applicable brokerage, commissions, currency conversion costs and amounts in respect of VAT which are not recoverable), if any, will be paid (without interest) to those persons entitled (as referred to above) pro rata to the relevant lapsed provisional allotments, save that no payment will be made of amounts of less than £5 or in respect of fractions of a pence, which amounts will be aggregated and will ultimately accrue to the benefit of Prudential.

Any transactions undertaken pursuant to this paragraph 5.1 of this Part IX shall be deemed to have been undertaken at the request of the persons entitled to the lapsed provisional allotments and neither Prudential, the Underwriters or any other person shall be responsible or have any liability whatsoever for any loss or damage (whether actual or alleged) arising from the terms of or timing of any such transaction, the market on which such transaction is carried out, any decision not to endeavour to procure acquirers or the failure to procure acquirers on the basis described above. The Joint Global Co-ordinators will be entitled to retain any brokerage fees, commissions or other benefits received in connection with these arrangements. Cheques for the amounts due will be sent in pounds sterling to UK Shareholders and Hong Kong dollars to HK Shareholders and Singapore Shareholders, by post, at the risk of the person(s) entitled, to their registered addresses (in the case of joint holders, to the registered address of the first named), provided that where any entitlement concerned was held in CREST the amount due will, unless Prudential (in its absolute discretion) otherwise determines, be satisfied by Prudential procuring the creation of an assured payment obligation in favour of the relevant CREST member's (or CREST sponsored member's) RTGS settlement bank in respect of the cash amount concerned in accordance with the RTGS payment mechanism.

Pursuant to section 4.04 of the deposit agreement relating to the ADR facility, the US Depositary, acting on behalf of the ADR holders, is expected to (subject to certain exceptions) sell the Nil Paid Rights received by it in connection with the Rights Issue and will allocate the proceeds of such sales for the accounts of the ADR holders who are not eligible to take up, or who otherwise elect not to take up, their entitlements in the Rights Issue.

## 5.2 *Withdrawal rights*

Persons wishing to exercise statutory withdrawal rights under section 87Q(4) of FSMA 2000 after the publication by Prudential of a supplementary prospectus (if any) in respect of this document must do so by depositing a written notice of withdrawal which must include the account number, the full name and address of the person wishing to exercise such right of withdrawal and, if such person is a CREST member, the participant ID and the member account ID of such CREST member, with Equiniti Limited by hand (during normal business hours) at Equiniti Limited, Corporate Actions, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA or by facsimile to Equiniti Limited (to obtain details for any facsimile transmission in these circumstances, shareholders should contact Equiniti Limited by telephoning the Shareholder Helpline) or with Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong (or faxed to Computershare Hong Kong Investor Services Limited on 3186 2965 (from within Hong Kong) or +852 3186 2965 (from outside Hong Kong)), so as to be received before the end of the period of two business days beginning with the first business day after the date on which the supplementary prospectus is published. Withdrawal is effective as at the time of receipt of the withdrawal notice by Equiniti Limited or Computershare Hong Kong Investor Services Limited, as applicable. Notice of withdrawal given by any other means or which is sent to or deposited with or received by facsimile by the Receiving Agent after the expiry of such period will not constitute a valid withdrawal. Furthermore, the exercise of withdrawal rights will not be permitted after payment by the relevant person in respect of the relevant Rights Issue Shares in full and the allotment of Rights Issue Shares to such person therefore becoming unconditional. In such circumstances, holders of Prudential Shares are advised to consult their professional advisers.

Provisional allotments of entitlements to Rights Issue Shares which are the subject of a valid withdrawal notice will be deemed to be declined. Such entitlements to Rights Issue Shares will be subject to the provisions of paragraph 5.1 above as if the entitlement had not been validly taken up.

## 6. **Taxation**

Information on certain tax aspects of the Rights Issue is set out in Part XVIII of this prospectus. The information contained in Part XVIII of this prospectus is intended only as a general guide to the current tax position in the United Kingdom, in Hong Kong, in Singapore and in the US. Qualifying Shareholders should consult their own tax advisers regarding the tax treatment of the Rights Issue in light of their own circumstances. **Shareholders who are in any doubt as to their tax position or who are subject to tax in any other jurisdiction should consult an appropriate professional adviser immediately.**

## 7. **Overseas Shareholders**

This document has been approved by the FSA, being the competent authority in the UK. Prudential has requested that the FSA provides a certificate of approval and a copy of this document to the relevant competent authorities in France and the Republic of Ireland, pursuant to the passporting provisions of FSMA 2000.

## 7.1 General

**The offer of Nil Paid Rights, Fully Paid Rights and/or the Rights Issue Shares pursuant to the Rights Issue and/or the distribution of this prospectus or any other document relating to the Rights Issue (including a Provisional Allotment Letter) to persons who have registered addresses in, or who are resident or located in or who are citizens of, or which are corporations, partnerships or other entities created or organised under the laws of countries other than the United Kingdom, Hong Kong or Singapore or to persons who are nominees of or custodians, trustees or guardians for any such persons or entities may be affected or prohibited by the laws or regulatory requirements of the relevant jurisdictions. Those persons should consult their professional advisers as to whether they require any governmental or other consents or need to observe any applicable legal requirement or other formalities to enable them to take up their rights under the Rights Issue.**

This paragraph 7 sets out certain restrictions applicable to persons who have a registered address outside the United Kingdom, Hong Kong or Singapore, who are resident or located in countries other than the UK, Hong Kong or Singapore, or who are persons (including, without limitation, custodians, nominees and trustees) who have a contractual or legal obligation to forward this document to a jurisdiction outside the UK, Hong Kong or Singapore or who hold Prudential Shares for the account or benefit of any such person. Rights Issue Shares will be provisionally allotted to all Qualifying Shareholders, including Overseas Shareholders. However, Provisional Allotment Letters should not be sent to, and Nil Paid Rights should not be credited to CREST or CCASS accounts of, any shareholders in the United States or the other Excluded Territories or to their agents or intermediaries except where Prudential and the Joint Global Co-ordinators are satisfied that such action would not result in a contravention of any registration or other legal requirement in any such jurisdiction or where Prudential is not aware that the relevant holder of Prudential Shares is in an Excluded Territory.

As required under Rule 13.36(2) of the Hong Kong Listing Rules, Prudential has made enquiries regarding the legal restrictions under the applicable securities legislation of the relevant jurisdictions and the requirements of the relevant regulatory body or stock exchange with respect to making the Rights Issue in the Excluded Territories. Prudential considered advice from legal advisers in the United States, India, Japan, Malaysia, New Zealand and South Africa that either (i) this document will be required to be registered or filed with or subject to approval by the relevant authorities in these jurisdictions; or (ii) Prudential would need to take additional steps to comply with the local legal and regulatory requirements if the Rights Issue were extended to the shareholders in these jurisdictions.

Having considered the circumstances, the Directors have formed the view that it is necessary or expedient to refrain from distributing documents relating to the Rights Issue (including Provisional Allotment Letters) to certain shareholders in the United States and shareholders in India, Japan, Malaysia, New Zealand and South Africa due to the time and costs involved in the registration of the document and/or compliance with the relevant local legal or regulatory requirements in those jurisdictions.

Receipt of this document and/or a Provisional Allotment Letter or the crediting of Nil Paid Rights to a stock account in CREST, CCASS or CDP does not and will not constitute an offer in those jurisdictions in which it would be illegal to make an offer and, in those circumstances, this document and/or a Provisional Allotment Letter must be treated as sent for information only and should not be copied or redistributed. No person who has received or receives a copy of this document and/or a Provisional Allotment Letter and/or who receives a credit of Nil Paid Rights to a stock account in CREST, CCASS or CDP in any territory other than the United Kingdom, Hong Kong or Singapore may treat the same as constituting an invitation or offer to him, nor should he in any event use the Provisional Allotment Letter or deal with Nil Paid Rights or Fully Paid Rights in CREST or Nil Paid Rights in CCASS or CDP, in the relevant territory, unless such an invitation or offer could lawfully be made to him or the Provisional Allotment Letter or Nil Paid Rights or Fully Paid Rights in CREST or Nil Paid Rights in CCASS or CDP could lawfully be used or dealt with without contravention of any registration or other legal or regulatory requirements.

Accordingly, persons (including, without limitation, custodians, nominees and trustees) who receive a copy of this document or a Provisional Allotment Letter or whose stock account in CREST, CCASS or CDP is credited with Nil Paid Rights or Fully Paid Rights should not, in connection with the Rights Issue, distribute or send the same in or into, or transfer Nil Paid Rights or Fully Paid Rights to any person in or into, any Excluded Territory. If a Provisional Allotment Letter or a credit of Nil Paid Rights or Fully Paid Rights in CREST, CCASS or CDP is received by any person in any such territory, or by his agent or nominee, he must not seek to take up the rights referred to in the Provisional Allotment Letter or in this document or renounce the Provisional Allotment Letter or transfer the Nil Paid Rights or Fully Paid Rights in CREST, CCASS or CDP (as applicable) unless Prudential or the Joint Global Co-ordinators determine that such actions would not violate applicable legal or regulatory requirements and has informed that person. Any person who does forward this document or a Provisional Allotment Letter or transfer Nil

Paid Rights or Fully Paid Rights into any such territories (whether pursuant to a contractual or legal obligation or otherwise) should draw the recipient's attention to the contents of this section 7 of this Part IX.

Subject to paragraphs 7.2 and 7.3 of this Part IX, any person (including, without limitation, agents, nominees and trustees) who has a registered address, or who is resident or located, outside the United Kingdom, Hong Kong or Singapore, or who is a citizen or resident of another jurisdiction, or which is a corporation, partnership or other entity created or organised under the laws of countries other than the United Kingdom, Hong Kong or Singapore or persons who are nominees of or custodians, trustees or guardians for any such persons or entities, wishing to take up their rights under the Rights Issue, must satisfy himself as to the full observance of the applicable laws of any relevant territory, including obtaining any requisite governmental or other consents, observing any other requisite formalities and paying any issue, transfer or other taxes due in such territories. This section 7 of this Part IX is intended as a general guide only and any person who is in any doubt as to his position should consult his professional adviser without delay.

Prudential and the Joint Global Co-ordinators (in their absolute discretion) may treat as invalid any acceptance or purported acceptance of the offer of Fully Paid Rights, Nil Paid Rights or Rights Issue Shares which appears to Prudential or the Joint Global Co-ordinators or their respective agents to have been executed, effected or despatched in a manner which may involve a breach of the laws or regulations of any jurisdiction or if, in the case of a Provisional Allotment Letter, it provides for an address for delivery of the share certificates in or, in the case of a credit of Rights Issue Shares in CREST, a CREST member or CREST sponsored member or, in the case of a credit of Rights Issue Shares in CCASS, a CCASS Participant or, in the case of a credit of Rights Issue Shares in CDP, a depositor or depository agent within the meaning of the Companies Act, Chapter 50 of Singapore, whose registered address is in, or who is resident or located in, any of the Excluded Territories (including any jurisdiction outside the United Kingdom, Hong Kong or Singapore in which it would be unlawful to deliver such share certificates or make such a credit or if Prudential or the Joint Global Co-ordinators believe or their respective agents believe that the same may violate applicable legal or regulatory requirements). The attention of persons with a registered address in, or who are resident or located in, the United States or who are nominees or custodians or trustees of persons who have such an address or who are so resident or located, is drawn to paragraph 7.2 below.

Entitlements to Rights Issue Shares which are not taken up by Qualifying Shareholders who have registered addresses in the US or any of the other Excluded Territories will be aggregated with entitlements to Rights Issue Shares which have not been taken up by other Qualifying Shareholders and, if possible, acquirers will be procured in respect of the relevant Rights Issue Shares as described in paragraph 5.1 above of this Part IX. The premiums (being the amount paid by the acquirers after deducting the Issue Price (in pounds sterling) and the expenses of procuring the acquirers including any applicable brokerage, commissions, currency conversion costs and amounts in respect of VAT which are not recoverable), if any, will be paid (without interest) to those persons entitled (as referred to above) pro rata to the relevant lapsed provisional allotments, save that amounts of less than £5.00 per holding will not be so paid but will be aggregated and will, ultimately, accrue for the benefit of Prudential. None of Prudential, the Underwriters or any other person shall be responsible or have any liability whatsoever for any loss or damage (actual or alleged) arising from the terms or the timing of the acquisition or the procuring of it or any failure to procure acquirers.

Despite any other provision of this document or the Provisional Allotment Letter, Prudential and the Joint Global Co-ordinators reserve the right to permit any Qualifying Shareholder to take up his rights if Prudential and the Joint Global Co-ordinators in their sole and absolute discretion are satisfied that the transaction in question is exempt from or not subject to the legislation or regulations giving rise to the restrictions in question. If Prudential and the Underwriters are so satisfied, Prudential will arrange for the relevant Qualifying Shareholder to be sent a Provisional Allotment Letter if he/she is a Qualifying Non-CREST Shareholder or a Qualifying Non-CCASS Shareholder or, if he/she is a Qualifying CREST Shareholder or a Qualifying CCASS Shareholder, arrange for Nil Paid Rights to be credited to the relevant CREST or CCASS stock account.

Those Qualifying Shareholders who wish, and are permitted, to take up their entitlement should note that payments must be made as described in paragraphs 2.1.2, 2.2.2 and 3.1.2 above of this Part IX.

Specific restrictions relating to certain jurisdictions are set out below.

## **7.2 United States**

### **7.2.1 Selling restrictions**

The Rights Issue Shares, the Nil Paid Rights, the Fully Paid Rights and the Provisional Allotment Letters have not been and will not be registered under the US Securities Act or under any relevant securities laws of any state or other jurisdiction of the United States. Accordingly, subject to certain exceptions, the Rights Issue Shares, the Nil Paid

Rights, the Fully Paid Rights and the Provisional Allotment Letters may not be offered, sold, taken up, resold, renounced, exercised, transferred or delivered, directly or indirectly, in or into the United States at any time except pursuant to the terms of an applicable exemption under the US Securities Act and applicable state and other securities laws of the United States.

Accordingly, subject to certain limited exceptions, neither this document nor the Provisional Allotment Letter constitutes an offer, or an invitation to apply for, or an offer or invitation to purchase, acquire or subscribe for, any Rights Issue Shares, Nil Paid Rights or Fully Paid Rights in the United States, and Provisional Allotment Letters and this prospectus will not be sent to, and Nil Paid Rights will not be credited to the CREST account of, any shareholder with a registered address in the United States.

Subject to certain limited exceptions, envelopes containing Provisional Allotment Letters should not be post-marked in the United States or otherwise despatched from the United States, and all persons acquiring Rights Issue Shares must provide an address for registration of the Rights Issue Shares issued upon exercise thereof outside the United States.

Subject to certain limited exceptions, any person who acquires Rights Issue Shares, Nil Paid Rights or Fully Paid Rights will be deemed to have declared, warranted and agreed, by accepting delivery of this prospectus or the Provisional Allotment Letter and delivery of the Rights Issue Shares, Nil Paid Rights or Fully Paid Rights, that it is not, and that at the time of acquiring the Rights Issue Shares, Nil Paid Rights or Fully Paid Rights it will not be, in the United States.

Prudential reserves the right to treat as invalid any Provisional Allotment Letter: (i) that appears to Prudential or its agents to have been executed in or despatched from the United States; or (ii) where Prudential believes acceptance of such Provisional Allotment Letter may infringe applicable legal or regulatory requirements; and Prudential shall not be bound to allot or issue any Rights Issue Shares, Nil Paid Rights or Fully Paid Rights in respect of any such Provisional Allotment Letter.

Notwithstanding the foregoing, Provisional Allotment Letters and this prospectus may be sent, the Nil Paid Rights may be offered and delivered and the Rights Issue Shares offered and sold in the United States to a limited number of persons reasonably believed to be “qualified institutional buyers” or “QIBs” by way of private placement in offerings exempt from registration under the US Securities Act. Any person reasonably believed to be a QIB to whom Rights Issue Shares are offered and sold, including Prudential ADR holders reasonably believed to be QIBs, will be required to execute and deliver an investor letter substantially in the form described in paragraph 7.2.2 of this Part IX below and may be required to make certain certifications in the Provisional Allotment Letter or the exercise form for the Nil Paid Rights and the Fully Paid Rights, as applicable.

In addition, Prudential ADR holders who wish, and who are permitted, to take up their entitlement relating to their ADR holdings, should note that their ability to take up such entitlement will depend on additional requirements and obligations, including, but not limited to, (i) the provision of information to the US Depositary pertaining to their Prudential ADR holding and details of any custodian through which they hold Prudential ADRs and (ii) the payment of additional fees.

Any person in the United States who obtains a copy of this document or a Provisional Allotment Letter and who is not a QIB is required to disregard them.

Until 40 days after the date on which the price is set for the placing of any remaining Rights Issue Shares by the Underwriters, an offer, sale or transfer of the Rights Issue Shares, Nil Paid Rights or Fully Paid Rights within the United States by a dealer (whether or not participating in the Rights Issue) may violate the registration requirements of the US Securities Act.

From the date of this prospectus through the 40th day after the date on which the price is set for the placing of any Rights Issue Shares by the Underwriters of any Rights Issue Shares not taken up in the Rights Issue (which is currently expected to be on or about 4 August 2010) the US Depositary, will not accept deposits of any Prudential Shares in the facility unless the shareholder certifies that the Prudential Shares were not acquired in this Rights Issue.

#### *7.2.2 Transfer restrictions in respect of the Rights Issue*

The offering and delivery of the Provisional Allotment Letters and Nil Paid Rights, and the offering and sale of the Rights Issue Shares in the United States to a limited number of persons reasonably believed to be QIBs, including ADR holders reasonably believed to be QIBs, is being made in reliance on an exemption from the registration requirements of the US Securities Act. The Nil Paid Rights, Fully Paid Rights, Rights Issue Shares and Provisional Allotment Letters have not been and will not be registered under the US Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and, accordingly, may not be offered, sold,

pledged, or otherwise transferred or delivered except pursuant to an exemption from registration under the US Securities Act or pursuant to an effective registration statement under the US Securities Act.

Each purchaser of Rights Issue Shares in the United States will be required to execute and deliver to Prudential and/or one or more of its designees an investor letter in the appropriate form, which will contain the following representations:

1. It is a QIB and, if it is acquiring the Rights Issue Shares as a fiduciary or agent for one or more investor accounts, (a) each such account is a QIB, (b) it has investment discretion with respect to each such account, and (c) it has full power and authority to make the representations, warranties, agreements and acknowledgements in this prospectus on behalf of each such account.
2. It will base its investment decision solely on this prospectus and not on any other information or representation concerning Prudential. It acknowledges that none of Prudential, any of its affiliates or any other person (including any of the Underwriters or any of their respective affiliates) has made any representations, express or implied, to it with respect to Prudential, the Rights Issue, the Nil Paid Rights, the Fully Paid Rights, the Rights Issue Shares or the accuracy, completeness or adequacy of any financial or other information concerning Prudential, the Rights Issue, the Nil Paid Rights, the Fully Paid Rights or the Rights Issue Shares, other than (in the case of Prudential only) the information contained in this prospectus. It acknowledges that it has not relied on any information contained in any research reports prepared by the Underwriters or any of their respective affiliates. It understands that this prospectus has been prepared in accordance with the Prospectus Rules and the HK Listing Rules, both of which differ from US disclosure requirements. In addition, the financial information in relation to Prudential contained in this prospectus has been prepared in accordance with IFRS and with European Embedded Value prepared in accordance with Principles issued by the CFO Forum of European Insurance Companies, and thus may not be comparable to financial statements of US companies prepared in accordance with US generally accepted accounting principles. It agrees that it will not distribute, forward, transfer or otherwise transmit this prospectus, any Provisional Allotment Letter or any other presentational or other materials concerning the Rights Issue (including electronic copies thereof) to any person (other than a QIB on behalf of which it acts), and it has not distributed, forwarded, transferred or otherwise transmitted any such materials to any person (other than a QIB on behalf of which it acts). It acknowledges that it has read and agreed to the matters set forth under paragraphs 7.2.1 and 7.2.2 of Part IX of this prospectus. It is aware, and each beneficial owner of such Rights Issue Shares has been advised, that the sale of Rights Issue Shares to them is being made in reliance on an exemption from, or transaction not subject to, the registration requirements of the US Securities Act.
3. It acknowledges that its purchase of any Rights Issue Shares is subject to and based upon all the terms, conditions, representations, warranties, acknowledgments, agreements and undertakings and other information contained in this prospectus. It agrees that it (a) will not look to any of the Underwriters for all or part of any loss it may suffer, (b) has no need for liquidity with respect to its investment in the Rights Issue Shares and (c) has no reason to anticipate any change in its circumstances, financial or otherwise, which may cause or require any sale or distribution by it of all or any part of the Rights Issue Shares.
4. It is an institution that (a) invests in or purchases securities similar to the Rights Issue Shares in the normal course of its business, (b) has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of its investment in the Rights Issue, and (c) is, and any accounts for which it is acting are, able to bear the economic risk, and able to sustain a complete loss, of such investment in the Rights Issue Shares.
5. It has made its own independent investigation and appraisal of the business, results, financial condition, prospects, creditworthiness, status and affairs of Prudential, and it has made its own investment decision to acquire the Rights Issue Shares. It understands that there may be certain consequences under US and other tax laws resulting from an investment in the Rights Issue Shares, including that it must bear the economic risk of an investment in the Rights Issue Shares for an indefinite period of time, and it will make such investigation and consult such tax, legal, currency and other advisors with respect thereto as it deems appropriate.
6. Any Rights Issue Shares that it acquires will be for its own account (or for the account of a QIB as to which it exercises sole investment discretion and has authority to make these statements) for investment purposes, and not with a view to resale or distribution within the meaning of the US securities laws.
7. It acknowledges and agrees that it is not taking up the Nil Paid Rights or the Rights Issue Shares as a result of any general solicitation or general advertising (as those terms are defined in Regulation D under the US Securities Act) or directed selling efforts (as that term is defined in Regulation S under the US Securities Act).

8. It acknowledges that the Rights Issue Shares will be “restricted securities” within the meaning of Rule 144(a)(3) under the US Securities Act and for so long as such securities are “restricted securities” (as so defined) the securities may not be deposited into any unrestricted depositary receipt facility in respect of Prudential Shares established or maintained by any depositary bank, including but not limited to Prudential’s existing ADR facility maintained by J.P. Morgan Depositary Services, as depositary for the Prudential ADRs.
9. It understands that the Nil Paid Rights and the Rights Issue Shares are being offered in a transaction not involving any public offering in the United States within the meaning of the US Securities Act and that the Nil Paid Rights, the Fully Paid Rights and the Rights Issue Shares have not been and will not be registered under the US Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold, pledged or otherwise transferred except (i) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S under the US Securities Act, (ii) with respect to the Rights Issue Shares only, pursuant to an exemption from registration provided by Rule 144 under the US Securities Act (if available), or (iii) pursuant to another exemption from, or in a transaction not subject to, the registration requirements of the US Securities Act, in each case in accordance with any applicable securities laws of any state or other jurisdiction of the United States. It understands that Rule 144A under the US Securities Act is not available for the resale of any Nil Paid Rights, Fully Paid Rights or Rights Issue Shares. In addition, it understands that no representation has been made as to the availability of Rule 144 of the US Securities Act or any other exemption under the US Securities Act or any state securities laws for the offer, resale, pledge or transfer of the Rights Issue Shares.
10. It understands that, although in the United States offers and sales of the Rights Issue Shares are being made to QIBs, such offers and sales are not being made under Rule 144A and that, if in the future it, any such other QIB whose account it is acting for, or any other fiduciary or agent representing such persons decides to offer, sell, deliver, hypothecate or otherwise transfer the Rights Issue Shares, it will do so only in compliance with the restrictions in paragraph 9 above.
11. It understands that any Rights Issue Shares delivered in certificated form will bear a legend substantially in the following form unless otherwise determined by Prudential in accordance with applicable law:

“THE SHARES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE “US SECURITIES ACT”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES, AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE US SECURITIES ACT, (2) PURSUANT TO AN EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE US SECURITIES ACT (IF AVAILABLE), OR (3) PURSUANT TO ANOTHER EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE US SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE US SECURITIES ACT FOR REALES OF THE SHARES REPRESENTED HEREBY. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE FOREGOING, THE SHARES REPRESENTED HEREBY ARE “RESTRICTED SECURITIES” WITHIN THE MEANING OF RULE 144(a)(3) UNDER THE SECURITIES ACT AND FOR SO LONG AS SUCH SECURITIES ARE “RESTRICTED SECURITIES” (AS SO DEFINED) THE SECURITIES MAY NOT BE DEPOSITED INTO ANY UNRESTRICTED DEPOSITARY RECEIPT FACILITY IN RESPECT OF SHARES ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK. EACH HOLDER, BY ITS ACCEPTANCE OF THIS SHARE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.”
12. It acknowledges and agrees that any offer, resale, pledge or other transfer made other than in compliance with the restrictions in paragraph 9 above will not be recognised by Prudential in respect of the Rights Issue Shares.
13. It confirms that, to the extent it is purchasing Rights Issue Shares for the account of one or more persons, (i) it has been duly authorised to make on their behalf the confirmations, acknowledgements and agreements set forth herein and (ii) these provisions constitute legal, valid and binding obligations of it and any other persons for whose account it is acting.

14. It acknowledges and agrees that Prudential, its affiliates, the Underwriters, their respective affiliates, the Receiving Agent and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. It agrees that if any of the representations, warranties, agreements and acknowledgements made herein are no longer accurate, it shall promptly notify Prudential and the Underwriters.
15. It represents and warrants that all necessary actions have been taken to authorise the purchase by it of the Rights Issue Shares.

The provisions of paragraph 5.1 above will apply to any rights not taken up by Qualifying Shareholders with a registered address in the United States, and the Joint Global Co-coordinators (as agents of Prudential) will use reasonable endeavours to procure, on behalf of such Qualifying Shareholders, acquirers for all (or as many as possible) of those Rights Issue Shares not taken up at a price per Rights Issue Share at least equal to the total of the Issue Price (in pounds sterling) and net of the expenses of procuring such acquirers (including any applicable brokerage, commissions, currency conversion costs and amounts in respect of VAT which are not recoverable) as can be obtained.

### *7.2.3 Transfer restrictions in respect of shares not taken up in the Rights Issue*

Each purchaser in the United States of Rights Issue Shares that were not taken up in the Rights Issue will be required to execute and deliver to the Underwriters an investor letter in the appropriate form, which will contain substantially the same representations as those contained in paragraph 7.2.2 above of this Part IX.

### **7.3 Other jurisdictions**

Provisional Allotment Letters have been and, where relevant, will be posted to Qualifying Non-CREST Shareholders and Qualifying Non-CCASS Shareholders (other than, subject to certain limited exceptions, those Qualifying Non-CREST Shareholders and Qualifying Non-CCASS Shareholders who have registered addresses in the United States, India, Japan, Malaysia, New Zealand and South Africa) and Nil Paid Rights have been and, where relevant, will be credited to the CREST stock accounts of Qualifying CREST Shareholders and the CCASS stock accounts of Qualifying CCASS Shareholders (other than, subject to certain limited exceptions, those Qualifying CREST Shareholders and Qualifying Non-CCASS Shareholders who have registered addresses in the United States, India, Japan, Malaysia, New Zealand and South Africa). No offer of or invitation to take up Rights Issue Shares is being made by virtue of this document or the Provisional Allotment Letters into the United States, India, Japan, Malaysia, New Zealand or South Africa. Qualifying Shareholders in jurisdictions other than those specified above may, subject to the laws of their relevant jurisdiction, accept their rights under the Rights Issue in accordance with the instructions set out in this document and, in the case of Qualifying Non-CREST Shareholders and Qualifying Non-CCASS Shareholders only, the Provisional Allotment Letter.

Qualifying Shareholders who have registered addresses in or who are resident in, or who are citizens of countries other than the United Kingdom, Hong Kong or Singapore should consult their appropriate professional advisers whether they require any governmental or other consents or need to observe any other formalities to enable them to take up their Nil Paid Rights or to acquire Fully Paid Rights (UK shareholders only) or Rights Issue Shares.

### **7.4 Representations and warranties relating to Overseas Shareholders**

#### *7.4.1 Qualifying Non-CREST Shareholders and Qualifying Non-CCASS Shareholders*

Any person accepting and/or renouncing a Provisional Allotment Letter or requesting registration of the Rights Issue Shares comprised therein represents and warrants to Prudential and the Underwriters that, except where proof has been provided to Prudential's satisfaction that such person's use of the Provisional Allotment Letter will not result in the contravention of any applicable legal requirement in any jurisdiction: (i) such person is not accepting and/or renouncing (on behalf of himself or any other person) the Provisional Allotment Letter, or requesting registration of the relevant Rights Issue Shares, from within the United States, (ii) such person is not a shareholder in any Excluded Territory, (iii) such person is not in any territory in which it is unlawful to make or accept an offer to acquire Rights Issue Shares or to use the Provisional Allotment Letter in any manner in which such person has used or will use it, (iv) such person is not acting for the account of any person who is located in the United States, unless (a) the instruction to accept or renounce was received from a person outside the United States and (b) the person giving such instruction has confirmed that (x) it has the authority to give such instruction, and (y) either (A) it has investment discretion over such account or (B) it is an investment manager or investment company that is acquiring the Rights Issue Shares in an "offshore transaction" within the meaning of Regulation S under the US Securities Act, (v) such person is not acting on a non-discretionary basis for a person within any territory referred to in (ii) or

(iii) above other than the United States at the time the instruction to accept or renounce was given, and (vi) such person is not acquiring Rights Issue Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Rights Issue Shares into, or for the benefit of any person in, the United States or any other territory referred to in (ii) or (iii) above. Prudential may treat as invalid any acceptance or purported acceptance of the allotment of Rights Issue Shares comprised in, or renunciation or purported renunciation of, a Provisional Allotment Letter if it: (a) appears to Prudential to have been executed in or despatched from the United States or any of the other Excluded Territories or otherwise in a manner which may involve a breach of the laws of any jurisdiction or if it or its agents believe the same may violate any applicable legal or regulatory requirement, (b) provides an address in the United States or any Excluded Territory (including any jurisdiction outside the United Kingdom, Hong Kong or Singapore in which it would be unlawful to deliver such definitive share certificates), or (c) purports to exclude the representation and warranty required by this paragraph 7.4.1 of this Part IX.

#### *7.4.2 Qualifying CREST Shareholders and Qualifying CCASS Shareholders*

A CREST member or CREST sponsored member who makes a valid acceptance in accordance with the procedures set out in this Part IX and a CCASS participant who makes a valid acceptance through HKSCC Nominees represents and warrants to Prudential and the Underwriters that, except where proof has been provided to Prudential's satisfaction that such person's acceptance will not result in the contravention of any applicable legal requirement in any jurisdiction: (i) such person is not within the United States, (ii) such person is not in any of the other Excluded Territories, or any territory in which it is otherwise unlawful to make or accept an offer to acquire Fully Paid Rights or Rights Issue Shares, (iii) such person is not accepting for the account of any person who is located in the United States, unless (a) the instruction to accept was received from a person outside the United States and (b) the person giving such instruction has confirmed that (x) it has the authority to give such instruction, and (y) either (A) it has investment discretion over such account or (B) it is an investment manager or investment company that is acquiring the Rights Issue Shares in an "offshore transaction" within the meaning of Regulation S under the US Securities Act, (iv) such person is not accepting on a non-discretionary basis for a person within any other territory referred to in (ii) above other than the United States at the time the instruction to accept was given, and (v) such person is not acquiring Fully Paid Rights or Rights Issue Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Fully Paid Rights or Rights Issue Shares into, or for the benefit of any person in, the United States or any other territory referred to in (ii) above. Prudential may treat as invalid any MTM instruction which appears to Prudential to have been despatched from the United States or the Excluded Territories or otherwise in a manner which may involve a breach of the laws of any jurisdiction or if it or its agents believe the same may violate any applicable legal or regulatory requirement or purports to exclude the warranty required by this paragraph 7.4.2 of this Part IX.

#### *7.4.3 Waiver*

The provisions of this section 7 of this Part IX and of any other terms of the Rights Issue relating to Overseas Shareholders may be waived, varied or modified as required for specific Qualifying Shareholder(s) or on a general basis by Prudential and the Joint Global Co-ordinators in their absolute discretion. Subject to this, the provisions of this section 7 of this Part IX supersede any terms of the Rights Issue inconsistent herewith. References in this section 7 of this Part IX to Qualifying Shareholders shall include references to the person or persons executing a Provisional Allotment Letter and in the event of more than one person executing a Provisional Allotment Letter, the provisions of this section 7 of this Part IX shall apply to them jointly and to each of them.

### **8. Times and dates**

Prudential shall, in its discretion and after consultation with its financial and legal advisers and with the agreement of the Joint Global Co-ordinators be entitled to amend the date that dealings in Nil Paid Rights commence and amend or extend the latest date for acceptance under the Rights Issue and all related dates set out in this document and in such circumstances shall notify the UKLA, the Hong Kong Stock Exchange, the SGX-ST via SGXNET (and will comply with all applicable rules and regulations in Hong Kong) and a Regulatory Information Service and, if appropriate, holders of Prudential Shares, but Qualifying Shareholders may not receive any further written communication. If a supplementary prospectus is issued by Prudential two (or fewer) days prior to the date specified in this document as the latest date for acceptance under the Rights Issue (or such later date as may be agreed between Prudential and the Joint Global Co-ordinators), the latest date of acceptance under the Rights Issue shall be extended to the date which is three business days after the date of issue of the supplementary prospectus (or such later date as may be agreed between Prudential and the Joint Global Co-ordinators) and the dates and times of principal events due to take place following such date shall be extended accordingly).

## **9. Change to Issue Price**

The Joint Global Co-ordinators can adjust the Issue Price (but not terminate the Underwriting Agreement) if any of the following occur before UK Admission:

- (i) Prudential issues a supplementary prospectus; or
- (ii) there is (a) a suspension in trading in Prudential securities on the London Stock Exchange or on the Hong Kong Stock Exchange or in trading generally on the New York Stock Exchange, the Hong Kong Stock Exchange or the London Stock Exchange or (b) the fixing of minimum or maximum pricing of securities by any of those exchanges or (c) a material disruption in commercial banking or securities settlement services in the US, Hong Kong or the UK; or
- (iii) a banking moratorium in the US, Hong Kong or the UK is declared.

Such an adjustment to the Issue Price will not change the total proceeds of the Rights Issue. The Issue Price cannot be reduced below 5 pence. If the Joint Global Co-ordinators exercise this option, Prudential will issue a supplementary prospectus detailing the effect of the change on the Rights Issue.

## **10. Rights Issue structure**

The Rights Issue has been structured in a way that is expected to have the effect of creating distributable reserves equal to the net proceeds of the Rights Issue less the par value of the Rights Issue Shares issued by Prudential. The intention of this structure is to facilitate the return of the proceeds to shareholders in the unlikely event that the Acquisition does not complete. Should the Acquisition complete, these distributable reserves would not exist. Prudential and Credit Suisse have agreed to acquire ordinary shares in a newly incorporated Jersey company, Prudential Rights (Jersey) Limited. Credit Suisse, as principal, will apply the proceeds of the Rights Issue to acquire redeemable preference shares in Prudential Rights (Jersey) Limited. Prudential will issue the Rights Issue Shares to those persons entitled thereto in consideration for Credit Suisse transferring its holdings of redeemable preference shares in Prudential Rights (Jersey) Limited, and transferring its holding of ordinary shares in Prudential Rights (Jersey) Limited to Prudential.

Accordingly, instead of receiving cash as consideration for the issue of the Rights Issue Shares, at the conclusion of the Rights Issue Prudential will own the entire issued share capital of Prudential Rights (Jersey) Limited, whose only asset will be its cash reserves, which will represent an amount equivalent to the proceeds of the Rights Issue. Prudential will be able to use this amount (including for the payment of the costs and expenses of the Rights Issue) on redemption of the redeemable preference shares it holds in Prudential Rights (Jersey) Limited and, if required, during an interim period prior to redemption, by procuring that Prudential Rights (Jersey) Limited lend the amount to Prudential (or one of Prudential's subsidiaries).

Accordingly, by taking up Rights Issue Shares under the Rights Issue and submitting a valid payment in respect thereof, a Qualifying Shareholder instructs the Receiving Agent and the HK Registrar (i) to the extent of a successful application under the Rights Issue, to apply such payment on behalf of Credit Suisse solely to subscribe for redeemable preference shares in Prudential Rights (Jersey) Limited and (ii) to the extent of an unsuccessful application under the Rights Issue, to return the relevant payment without interest to the applicant. Further details of this structure are set out in paragraph 16.4 of Part XIX (*Additional Information*) of this document.

## **11. Irish Register**

Holders of Prudential Shares registered on the Irish Register will, save as set out below, be treated as Qualifying Non-CREST Shareholders for the purposes of the Rights Issue. Subject to the passing of the Rights Issue Resolution (without material amendment) at the General Meeting, holders of Prudential Shares on the Irish Register will be sent a Provisional Allotment Letter on Monday 7 June 2010. Any such holders of Prudential Shares who take up rights to acquire Rights Issue Shares whether pursuant to the Provisional Allotment Letter sent to them or otherwise will have such Rights Issue Shares issued to them on the Irish Register (not the UK Register), and Capita Registrars (Ireland) Limited will post share certificates to such holders by Thursday 1 July 2010. Payments by holders of Prudential Shares on the Irish Register to take up rights under any Provisional Allotment Letter must be made in pounds sterling.

## **12. Transactions in Prudential securities**

Since the announcement of the Acquisition, certain affiliates of Prudential and other entities have engaged and intend to continue to engage in various dealing activities involving Prudential Shares and Prudential ADRs. Among other things, trustees for Prudential Group employee share plans have purchased and intend to continue to purchase

Prudential Shares and Prudential ADRs on behalf of participants in such plans. These activities have occurred and are expected to continue to occur through the closing of the Rights Issue predominantly outside the United States, although purchases of Prudential Shares and Prudential ADRs on behalf of US based participants in such plans have occurred and may continue to occur within the United States in the ordinary course of business. Separately, certain affiliates of Prudential have purchased and sold, and intend to continue to purchase and sell, Prudential Shares and Prudential ADRs as part of their ordinary asset management activities. These activities have generally occurred, and are expected through the closing of the Rights Issue solely to occur, outside the United States. These affiliates of Prudential and other entities are not obliged to purchase Prudential Shares and Prudential ADRs and any such purchases may be discontinued at any time. These activities could have the effect of preventing or retarding a decline in the market price of Prudential Shares or Prudential ADRs.

Subject to certain restrictions in the Underwriting Agreement, the Underwriters and any of their respective affiliates may, in accordance with applicable legal and regulatory provisions, engage in transactions (including short sales) in relation to the Nil Paid Rights, the Fully Paid Rights, the Rights Issue Shares, Prudential Shares and/or related instruments for their own account for the purpose of hedging their underwriting exposure or otherwise. Except as required by applicable law or regulation, the Underwriters do not propose to make any public disclosure in relation to such transactions.

### **13. Governing law and jurisdiction**

The terms and conditions of the Rights Issue as set out in this document and the Provisional Allotment Letter or Singapore Application Form and any non-contractual obligations related thereto shall be governed by, and construed in accordance with, English law. The Rights Issue Shares will be allotted and issued pursuant to the Companies Act. The courts of England and Wales are to have exclusive jurisdiction to settle any dispute which may arise out of or in connection with the Rights Issue, this document, the Provisional Allotment Letter or the Singapore Application Form. By accepting rights under the Rights Issue in accordance with the instructions set out in this document and, in the case of Qualifying Non-CREST Shareholders and Qualifying Non-CCASS Shareholders only, the Provisional Allotment Letter, and, in the case of Qualifying CDP Shareholders only, the Singapore Application Form, Qualifying Shareholders irrevocably submit to the jurisdiction of the courts of England and Wales and waive any objection to proceedings in any such court on the ground of venue or on the ground that proceedings have been brought in an inconvenient forum.

## PART X

### SUPERVISION AND REGULATION

The Prudential Group's and the AIA Group's principal insurance and investment operations are in Asia, Australasia, the United Kingdom and the United States. Accordingly, they are, and the Enlarged Group will be, subject to applicable Asian, Australasian, United Kingdom and United States insurance and other financial services regulation which is discussed below.

#### A. ASIAN AND AUSTRALASIAN SUPERVISION AND REGULATION

##### 1. Regulation of insurance business

The Prudential Group's and the AIA Group's businesses in Asia and Australasia are subject to all relevant local regulatory and supervisory schemes. These laws and regulations vary from country to country, but the regulators typically grant (or revoke) licences and therefore control the ability to operate a business.

The industry regulations are usually widely drawn and will include provisions governing both financial matters and the way business is conducted in general. Examples include the registration of agents, the approval of products, asset allocation, minimum capital and the basis for calculating the company's solvency and reserves and the valuation of policyholder liabilities. Regulatory authorities may also regulate affiliations with other financial institutions, shareholder structures and the injection of capital and payment of dividends. Financial statements and other returns are filed with the regulators. The regulators may also conduct physical inspections of the operations from time to time.

A number of jurisdictions across Asia and Australasia require insurance companies to participate in policyholder protection schemes (i.e. contribute to a fund to support policyholders in the event of an insurance company failing).

In addition to the local regulatory regimes in each of the geographical markets in which the Enlarged Group operates, the Hong Kong Office of the Commissioner of Insurance (the "OCI") exercises extra-territorial regulatory oversight over branches of AIA Co (located in Singapore, Brunei, Thailand and China) and AIA-B (located in Macau, Korea, Taiwan and New Zealand) in respect of certain risk management aspects. As a result, the regulatory framework in Hong Kong is relevant not only to AIA Co's and AIA-B's Hong Kong operations but also applies to a substantial number of the AIA Group's local operating units that are branches of AIA Co or AIA-B. Please see "Hong Kong (The Prudential Assurance Company Limited, AIA Co and AIA-B)" in this section for further details of regulation at the AIA Group level.

The Bermuda Monetary Authority (the "BMA") regulates AIA-B's business in Bermuda, as well as that of its branches in Asia (in addition to any relevant local law and regulation). Please see "Bermuda — AIA-B" in this section for further details of regulation in Bermuda.

Subsidiaries of AIA Co and AIA-B, including those in Australia, Vietnam, Indonesia, Malaysia and the Philippines, are not subject to supervision and regulation by the OCI or the BMA (but are subject to applicable local regulatory requirements).

For Prudential Corporation Asia's and the AIA Group's insurance operations the details of the regulatory regimes are as follows:

#### **Hong Kong — The Prudential Assurance Company Limited, AIA Co and AIA-B's Hong Kong branch ("AIA-B HK")**

##### ***Overview***

The Hong Kong branch of PAC is authorised to carry on both long-term business and general business in Hong Kong under a composite licence. The AIA Group is authorised to carry on insurance business in Hong Kong through AIA Co and AIA-B HK. AIA Co is authorised to carry on both long-term business and general business under a composite licence. AIA-B HK is licensed in respect of all classes of long-term business and in respect of health and protection classes of general business.

The OCI is the regulatory body set up for the administration of the Insurance Companies Ordinance (the "ICO"). The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority ("IA") for administering the ICO. The principal functions of the IA are to ensure that the interests of policyholders or potential policyholders are protected and to promote the general stability of the insurance industry. The IA has the following major duties and powers: (i) authorisation of insurers to carry on insurance business in Hong Kong;

(ii) regulation of insurers' financial condition primarily through the examination of the annual audited financial statements and business returns submitted by the insurers; and (iii) development of legislation and guidelines on insurance supervision.

The Hong Kong operations of the Enlarged Group will also be subject to the codes and guidance stipulated by a self-regulatory body — the Hong Kong Federation of Insurers (the “HKFI”). HKFI actively promotes its self-regulatory regime with respect to areas like conduct of insurers and insurance intermediaries, cooling off initiatives, policy replacement and initiative on needs analysis, etc. The Insurance Agents Registration Board of the HKFI is responsible for administering the registration and approval of insurance intermediaries of insurance agents, their responsible officers and technical representatives; and handling complaints against them and providing enquiry services to and handling complaints from the public relating to insurance agents. Please see “The Code of Conduct for Insurers”, “The Insurance Claims Complaints Bureau” and “Regulation of Insurance Intermediaries” in this section.

Currently, the Hong Kong government is researching into the possibility of making the IA an independent governing body as this would give the OCI more flexibility in its operations and prepare Hong Kong for the risk-based capital regulatory regime. On the other hand, OCI is also exploring with the HKFI the possibility of setting up a policyholder protection fund in the event of an insurer's insolvency.

#### **Authorisation under the ICO**

Companies carrying on insurance business in or from Hong Kong must obtain authorisation from the OCI. Authorisation will be granted only to insurers meeting certain requirements set out in section 8 of the ICO, which focuses on, among other things, the following items:

- paid-up capital;
- solvency margin;
- fitness and properness of directors and controllers; and
- adequacy of reinsurance arrangements.

In addition, an insurer must meet certain other criteria contained in the authorisation guidelines issued by the OCI which are intended to ensure that the insurer is financially sound and competent to provide an adequate level of services to the insured public. These conditions continue to apply to an insurer after its authorisation.

#### **Types of insurance business under the ICO**

The ICO requirements vary depending on the type of insurance business being undertaken by an insurer. The ICO defines two main types of business as follows:

- long-term business covers those types of insurance business in which policies are typically in place for long periods and includes life and annuity, linked long-term, permanent health and retirement scheme management policies; and
- general business covers all business other than long-term business, including accident and sickness, fire, property, motor vehicle, general liability, financial loss and legal expenses insurance.

Both types of business defined in the ICO include reinsurance as well as direct insurance business. With the exception of certain requirements in the case of pure reinsurers, the authorisation criteria are the same for both direct insurers and reinsurers.

An insurer that undertakes both long-term and general business is referred to by the OCI as a composite business insurer.

In addition to these main types of business, the ICO imposes further requirements on insurers conducting insurance business relating to liabilities or risks in respect of which persons are required by law to be insured (“Statutory Business”), including employees' compensation insurance and third party insurance in respect of motor vehicles.

#### **Minimum paid-up capital requirement**

Section 8(3)(b) of the ICO sets the following minimum paid up capital requirements for insurers depending on the type of business they intend to undertake:

- general business without Statutory Business: HK\$10 million;
- general business including Statutory Business: HK\$20 million;

- long-term business: HK\$10 million; and
- composite business: with or without statutory businesses HK\$20 million.

### **Solvency margin**

Pursuant to sections 8(3)(a) and 35AA of the ICO, an insurer is required to maintain at all times an excess of assets over liabilities of not less than a required solvency margin. The objective is to provide a reasonable safeguard against the risk that the insurer's assets may be inadequate to meet its liabilities arising from unpredictable events, such as adverse fluctuations in its operating results or the value of its assets and liabilities.

For general business insurers, the ICO stipulates an absolute minimum solvency margin of HK\$10 million, or HK\$20 million in the case of insurers carrying on Statutory Business. Above these minimum levels, solvency margins are calculated on the basis of the greater of an insurer's relevant premium income (defined as the greater of gross premium income after deduction of reinsurance premium payments or 50% of gross premium income) or relevant outstanding claims (defined as the sum of unexpired risks plus the greater of 50% of claims outstanding before deduction of sums recoverable from reinsurers or the amount of claims outstanding after deduction of sums recoverable from reinsurers) as follows:

- 20% of premium income/outstanding claims up to HK\$200 million; and
- 10% of premium income/outstanding claims in excess of HK\$200 million.

To determine whether a general business insurer meets the solvency margin requirement, its assets are valued in accordance with the Insurance Companies (General Business) (Valuation) Regulation (Chapter 41 G of the Laws of Hong Kong) (the "Valuation Regulation"). The Valuation Regulation prescribes the valuation methods for different types of assets commonly found on an insurer's balance sheet. To ensure a prudent diversification of investments, the Valuation Regulation also stipulates admissibility limits for different categories of assets. The admissibility limits, however, do not apply to assets maintained in Hong Kong pursuant to section 25A of the ICO as described below.

For long-term business insurers, the ICO stipulates an absolute minimum solvency margin of HK\$2 million. Above this minimum level, solvency margins are determined in accordance with the Insurance Companies (Margin of Solvency) Regulation (Chapter 41 F of the Laws of Hong Kong), which sets out a series of calculations to be used depending on the particular class of long-term business involved.

To determine whether a long-term business insurer meets the solvency margin requirements, its assets and liabilities are valued in accordance with the Insurance Companies (Determination of Long-Term Liabilities) Regulation (Chapter 41 E of the Laws of Hong Kong), which sets out the bases for the determination of the amount of long-term business liabilities. An insurer is required to adopt prudent provisions and assumptions, particularly on interest rates, when valuing the amount of long-term business liabilities. Among others, valuation methods are specified for calculating the yields on assets and the amount of future premiums payable under an insurance contract.

For composite insurers, the ICO stipulates a minimum solvency margin based on the aggregate of the solvency margin required in respect of an insurer's general business and its long-term business, both calculated as described above.

### **Fit and proper directors and controllers**

Section 8(2) of the ICO requires that all directors and controllers of an insurer must be "fit and proper" persons to hold such positions. Section 9 of the ICO defines an insurer's controllers as including, among others, a managing director of the insurer or its corporate parent, a chief executive officer of the insurer or its corporate parent (only if the parent is also an insurer), a person in accordance with whose directions or instructions the directors of the insurer or its corporate parent are accustomed to act or who, alone or with any associate or through a nominee, is entitled to exercise, or control the exercise of, 15% or more of the voting power at any general meeting of the insurer or its corporate parent. Sections 13A, 13B and 14 of the ICO also require notification to the OCI of any change in the directors or controllers of an authorised insurer and the prior approval of the OCI for the appointment of certain controllers, including the chief executive of an insurer.

Although the term "fit and proper" is not defined further in the ICO, the OCI has issued a guidance note which sets out those factors that the OCI will take into account in applying the "fit and proper" test to the directors or controllers of an insurer. These factors include a director's or controller's financial status, character, reputation, integrity, reliability, qualifications and experience regarding the functions to be performed by such director or controller and ability to perform such functions efficiently, honestly and fairly.

### *Adequate reinsurance arrangements*

Section 8(3)(c) of the ICO requires all insurers to have adequate reinsurance arrangements in-force in respect of the risks of those classes of insurance business they carry out, or to justify why such arrangements are not necessary. In considering the adequacy of reinsurance arrangements of an insurer, the OCI will take into account the following factors:

- the type of reinsurance treaties entered into by the insurer;
- the maximum retention of risks by the insurer;
- the security of the reinsurers; and
- the spread of risks among participating reinsurers.

With regard to the spread of risks among reinsurers, the OCI considers that additional risks arise where a reinsurer is a related company of the insurer. To address this concern, the OCI has issued a guidance note on reinsurance with related companies, which sets out the criteria to be used in determining the adequacy of such arrangements. The OCI will consider a related reinsurer to provide adequate security if any of the following requirements are met:

- the reinsurer is itself authorised under the ICO;
- the reinsurer or any one of its direct or indirect holding companies has received an adequate rating from a credit rating agency (currently the OCI specifies an Insurer Financial Strength Rating of AA- or above by S&P, Aa3 or above by Moody's or A+ or above by A.M. Best, or equivalent rating); or
- the reinsurer or any one of its direct or indirect holding companies is otherwise considered by the OCI as having a status comparable to the above.

In the event that none of these requirements is met by a related reinsurer, the OCI will restrict the amount of net reinsurance it deems recoverable from that reinsurer when assessing the cedent's financial position, unless it determines that acceptable collateral security, such as an irrevocable and permanently renewable letter of credit, is in place in respect of the arrangement with that reinsurer.

### *Maintenance of assets*

Section 25A of the ICO requires insurers carrying on general business to maintain assets in Hong Kong in respect of the liabilities arising from their Hong Kong business. The minimum amount of assets to be maintained is calculated on the basis of an insurer's net liabilities and the proportion of its solvency margin requirement attributable to its general business in Hong Kong, taking into account the level of reinsurance that has been entered into by the insurer in respect of its liabilities.

Sections 22 to 23 of the ICO require insurers carrying on long-term business to keep separate accounts for different classes of long-term business and to maintain certain levels of assets calculated on the basis of their solvency margins in respect of each class of business in funds that are applicable only to that particular business.

The OCI has also issued a guidance note on reserve provisioning for Class G of long-term business (defined in the ICO as long-term business involving retirement scheme contracts which provide for a guaranteed capital or return) to reinforce and enhance the required standard of provision for Class G business. Policies classified under Class G of long-term business are mainly offered as retirement scheme contracts under retirement schemes regulated pursuant to the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong) (the "MPFSO") and the Occupational Retirement Schemes Ordinance (Chapter 426 of the Laws of Hong Kong) (the "ORSO"). An insurer authorised to carry on long-term business is required, among other things, to maintain a separate long-term business fund for its Class G business carried on in or from Hong Kong. In respect of the Class G business fund, the OCI requires that the value of the assets contained in the fund are in the aggregate not less than the amount of the liabilities attributable to such business.

### *Accounting and reporting requirements*

The ICO requires insurers to maintain proper books of accounts which must exhibit and explain all transactions entered into by them in the course of their business. Insurers must submit information including audited financial statements, a directors' report and statistics relating to the valuation of their insurance business and outstanding claims to the OCI on an annual basis.

Insurers carrying on long-term business are also required to appoint an actuary to conduct an annual actuarial investigation and submit a report to the OCI on their financial condition in respect of the long-term business. The

appointed actuary is responsible for advising on all actuarial aspects of the financial management of an insurer's long-term business including proper premium setting, a prudent reserving policy, a suitable investment allocation, appropriate reinsurance arrangements and due reporting of irregularities to the OCI.

### **Corporate governance of authorised insurers**

The OCI has issued a guidance note on the corporate governance of authorised insurers, which aims to enhance the integrity and general well-being of the insurance industry by providing assistance to authorised insurers for the evaluation and formulation of their internal practices and procedures. This guidance note sets out the minimum standard of corporate governance expected of authorised insurers and applies to both authorised insurers incorporated in Hong Kong and authorised insurers incorporated outside Hong Kong where 75% or more of their annual gross premium income pertains to their Hong Kong insurance business, unless written consent for exemption has been obtained from the OCI. This guidance note covers the following key items:

- structure of senior management;
- roles and responsibilities of the board of directors;
- board matters;
- board committees;
- internal controls;
- compliance with laws and regulations; and
- servicing of clients.

Irrespective of the proportion of an overseas insurer's Hong Kong insurance business, the OCI expects such an insurer to observe strictly any applicable guidelines on corporate governance promulgated by its home regulatory authority.

### **Asset management**

In order to ensure that an insurer will meet its contractual liabilities to policyholders, its assets must be managed in a sound and prudent manner, taking into account the profile of liabilities and risks of the insurer. The OCI has issued a guidance note on asset management by authorised insurers, which is adopted from the paper "Supervisory Standard on Asset Management By Insurance Companies" as approved by the International Association of Insurance Supervisors in 1999. This guidance note applies to both an insurer incorporated in Hong Kong and the Hong Kong branch of an insurer incorporated outside Hong Kong whose investment in financial assets exceeds HK\$100 million. This guidance note provides a checklist for assessing how insurers should control the risks associated with their investment activities and includes guidance and commentary on the following key items:

- investment process, policy and procedures;
- overall asset management strategies;
- investment mandate given by the board of directors to senior management;
- audit in respect of the insurer's asset management functions;
- risk management functions; and
- internal controls.

In order to assess how insurers control the risks associated with their investment activities, the OCI may periodically request information from insurers, including accessing information through on-site inspections and discussion with insurers.

### **Power of intervention**

The IA is empowered under Part V of the ICO to intervene in an insurer's business and take appropriate actions in the following circumstances:

- where the IA considers that the exercise of this power is desirable for protecting the interests of existing and potential policyholders against the risk that the insurer may be unable to meet its liabilities or to fulfil the reasonable expectations of existing or potential policyholders;

- where it appears to the IA that the insurer or its corporate parent has failed to satisfy any of its obligations under the ICO;
- where it appears to the IA that the insurer has provided misleading or inaccurate information to it for the purposes of the ICO;
- where the IA is not satisfied as to the adequacy of the insurer's reinsurance arrangements;
- where the IA is not satisfied with the financial condition of the insurer or its compliance position with the prescribed regulatory benchmark or requirements in respect of, amongst others, its assets and liabilities matching position, reserving level or financial projections; or
- where the insurer fails to comply with the on-going authorisation conditions and requirements imposed by the IA and any financial undertakings provided thereof by its corporate controller and "fitness and properness" of its directors and controllers.

The IA may also intervene in an insurer's business, whether or not any of the above circumstances exist, at any time during the 5 year period following authorisation of the insurer or a person becoming a controller of an insurer.

The actions that the IA may take in intervening in an insurer's business include:

- restrictions on the insurer effecting new business;
- limits on the amount of premium income an insurer may receive during a specified period in respect of certain classes of business;
- restrictions on types of investments an insurer may make, or requirements that the insurer realise certain types of investments within a specified period;
- requirements that an insurer maintain assets in Hong Kong equal to the whole or a specified portion of the liabilities arising from its Hong Kong business, and that these assets be held in the custody of a trustee approved by the IA;
- the appointment of a manager to assume control of an insurer; and
- requirements that the insurer has to conduct a special actuarial investigation on its long term business, to produce information and documents and to accelerate submission of returns by the insurer.

### Section 35 Orders

Following the AIG Events, letters dated 17 September 2008 were issued from the IA to each of AIA Co and AIA-B HK ("Section 35 Orders") requiring each of AIA Co or AIA-B, including all of their branches, as appropriate:

- 1) to ensure that all insurance business and all transactions with any "specified person" are on normal commercial terms;
- 2) to ensure that AIA Co or AIA-B does not place any deposit with or transfer assets (except for normal insurance transactions) or provide financial assistance to any "specified person" without first obtaining written consent from the IA; and
- 3) to inform the IA as soon as practicable of any circumstances which may put the interest of policyholders or potential policyholders at risk.

For the purpose of the Section 35 Orders, "specified person" includes but is not limited to an insurer's branches, directors, controllers, shareholders and associates or group companies.

Among other consequences, the Section 35 Orders place restrictions on the ability of AIA Co and AIA-B to engage in capital related transactions with specified persons. Accordingly, the Section 35 Orders restrict the ability of AIA Co and AIA-B to pay dividends to their parent companies, and limit their ability to engage in intercompany transactions with specified persons, such as payment of intercompany service fees, without first obtaining written consent from the IA.

By further letters dated 18 September 2008 to AIA Co and AIA-B, the IA required that AIA Co and AIA-B not acquire a new controller without first obtaining written consent from the IA.

In connection with the Section 35 Orders, Prudential has given to the IA an undertaking that it will:

- (i) ensure that (a) AIA Co and AIA-B will at all times maintain a solvency ratio of not less than 150%, both on an individual insurer basis and on an AIA Co/AIA-B consolidated basis; (b) it will not withdraw any capital or

transfer any funds or assets out of either company that will cause AIA Co or AIA-B's solvency ratio to fall below 150%, except with, in the case of either (a) or (b), the prior written consent of the IA; (c) should the solvency ratio of AIA Co and/or AIA-B fall below 150% it will take steps as soon as possible to restore it to at least 150% in a manner acceptable to the IA; and (d) any proposed transfer of capital, funds or assets out of AIA Co or AIA-B will require certification by both the Appointed Actuary of the relevant company and an independent actuary or independent auditor acceptable to the IA;

- (ii) comply with the matters set out in the undertaking relating to legal, regulatory and supervisory compliance; group structure, corporate governance, the senior management team; and the plan for the integration of the Enlarged Group's businesses in Asia; and
- (iii) use its best endeavours to comply with all enhancements or improvements to those matters referred to in (ii) above that may be prescribed from time to time by the IA.

In consideration of Prudential providing the aforesaid undertaking, the IA has agreed to vary the Section 35 Orders, with effect from completion of the acquisition of AIA by New Prudential by deleting the words "or transfer assets (except for normal insurance transactions)" from sub-paragraph (2) above.

### **The Code of Conduct for Insurers**

As part of the self-regulatory initiatives taken by the industry, the HKFI has published The Code of Conduct for Insurers. This code seeks to: describe the expected standard of good insurance practice in the establishment of insurance contracts and claims settling; promote the disclosure of relevant and useful information to customers; facilitate the education of customers about their rights and obligations under insurance contracts; foster a high professional standard in the transaction of insurance business; and encourage insurers to promote and enhance the industry's public image and standing. This code applies to all general insurance members and life insurance members of the HKFI and applies to insurance effected in Hong Kong by individual policyholders resident in Hong Kong and insured in their private capacity only. As a condition of membership of the HKFI, all general insurance members and life insurance members undertake to abide by this code and use their best endeavours to ensure that their staff and insurance agents observe its provisions.

### **The Insurance Claims Complaints Bureau**

The Insurance Claims Complaints Bureau was established to implement self-regulation in the interpretation and handling of insurance claims complaints arising from all types of personal insurance policies taken out by residents of Hong Kong. The Insurance Claims Complaints Panel was established by the Insurance Claims Complaints Bureau with the objective of providing independent and impartial adjudication of complaints between insurers and their policyholders. The Insurance Claims Complaints Panel is in charge of handling claims complaints from both policyholders themselves and their beneficiaries and rightful claimants. The Insurance Claims Complaints Panel, in making its rulings, is required to act in conformity with the terms of the relevant policy, general principles of good insurance practice, any applicable rule of law or judicial authority, and any codes and guidelines issued from time to time by the HKFI.

### **Regulation of insurance intermediaries**

Insurance intermediaries are defined under the ICO as either insurance agents or insurance brokers. The key difference between the two types of insurance intermediaries is that insurance agents act as agents or subagents of insurers, while insurance brokers act as agents of policyholders and potential policyholders. Both are subject to a self-regulatory system supported by provisions contained in Part X of the ICO.

Under the ICO, a person is prohibited from holding itself out as an insurance agent or insurance broker unless such person is properly appointed or authorised. A person is also prohibited from holding itself out as an appointed insurance agent and an authorised insurance broker at the same time. It is also an offence under the ICO for an insurer to effect a contract of insurance through, or accept insurance business referred to it by, an insurance intermediary who has not been properly appointed or authorised.

To act as an insurance agent, a person is required to be appointed by an insurer and registered with the Insurance Agents Registration Board established by the HKFI. Under Section 66 of the ICO, an insurer is required to keep a register of appointed insurance agents and to make such register available for public inspection at its registered office (or principal place of business) in Hong Kong, or the registered office of the HKFI. An insurer is required to give the OCI and/or the Insurance Agents Registration Board details of the registration or removal of its appointed insurance agents within seven days of such registration or removal.

An insurer is required to comply with the Code of Practice for the Administration of Insurance Agents issued by the HKFI and endorsed by the OCI pursuant to section 67 of the ICO. The Code of Practice for the Administration of Insurance Agent specifies the rules and procedures governing the registration and de-registration of insurance agents, the power of the Insurance Agents Registration Board to handle complaints and to require insurers to take disciplinary actions against their insurance agents, the “fit and proper” criteria for insurance agents and the minimum requirements of agency agreements. An insurer is responsible for the actions of its appointed insurance agents in their dealings with clients in respect of the issue of insurance contracts and related insurance business. The OCI has the power to direct the de-registration of an appointed insurance agent.

### **Taiwan — PCA Life Assurance Company Limited, AIA-B’s Taiwan branch (“AIA Taiwan”)**

#### **Overview**

Currently, composite licences to sell both life and non-life insurance are not granted and PCA Life Assurance Company Limited and AIA Taiwan are both licensed for life insurance business only.

The Financial Supervisory Commission (the “FSC”) is responsible for regulating the entire financial services sector. The FSC’s responsibilities include supervision, examination and investigation. The Insurance Bureau (the “IB”) of the FSC is responsible for the insurance sector.

Taiwanese laws are based on a civil code model and each competent authority is given powers to develop and issue regulation on specific topics or issues. Many of the current insurance regulations were revised and promulgated in 2007 in response to the significant amendment of the Insurance Act in 2007. Similar to many Asian countries, the provisions of insurance regulations tend to be prescriptive.

In 2007, the FSC promulgated the guidance notes related to foreign currency denominated traditional life business. Insurers must satisfy several requirements related to disciplinary performance, risk-based capital, risk management controls, and complaints efficiency in order to qualify. At this stage, only life insurance and annuity products denominated in US dollars are permitted. Prior approval from the Central Bank of Taiwan and IB is required and the underlying foreign portfolio is also subject to the 45% foreign investment limit as per the Insurance Act.

In 2007, the FSC promulgated a regulation governing the engagement by insurers in insurance trust business. Before engaging in insurance trust business, an insurer is required to meet certain qualifying requirements and to apply to the IB for approval. The insurer may invest the entrusted money into cash, bank deposits, bonds, financial debentures, short-term bills, and other instruments otherwise approved by the IB. Further, it is required not only to segregate the trust assets from its own assets by establishing a separate account for the trust assets, but also to build a risk management and internal control system to ensure the proper management of the business.

Generally, the insurance law and regulations focus mainly on administrative supervision of insurance operations rather than conduct of business. An exception is the Regulation, Guideline and Self-Discipline Regulation related to the sale of investment-linked insurance products, where specific requirements, such as the obligations on insurers to disclose to prospective customers the costs of the product and the risks involved, to set up “Know Your Customers” operating principles and to perform needs analysis in identifying risk appetite and financial objectives of policy applicants are established. Other requirements include establishing risk classes for structured notes products, sample testing of new business to determine appropriateness of sales process and policy suitability, and conducting regular inspection to avoid the use of inappropriate sale materials.

Since September 2008, and following the AIG Events, AIA Taiwan has been required by the FSC to observe additional reporting requirements in respect of any significant decisions or resolutions relating to policyholders’ rights and in relation to AIA Taiwan’s parent company’s financial situation.

### **Korea — PCA Life Insurance Company Limited, AIA Korea**

#### **Overview**

Both PCA Life Insurance Company Limited and AIA Korea are authorised to carry on life insurance business in Korea including but not limited to casualty insurance, illness insurance, nursing insurance and incidental business and services related thereto.

Korea’s financial supervision structure underwent major change on 29 February 2008, when the Financial Supervisory Commission was integrated with the Financial Policy Bureau of the former Ministry of Finance and Economy to become the Financial Services Commission (the “FSC”). As Korea’s principal supervisory authority, the new FSC is given broad statutory mandate to carry out three key functions, financial policy formulation, financial institution and market oversight, and anti-money laundering. The FSC thus has the statutory authority to draft and amend financial laws and regulations and issue regulatory licences to financial institutions.

The Financial Supervisory Service (the “FSS”) acts as the executive supervisory authority for the FSC and principally carries out examination of financial institutions along with enforcement and other oversight activities as directed or charged by the FSC. Therefore, detailed rules under the supervisory regulation are prepared by the FSS.

In respect of anti-money laundering, the Korea Financial Intelligence Unit (KoFIU), which was also integrated into the FSC as part of the reorganisation, leads the government’s anti-money laundering and counter-terrorism financing efforts.

Currently, the country does not permit a company to operate both life and non-life insurance at the same time. The Republic of Korea operates a civil law system, with the FSC prescribing many detailed regulations for insurers to comply with. In the past, the FSC has also been very interventionist in setting and enforcing rules on the insurance industry. However, the style of regulation has been gradually changing along with the trend of liberalisation of financial services. This is most pronounced with the regulator focusing on the deregulation in asset management and product design activities. Furthermore, the FSS is setting an aggressive insurance supervisory agenda that would strengthen supervision while promoting deregulation. The regulator is moving towards risk-based supervision focusing on various risks of insurers’ operations. As part of the shift to risk-based supervision, the FSS has introduced the Risk Assessment and Application System (“RAAS”) to assess insurers’ various risks and relevant internal control and Risk-Based Capital (“RBC”) solvency requirement.

Both the Insurance Business Act and Insurance Business Supervisory Regulations have not been very specific on the entity’s responsibilities for the suitability of products. There is no explicit requirement for an insurer to consider the suitability of the product for the potential customer. However, on 18 December 2008, the FSC introduced a revised bill for an Insurance Business Act to the National Assembly (Korea’s legislative body) which will become effective provided it is passed in the National Assembly. It establishes the definition of an insurance product and also strengthens consumer protection measures. It overhauls the examination procedure for an insurance product and also establishes a basis for fair competition among businesses in various financial sectors. The revised bill is still pending in the National Assembly.

The FSS also operates a Consumer Protection Department and a Dispute Settlement Department in the Customer Protection Division to resolve and prevent customer complaints and disputes relating to insurance companies.

Korea currently allows many different forms of channels for distributing life insurance products including brokers, agents, telemarketing, direct mailing, bancassurance and mass media television selling.

### **Capital requirements**

In respect of an insurer’s capital adequacy requirement, Korea previously had a solvency margin requirement. Effective from 1 April 2009, Korea adopted a risk-based capital requirement to replace the solvency margin requirement. A two-year transition period between the two requirements is currently in place, which means that both requirements will be enforced in parallel until 31 March 2011. During this transition period, insurers have the discretion to elect which of the two requirements to comply with. From 1 April 2011, it will be mandatory for all insurers to comply with the risk-based capital requirement.

The solvency margin requirement under the Korean Insurance Business Act is intended to ensure that insurers maintain a solvency surplus against future liabilities, and the requirement is based on the European Union solvency ratio model. In particular, all insurers, including branches of foreign insurers, must maintain net assets of equal or greater value to an amount calculated on the basis of the liabilities that they insure such that they maintain a solvency margin ratio of at least 100%.

The risk-based capital requirement was introduced pursuant to amendments to the Insurance Business Supervisory Regulation and its relevant enforcement regulations issued pursuant to the Insurance Business Act. Under this requirement, the ratio of an insurer’s available capital to required capital is calculated, and the analysis of equity capital used to determine capital adequacy is expanded, to take into account market, credit, operational, insurance and interest rate risks, which are not currently taken into consideration under the solvency margin requirement.

In the event an insurer fails to satisfy the applicable capital adequacy requirement and this poses a threat to the financial soundness of that insurer in Korea, the FSC may take prompt corrective action which ranges from issuing a recommendation to an insurer to increase its capital reserves or restrict its investments in high-risk securities and other assets to issuing an order to an insurer to suspend its business or transfer it to a third party.

### **Reserve requirements**

In order to satisfy the payment obligations of an insurer’s policies, which include claims, reimbursements and dividends payable to policyholders, an insurer must establish and maintain a separate liability reserve in respect of

each of the following: insurance premiums reserve, unexpired insurance premiums reserve, insurance claim payments reserve, dividends reserve, profit dividends reserve, dividend insurance loss maintenance reserve and reinsurance premiums reserve. However, if an insurer acquires reinsurance of its liability under an insurance contract and such reinsurance satisfies stipulated regulatory conditions, the liability reserve in respect of that insurance contract need not be maintained by the insurer.

### **Statutory fund**

Under the Depositor Protection Act of Korea, the Korea Deposit Insurance Corporation insures certain liabilities (the “KDIC Insured Liabilities”) owed to the public in Korea by financial institutions. The KDIC Insured Liabilities of an insurer under the Depositor Protection Act of Korea include insurance premiums, surrender values and insurance claims payable by an insurer to an individual policyholder. Under the Depositor Protection Act of Korea, all insurers are required to contribute an annual insurance premium to the Korea Deposit Insurance Corporation at a rate determined pursuant to the Depositor Protection Act, up to a maximum of 0.5% of an insurer’s KDIC Insured Liabilities in that year. The annual insurance premium payable by an insurer is currently approximately 0.16% of the average of the insurer’s annual premium income and liability reserve. Under the current rules, the Korea Deposit Insurance Corporation insures only up to a total of Korean Won 50 million per individual against each insurer.

### **Asset management**

Subject to certain exceptions, the Insurance Business Act provides for caps on the proportion of an insurer’s total investments that can be held in particular classes of assets or exposure to particular counterparts. Such caps may be revised by the FSC from time to time as it deems necessary.

The Insurance Business Act restricts, among other things, certain asset management transactions such as the making of speculative loans, loans for the acquisition of the insurer’s own securities, loans for political funds and foreign exchange and financial derivative transactions that fail to meet the requirements of the FSC.

Use of insurance funds by an insurer is subject to certain restrictions, including a general prohibition on an insurer offering its assets as security or guaranteeing debts of any other person (unless permitted under the Insurance Business Act), and a general prohibition on an insurer owning more than 15% of the voting shares of another corporation unless that corporation is a subsidiary of the insurer and the approval of the FSC has been obtained.

### **Reinsurance**

Pursuant to the Insurance Business Supervisory Regulation issued pursuant to the Insurance Business Act, an insurer will be given credit for the purposes of its solvency margin and risk-based capital calculations only for ceded reinsurance covering a maximum of 50% of its total insurance liabilities. Any reinsurance ceded by an insurer in excess of 50% will be disregarded in calculating its capital requirements. In addition, insurers are required to give notice to the FSS within one month after execution of (or change of) every reinsurance treaty where the reinsurance treaty determines reinsurance premiums with reference to an expected rate of investment return, or the reinsurance treaty provides for a limitation of the reinsurer’s liability.

### **Regulation of products**

Any new product (including its terms, introduction to the market and premium rates and their calculation methods) is subject to *ex ante* or *ex post* review by the FSS (“Process for File & Use” or “Use & File”, depending on the product). In addition, an insurer must disclose on its internet website certain information, including a summary of its products, insurance terms, applicable interest rates and, in relation to the premium rates of variable insurance products, the calculation method for such rates and information on any designated accounts for such variable insurance products.

### **Restrictions on foreign insurers**

In the event that the head office of a Korean branch of a foreign insurer is closed due to a merger or transfer of business in its home jurisdiction, is subject to suspension or revocation of its insurance licence by any foreign financial supervisory agency on grounds of illegal conduct or unfair business practices, or suspends its insurance business or ceases to operate, the insurance licence of that insurer’s Korean branch may be revoked.

A branch of a foreign insurer must hold assets located in Korea equivalent to the liability reserve sufficient to fulfil all insurance contracts written in Korea. If the amount of assets located in Korea held by the branch of a foreign insurer is determined to be insufficient based on the annual audited accounts, the assets must be supplemented through an injection of capital within 60 calendar days. In the event an insurer is instructed to remedy any deficiency following a decision of the FSS in consultation with the FSC, remedial action must be taken within 30 calendar days.

### Financial reporting requirement

An insurer is required to close its books on 31 March of each year and submit its financial statements, including supplementary statements, audit reports, a statement of repaid funds and a statement of interest on funds, to the FSC within three months.

### **Singapore — Prudential Assurance Company Singapore (Pte) Limited, AIA Singapore and Pru Life Assurance Limited**

#### Overview

Prudential Assurance Company Singapore (Pte) Limited and AIA Singapore are registered by the Monetary Authority of Singapore (the “MAS”) to design and sell both life and general insurance business pursuant to the Insurance Act, Chapter 142 of Singapore (the “Singapore Insurance Act”).

Under the Singapore Insurance Act, the MAS is responsible for insurance company regulation and supervision. In order to sell insurance in Singapore, companies need to be registered with the MAS. The MAS also has responsibility for supervising compliance with anti-money laundering (“AML”) provisions, though suspicious transactions must be notified to the Commercial Affairs Department, an enforcement agency of the Singapore Police Force. In 2007, new regulations were introduced to strengthen further the AML requirements. They were revised in 2009.

Another relevant regulatory authority for the business is the Central Provident Fund (the “CPF”) Board. The CPF is a social security savings scheme jointly supported by employees, employers and the government. CPF members are employees and self-employed persons in Singapore with the CPF Board acting as the trustee. The CPF Board regulates insurers in the operation of various CPF schemes including the CPF Investment Scheme where CPF monies are used by policyholders to purchase insurance policies such as annuities and investment-linked policies.

The MAS is empowered under the Singapore Insurance Act to make regulations for the sector and it also issues, *inter alia*, Notices, Circulars and Guidelines. In practice, the MAS and CPF Board have very detailed legislation frameworks to govern insurance companies and the distribution of insurance products in Singapore.

Registered insurers in Singapore are subject to a risk-based capital (“RBC”) framework. The framework sets out the valuation methodology for assets and liabilities, rules relating to the operations of life insurance funds, capital requirement rules, the role of actuaries, and a set of statutory reporting standards. An insurer has to notify the MAS when it has failed or is likely to fail to comply with the mandated RBC indicators or when a financial resources warning event has occurred or is likely to occur.

The MAS has also issued Notices that cover the market conduct standards for life insurers including such areas as appointing and training representatives, maximum tier structure, loans and advances, disciplinary action, disclosure, sales process and replacement of life policies. In addition, the MAS has recently issued a set of guidelines entitled “Guidelines on Fair Dealing — Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers”.

#### Capital requirements

A registered insurer is required at all times to maintain a minimum level of paid-up ordinary share capital and to ensure that its financial resources are not less than the greater of:

- (a) the sum of:
  - (i) the aggregate of the total risk requirement of all insurance funds established and maintained by the insurer under the Singapore Insurance Act; and
  - (ii) where the insurer is incorporated in Singapore, the total risk requirement arising from the assets and liabilities of the insurer that do not belong to any insurance fund established and maintained under the Singapore Insurance Act (including assets and liabilities of any of the insurer’s branches located outside Singapore); or
- (b) a minimum amount of 5 million Singapore Dollars.

The MAS has the authority to direct that the insurer satisfy capital adequacy requirements other than those that the insurer is required to maintain under the Singapore Insurance Act if the MAS considers it appropriate.

### Statutory deposit

A person carrying on insurance business in Singapore as an insurer, while registered in respect of any class of insurance business, is required to have at all times in respect of that class of business a deposit (in assets of such nature as the MAS may specify) with the MAS of a value of not less than 500,000 Singapore Dollars. Subject to the approval of the MAS, a bank covenant for an equivalent amount may be provided to the MAS in lieu of the deposit.

### Statutory fund

The MAS maintains a Policy Owners' Protection Fund for the purposes of indemnifying, assisting or protecting policy owners and others who may be prejudiced by the inability of registered insurers to meet their liabilities under life policies and compulsory insurance policies issued by such insurers. For the purposes of funding the Policy Owners' Protection Fund, the MAS may impose a levy on registered insurers. Among other things, in order to secure continuity of insurance for every policy owner of a registered insurer in liquidation or in financial difficulties who is a policy owner in respect of a life policy which was a Singapore policy or an offshore policy and not being a contract of reinsurance, the MAS may take measures to secure or facilitate the transfer of the life business of the insurer, or part of that business, to another registered insurer or to secure the issue by another registered insurer to the policy owners of life policies in substitution of their existing policies.

### Asset management

The MAS Notice 104 "Use of Derivatives for Investment of Insurance Fund Assets" provides that insurers are only permitted to enter into or effect derivative transactions for the purposes of hedging and efficient portfolio management. In addition, insurers are prohibited from taking uncovered positions in derivatives.

The MAS Notice 105 "Appointment of Custodian and Fund Manager" requires a registered insurer to file with the MAS a list of all assets of all insurance funds established and maintained under the Singapore Insurance Act by the insurer where documents evidencing title are kept by custodians for the insurer as at the end of that accounting period, to apply best practice standards in appointing overseas custodians, and to notify the MAS prior to the appointment of a fund manager or revocation of such appointment.

The MAS Notice 317 "Asset Management of Life Insurance Funds" sets out the basic principles that govern the oversight of the asset management process of life insurance funds. It requires insurers to establish an investment committee and prescribes the main elements that must be incorporated in the investment policy of an insurer carrying on life insurance business.

The MAS Notice 320 "Management of Participating Life Insurance Business" requires an insurer which has established or will be establishing a participating fund to put in place an internal governance policy which shall include information on, among other things, the investment of participating fund assets.

### Separate accounts requirement

Every registered insurer is required to establish and maintain a separate insurance fund (a) for each class of insurance business carried on by the insurer that (i) relates to Singaporean policies and (ii) relates to offshore policies; (b) for its investment-linked policies and for its non-investment-linked policies; and (c) if no part of the surplus of assets over liabilities from an insurer's non-participating policies is allocated by the insurer by way of bonus to its participating policies, in respect of non-investment-linked policies (i) for participating policies and (ii) for non-participating policies.

The MAS Notice 101 "Maintenance of Insurance Funds", the MAS Notice 313 "Basis for Establishing Separate Funds for Participating and Non-participating Policies" and the MAS Guidelines on Implementation of Insurance Fund Concept provide further guidance and requirements on the establishment and maintenance of insurance funds and the segregation of the assets of registered insurers in Singapore as required under the Singapore Insurance Act.

The solvency requirement in respect of an insurance fund must at all times be such that the "financial resources" of the fund are not less than the "total risk requirement" of the fund. Each of the "financial resources" of an insurance fund and its "total risk requirement" is determined, and assets are valued, in accordance with the requirements of the Insurance (Valuation and Capital) Regulations 2004. The MAS has the authority to direct that the insurer satisfy fund solvency requirements other than those that the insurer is required to maintain under the Singapore Insurance Act if the MAS considers it appropriate.

The assets in the insurance fund shall only be applicable to meet such part of the insurer's liabilities and expenses as is properly attributable (excluding certain levies).

### **Reinsurance**

The MAS Notice 114 “Reinsurance Management Strategy” sets forth the guiding principles relating to the oversight of the reinsurance management process of insurers and includes the principle that the board of directors and senior management of an insurer are required to develop, implement and maintain a reinsurance management strategy appropriate to the operations of the insurer to ensure that the insurer has sufficient capacity to meet obligations as they fall due.

The MAS Notices 208 and 316 “Financial Reinsurance” impose certain requirements in respect of financial reinsurance for insurers registered to carry on general business and life business respectively. These include guidelines and mandatory requirements on, among other things, prudent management oversight, disclosure and reporting obligations and transfers of insurance risk.

### **Regulation of products**

A direct insurer registered to carry on life business may only issue a life policy or a long-term accident and health policy if the premium chargeable under the policy is in accordance with rates fixed with the approval of an appointed actuary or, where no rates have been so fixed, is a premium approved by the actuary.

Before offering certain new products, an insurer is required under the MAS Notice 302 “Product Development and Pricing” to obtain approval from the MAS. For products that do not require the MAS’s approval, an insurer should notify the MAS of any such product launched within a prescribed period. Such request or notification shall include information on, among other things, the tables of premium rates.

### **Appointment and duties of actuaries**

Insurers carrying on life and general business are required to appoint an actuary approved by the MAS, and are required to (a) in respect of their life business, have an investigation made by an actuary approved by the MAS into the financial condition of that business; and (b) in respect of their general business, have an investigation made by an actuary approved by the MAS into their liabilities in respect of insurance policies. Reports of such investigations must be lodged with the MAS.

The appointed actuary is responsible for, among other things, reporting to the principal officer of a life insurer on various matters including matters which in the actuary’s opinion have a material adverse effect on the financial condition of a life insurer. In the event a life insurer fails to take steps to rectify any matter reported by the actuary to its principal officer, the actuary is required to report directly to the MAS.

### **Financial reporting requirements**

The Insurance (Accounts and Statements) Regulations 2004 sets forth various reporting requirements and prescribes the forms in which the relevant returns and statements of a registered insurer are to be made. The regulatory framework also prescribes the valuation of assets and liabilities of an insurance fund, as well as the valuation of life and general insurance policy liabilities at a policy-by-policy level.

A registered insurer is required to file with the MAS, among other things, (a) for each quarter and each accounting period, statements for each insurance fund established and maintained under the Singapore Insurance Act; (b) a report by an actuary on its investigation into the valuation of policy liabilities and the financial soundness in respect of the insurer’s life insurance business; (c) a report by an actuary on its investigation into the valuation of policy liabilities in respect of the insurer’s general insurance business; (d) statements on the fund solvency requirement and capital adequacy requirement; (e) an auditor’s report and supplementary report (if any); and (f) any other information the MAS may require for the discharge of its functions under the Singapore Insurance Act.

In the case of a company incorporated or established outside Singapore, the financial audit need not extend beyond the business for which an insurance fund is maintained under the Singapore Insurance Act. Such a registered insurer incorporated outside Singapore is required to file with the MAS for each fiscal year, in respect of the insurer’s global business operations, a statement of the financial position of the insurer as of the end of that fiscal year. A registered insurer incorporated in Singapore is required to file with the MAS statements in respect of its global business operations for each quarter and each accounting period.

In addition, the MAS Notice 306 “Market Conduct Standards for Life Insurers Providing Financial Advisory Services” as defined under the Financial Advisers Act (Cap. 110) and the MAS Notice 318 “Market Conduct Standards for Direct Life Insurer as a Product Provider” require insurers to submit information on their businesses to the MAS annually.

### MAS directions

Since October 2008, the Monetary Authority of Singapore (“MAS”) has issued certain directions to AIA Singapore specifying that it comply with increased capital adequacy requirements. In addition, the directions provide that prior MAS consent be sought in respect of certain transactions including transfers or disposals of certain assets (including land or buildings) and financing and guarantee arrangements. The directions also impose certain additional reporting requirements on AIA Singapore.

### **Malaysia — Prudential Assurance Malaysia Berhad, AIA Malaysia**

#### Overview

Prudential Assurance Malaysia Berhad and AIA Malaysia have composite licences to carry on both life and general insurance business in Malaysia pursuant to the Insurance Act 1996. In addition, both companies are members of the Life Insurance Association of Malaysia and the General Insurance Association of Malaysia.

In Malaysia, Bank Negara Malaysia (“BNM”) is the regulatory body responsible for supervising and regulating the conduct of insurance business. All insurance companies must be licensed by the Minister of Finance. Licensed insurers must comply with the provisions of the Insurance Act 1996, the Insurance Regulations 1996, the Companies Act 1965 and guidelines and circulars issued by BNM. The Life Insurance Association of Malaysia and the General Insurance Association of Malaysia are self-regulated bodies. Resolutions and circulars issued by these associations are binding on the member insurance companies.

At the end of 2006, BNM carried out an exercise of realignment of its regulatory and supervisory functions which resulted in the establishment of a Consumer and Market Conduct Department. More emphasis has been placed on fair market conduct by the insurance industry and protection of the consumers’ interests.

With the objective of promoting greater transparency in the sale of insurance products, BNM has issued guidelines on the minimum disclosure requirements to be observed by insurers and their intermediaries in their interaction with prospective policy owners. The guidelines specify the timing and minimum information that must be disclosed to a prospective policy owner at the pre-contract stage and at the point of entering into a contract to enable them to make informed decisions and during the term of the contract. This information, which should be timely, clear, concise, accurate, relevant, consistent and comparable and with important information highlighted, includes details of types of cover offered, product features, benefits, restrictions, premium payments and exclusions of the policy as well as any significant conditions and obligations which the policy owner must meet. There are additional product-specific disclosure requirements to be met. The board of directors of a Malaysian insurer or a committee of its board of directors is expected to ensure that proper systems and processes are in place to implement the guidelines.

In an effort to further reform the regulation of insurers and reflect better the risks being faced by each entity, BNM has implemented an RBC framework for insurers, which took effect on 1 January 2009. Compliance with the RBC framework is a condition of licence for all insurers, and any failure to comply with the RBC framework could result in the revocation of an insurer’s licence. The RBC framework sets out the capital adequacy ratio calculations, capital requirements to mitigate major risks, the valuation bases for assets and liabilities, and supervisory expectations relating to the investment of insurance funds. Additionally in early 2008, BNM released a consultation paper on risk governance framework for insurers. The consultation paper outlines the risk governance function of an insurer, including the roles and responsibilities of the board of directors of a Malaysian insurer and its management in relation to risk governance. The paper further outlines the function of risk management, compliance and internal audit and their respective oversight responsibilities relating to risk management.

In its risk-based approach in regulating and supervising the insurance industry, more specific responsibilities have been placed on the board of directors of a Malaysian insurer and its senior management in managing the risks of the business. BNM continues to assess the performance of an insurer by analysing its statutory returns and reports submitted and regular communication with the insurer concerned.

BNM does not permit a person to hold, either directly or indirectly, shares in more than one licensee carrying on the same class of insurance business. Prudential Assurance Malaysia Berhad and AIA Malaysia carry on the same classes of insurance business and as such, the Enlarged Group’s operations in Malaysia would have to be restructured. Any restructuring would require the prior approval of BNM who have indicated a willingness to provide a grace period for restructuring to take place.

#### Capital requirements

As noted above, BNM has recently introduced an RBC framework aimed at improving the risk management practices of insurers. Under the RBC framework, insurers are required to maintain a capital adequacy level that is

commensurate with their risk profiles. Each insurer is required to determine the adequacy of the capital available in its insurance and shareholders' fund to support the total capital required by the Insurer. This will serve as a key indicator of the insurer's financial resilience and will be used to determine any supervisory interventions by BNM.

Under the RBC framework guidelines, the board of directors and senior management of a Malaysian insurer are also expected to identify, monitor and control risks which are not adequately addressed under the framework. An insurer is also expected to manage actively its capital adequacy by taking into account the potential impact of its business strategies on its risk profile and overall financial resilience.

### **Reserve requirements**

The RBC framework requires the appointed or signing actuary of a life insurer to determine the required amount of policy reserves for the life insurance liabilities and the general insurance signing actuary to determine the level of reserves for general insurance business. The basis used should be no less stringent than that prescribed in the RBC framework.

### **Separate accounts requirements**

An insurer is required to establish and maintain separate insurance funds for its Malaysian policies and for its foreign policies and, where directed by BNM, for different categories or description of its insurance business or classes of policies. An insurer is required to pay into the applicable insurance fund all money received in respect of policies of a class to which the insurance fund relates, keep the assets of its insurance fund separate from its other assets and maintain assets of equivalent or higher value than the liabilities of that insurance fund. An insurer may apply the assets of an insurance fund only to meet such of its liabilities and expenses as are properly attributable to that insurance fund.

An insurer may withdraw the surplus from a general insurance fund where there is a surplus of assets over liabilities at the end of a fiscal year, subject to any instrument or contract binding the licensed insurer or its constituent documents. For a life insurance fund, upon the actuarial valuation and recommendation by the appointed actuary, the life insurer may allocate a part of the surplus attributable to participating and non-participating policies by way of a bonus paid to participating policies and for transfer out of that life insurance fund to the shareholders' fund, subject to such limits and such proportions as may be prescribed.

### **Asset management**

The investment limits on individual asset classes and exposure limits to counterparties are provided in the RBC framework. The RBC framework also sets out the supervisory expectations in respect of the investment of an insurer's assets.

### **Reinsurance**

A licensed insurer's reinsurance arrangements must be consistent with sound insurance principles. The general principles to be observed in a reinsurance arrangement are the appropriateness of retention level, security of reinsurers, spread of reinsurers and appropriateness of reinsurance treaties. An insurer is required both to design its reinsurance programme in line with its exposure and portfolio of business, taking into account, among other things, its insurance risk profile and the concentration of its business and to ensure that its reinsurance arrangements provide adequate protection for all classes of business underwritten to enable it to pay its liabilities as they come due. In placing reinsurance in respect of general insurance, an insurer must accord priority to local reinsurers up to such local reinsurers' full retention capacity before securing reinsurance support from foreign insurers.

### **Financial reporting requirements**

In general, insurers are required to submit each of the following to BNM within a specified timeframe: (a) audited annual accounts; (b) an auditor's report and certificate; (c) an appointed actuary's report and certificate; (d) a report on the action taken by the board of directors of the Malaysian insurer on the auditor's report; (e) the Malaysian insurer's board of directors' report on its operations; and (f) quarterly returns of each fiscal year. BNM has also issued guidelines which require an insurer to submit additional reports which, among other things, relate to such insurer's investments, claims, reinsurance, solvency and capital adequacy.

BNM has announced that it is undertaking a comprehensive review of the Insurance Act 1996. Detailed proposals of the legislative changes are expected to be finalised by the end of 2010.

### **BNM requirements**

Under a letter dated 16 September 2008, and following the AIG Events, BNM requested AIA Malaysia to obtain prior written approval of BNM in relation to the following:

- 1) payment of dividends (interim and/or final) to its shareholders;
- 2) extension of credit facilities to related-parties within the AIG Group (which for these purposes is understood also to include members of the AIA Group);
- 3) guarantees or undertakings given to/on behalf of related-parties within the AIG Group (which for these purposes is understood also to include members of the AIA Group); and
- 4) any other related-party transactions, excluding any transaction in the ordinary course of AIA Malaysia's business relating to insurance policies, reinsurance cessions and claims.

### **Malaysia (Takaful business) — Prudential BSN Takaful Berhad, AIA Takaful International Berhad**

#### **Overview**

Prudential BSN Takaful Berhad (“Prudential Takaful”) (a Prudential joint venture with Bank Simpanan Nasional) was the first overseas insurer to be granted a domestic Takaful Licence in Malaysia. In addition, AIA Takaful International Berhad (“AIA Takaful”) was granted Malaysia's first “International Takaful” operator licence to carry out family solidarity and general Takaful businesses in currencies other than ringgit. An International Takaful operator licence means AIA Takaful may engage in Takaful business in other countries, provided that such other countries' local requirements are complied with.

The Takaful business in Malaysia is also governed by BNM similarly to the insurance companies. In addition, the business is required to be a member of the Malaysian Takaful Association (“MTA”), which is an association for Takaful operators to improve industry self-regulation through uniformity in market practice and to promote a higher level of co-operation among operators. Resolutions and circulars issued by the MTA are binding on the member insurance companies.

Takaful in Malaysia is considered to be part of mainstream mercantile law, and hence part of civil law, and is therefore subject to the civil court structure of Malaysia. It is not regulated by Shariah law in Shariah courts. However, the operation system of a Takaful operator must conform to the rules and requirements of Shariah as regulated in the Takaful Act 1984, which elevates the Shariah Advisory Council to the position as the sole authority on Shariah matters. A Takaful operator is required to establish a Shariah advisory body approved by the Director General of Takaful to advise on the operations of its Takaful business. To strengthen further the Shariah and legal infrastructure, the Guidelines on the Governance of Shariah Committee for Islamic Financial Institutions were issued in 2004 to streamline the functions and duties of Shariah Committee of Takaful operators and strengthen their independence. BNM has indicated that, in line with efforts to enhance the Shariah governance of Islamic financial institutions, a new Shariah governance framework will be issued in 2010 to provide comprehensive guidance on the roles and responsibilities of the Shariah committee and the board management of Islamic financial institutions in ensuring that the operations of the Islamic financial institutions are in compliance with Shariah principles.

Although the Takaful operator is also governed by the same regulator (BNM), the industry is regulated slightly differently from insurance companies. The differences relate in the main to matters where the regulators still find the Takaful operators not ready. For example, the risk-based capital framework that has been implemented for insurers has not yet been implemented for Takaful operators given the nature of the business (i.e. Shariah compliant) and the maturity of the industry. However, as reported in the Financial Stability and Payment Systems Report 2009, the conceptual parameters of the capital model and development of the valuation components for family and general Takaful business under the RBC Framework for takaful operators (“RBCT”) has been substantially completed. Consultation with the industry on the detailed RBCT and impact assessments will commence in 2010 with a target timeline for implementation of the framework on a parallel basis by 2011. In other areas regulation is similar to the insurance industry.

The regulators acknowledge that comprehensive regulatory and supervisory frameworks need to be developed to support the sound expansion of the Takaful industry. The regulators are taking steps to, among other things: (i) review the Takaful Act 1984 and subsidiary legislation to address existing inadequacies of the acts; (ii) progressively increase the statutory minimum paid up capital for Takaful operators; (iii) introduce accounting standards for Takaful businesses and draft model accounts for Takaful operators; and (iv) monitor and refine further code of ethics and standard market practices for Takaful operators.

BNM has announced that it is undertaking a comprehensive review of the Takaful Act 1984. Detailed proposals of the legislative changes are expected to be finalised by the end of 2010.

## **China — CITIC-Prudential Life Insurance Company Limited, branches of AIA Co**

### ***Overview***

CITIC-Prudential Life Insurance Company Limited (Prudential's joint venture with CITIC) is authorised to conduct life insurance business in China. As at the end of 2009, CITIC-Prudential Life had business in 31 cities across China, including in the key markets of Guangdong, Beijing, Shanghai, Hubei, Shandong, Zhejiang, Jiangsu, Tianjin, Guangxi, Fujian and Hebei.

AIA Co currently holds nine insurance business permits and nine business licences in different locations of China. AIA Co has a branch in each of Beijing, Guangdong, Shanghai, Shenzhen and Jiangsu. Within the Guangdong province, AIA Co has a sub-branch in each of Foshan, Jiangmen and Dongguan and within the Jiangsu province, AIA Co has a central sub-branch in Suzhou.

The insurance business permits of these branches and sub-branches were issued by the China Insurance Regulatory Commission ("CIRC") and the business licences were issued by the relevant local Administrations for Industry and Commerce. These permits and licences allow AIA Co's branches and sub-branches in China to provide individual and group life insurance products, accident and health products and reinsurance business thereof.

Chinese law and regulations do not generally permit a foreign insurance company or insurance group with an existing insurance business in China to hold a second Chinese insurance company. As such, the Enlarged Group's operations in China may need to be restructured. Any restructuring would require the prior approval of the CIRC.

The body responsible for regulation of the insurance sector is the CIRC established in 1998. CIRC reports directly to the State Council. The main laws and regulations that govern the Enlarged Group's operations in China are the Insurance Law of the People's Republic of China (enacted in 1995 and amended in 2009) and the Regulation on the Administration of Foreign Funded Insurance Companies (enacted in 2001) and the Regulation on the Administration of Insurance Companies (enacted in 2004 and amended in 2009).

CIRC is authorised to conduct administration, supervision and regulation of the Chinese insurance market, and to ensure that the insurance industry operates in a stable manner in compliance with the law. It drafts relevant regulations regarding insurance supervision, examines and approves the establishment of insurance companies and their branches and supervises market conduct. In November 2008, to ensure enforcement of the regulations, CIRC established a special department, namely the inspection bureau, to strengthen the function of investigating significant non-compliance issues and the conduct of insurance companies and the handling of complaints. CIRC has local offices in all the provinces and selected direct administrative cities and regions across the country. One of the key responsibilities of the local offices is to set and administer implementation rules and guidelines in the application of the regulations introduced by CIRC. The local offices will also regulate many aspects of the insurance companies' activities within the locations for which they are responsible, including but not limited to business, sales and agent conducts, sales licensing practices, approving new sales offices and assessing minor administrative penalties.

CIRC has focused specific attention on the area of risk prevention. Accordingly, it has identified five lines of defence against risks, namely internal management and control systems, supervision of solvency adequacy, on-site inspection, fund management regulation and insurance security fund. In 2008, in response to the global financial crisis, more importance has been attached to the supervision of internal control systems, corporate governance, marketing conduct and information disclosure of insurance companies. In addition to the introduction of additional regulations and rules, a classified supervision system was developed by the regulator to detect and monitor the operation and financial risks of the industry. Under the system, insurance companies will be classified into four groups based on the risk indicators relating to solvency margins, corporate governance, capital management, financial status and market conduct. Different administrative measures such as risk warning, on-site inspection, restriction of business expansion and investment, may be imposed on different groups.

China promulgated a new Anti-Money Laundering ("AML") Law applicable to all financial institutions in November 2006. The People's Bank of China ("PBOC") was entrusted with the responsibility and authority for regulating all AML activities in China. PBOC also introduced several additional AML measures between November 2006 to June 2007 to provide specific rules and guidelines in the application of the AML Law. The areas covered would include customer identification, reporting of large volume and other suspicious transactions, record-keeping and reporting of suspicious transactions involving terrorism financing.

### **Capital requirements**

The minimum registered paid-up capital of a foreign invested insurance company is RMB200 million. A similar requirement is imposed on a Chinese branch of a foreign insurance company. Both foreign invested insurance companies and Chinese branches of foreign insurance companies are required to maintain a solvency ratio that is not lower than 100%. Under relevant PRC regulations, the solvency ratio is the ratio of actual capital to the minimum capital requirement applicable to the insurer pursuant to relevant regulations. The actual capital is the difference between the admitted assets and admitted liabilities. The CIRC requires solvency reports to be submitted quarterly, annually or *ad hoc* as required by the CIRC. Where an insurer is not able to meet its solvency requirement, it is required to immediately report to the CIRC.

### **Reserve requirements**

The CIRC has promulgated various rules and regulations on the reserves to be established and maintained by insurers, and the reserve requirements pursuant to such rules and regulations depend on the nature and type of insurance product. Reserves that the CIRC generally requires a life insurer to maintain include an unearned premium reserve, a life insurance reserve, a long-term health insurance reserve and an insurance-claims payment reserve. The reserve amounts are generally determined with reference to, among other things, actuarial projections of future cash flows.

### **Statutory and other deposit requirements**

A foreign invested insurance company is required to deposit 20% of its registered capital and a foreign insurer's Chinese branch is required to deposit 20% of its working capital with a bank designated by the CIRC. This statutory deposit may only be used to discharge debts owed by an insurer in the event that it is put into liquidation or declared bankrupt.

A life insurer is required by the CIRC to contribute up to 1% of its total assets to an insurance protection fund, which is a non-governmental fund maintained by a state-owned fund management company. In the event any insurer is put into liquidation or declared bankrupt or deemed by the CIRC to pose material risks to the public interest and financial stability, this insurance protection fund may be used, among other things, to pay policyholders or other life insurance companies accepting life policies assigned from the insolvent life insurer.

### **Separate accounts requirement**

An insurer is required to maintain assets in separate accounts for certain types of products specified by the CIRC, including participating, universal life and investment-linked products. Establishment, amalgamation, demerger and closure of investment accounts maintained in respect of investment-linked products are subject to the approval of the CIRC.

### **Asset management**

An insurer is required to invest its insurance funds in a stable and prudent manner. An insurer may only invest its insurance funds in bank deposits, securities, including, without limitation bonds, stocks and securities, investment fund shares, real estate and other permitted investments as stipulated by the China State Council. The CIRC also sets caps on the proportion of an insurer's total investments that can be held in particular classes of assets. Such caps may be revised by the CIRC from time to time. The approvals of the CIRC and State Administration of Foreign Exchange are required if the insurer wishes to invest insurance funds denominated in foreign currencies offshore.

### **Reinsurance**

An insurer may reinsure its liabilities within its authorised scope as stated in its insurance business permit and business licence. An insurer is required to implement a comprehensive risk management system and report to the CIRC annually regarding its reinsurance arrangements. An insurer may only cede its liabilities to reinsurers who satisfy the CIRC's credit rating requirements (as specified from time to time) or are Chinese state-owned reinsurers.

### **Regulation of products**

Products which are legally mandatory, newly developed life insurance or may concern the public interest are required to be reviewed and approved by the CIRC before they can be introduced to the market for sale.

### Financial reporting requirements

The CIRC requires each insurer to file with the CIRC monthly financial accounts, annual audited financial statements and annual audited solvency statements prepared in accordance with applicable Chinese laws, rules and regulations.

### CIRC Notices

Following the AIG Events, Notices issued by the CIRC in 2008 ordered AIA Co's branches in Shanghai, Guangdong, Jiangsu, Beijing and Shenzhen, and sub-branches in Suzhou Central, Dongguan and Jiangmen to:

- 1) maintain sufficient funds to cope with possible cancellations and prevent liquidity risk and monitor liquidity daily; and
- 2) enhance capital fund safety by: (a) not entering into any mortgage, guarantee, letter of credit or incurring debt other than in the normal course of business; (b) not transferring any assets or funds outside of China; and (c) obtaining approval from the CIRC on any affiliated transaction with AIG including reinsurance transactions (so as to prevent capital and assets from flowing outside of China).

### **Thailand — Prudential Life Assurance (Thailand) Public Company Limited, branches of AIA Co (AIA (Life) Thailand and AIA (Non-Life) Thailand)**

#### Overview

Prudential Life Assurance (Thailand) Public Company Limited is authorised to carry on long-term insurance business in Thailand. AIA (Life) Thailand is authorised to carry on long-term insurance and reinsurance business and AIA (Non-Life) Thailand is authorised to carry on general insurance business (in respect of health and protection business).

As branches of a foreign company, AIA (Life) Thailand and AIA (Non-Life) Thailand are also regulated by the Department of Business Development of the Ministry of Commerce. AIA (Life) Thailand holds a foreign business certificate for the conduct of a life insurance business and AIA (Non-Life) Thailand holds a foreign business certificate for the conduct of a non-life insurance business. AIA (Life) Thailand also holds a foreign business licence to permit the provision of back office, internal auditing and compliances services to other AIG affiliates in Thailand.

In Thailand, the insurance business is regulated and supervised by the Office of Insurance Commission ("OIC"). The OIC came about as a result of the September 2007 statutory transformation of the Department of Insurance of the Ministry of Commerce. The OIC is now the independent regulatory organisation handling day-to-day insurance business affairs and reporting to the Ministry of Finance. The Secretary General of the Insurance Commission holds the statutory appointment of Insurance Registrar. Each quarter, insurers must contribute a proportion of their insurance premia to the OIC to cover the OIC's operational expenses. The current rate for life insurers is between 0.1% and 0.3% (depending on the type of policy, its duration and payment terms) and the current rate for non-life insurers is between 0.2% and 0.3% (depending on the amount of insurance premia received).

The Insurance Commission Act 2007 embodies the Insurance Commission, the principal decision-maker for the insurance business. The Insurance Commission consists of a 13-member Board, chaired by the Permanent Secretary of Finance and includes the Permanent Secretary of Commerce, the Secretary General of the Consumer Protection Board, the Governor of the Bank of Thailand and the Secretary General of the Securities and Exchange Commission as *ex officio* commissioners. The other six to eight Commissioners are selected from experts in the fields of law, accountancy, business administration, finance, economics and insurance.

The life and non-life insurance business is governed by the Life Insurance Act 1992 (as amended by the Life Insurance Act (No. 2) 2008) and the Non-Life Insurance Act 1992 (as amended by the Non-Life Insurance Act (No. 2) 2008) respectively. As well as governing the operations of the life and non-life businesses, these Acts regulate funds, investments and insurance policies and impose a variety of statutory requirements. The OIC has the power to manage and supervise insurance companies, protect insured persons and the general public, implement policies with respect to insurance funds, and regulate the professional conduct, qualifications and licensing of insurance brokers, agents and actuaries.

In the private sector, the Thai Life Assurance Association and the General Insurance Association play an active development role for their membership and support the insurance business as its representative bodies.

### Capital requirements

A branch office of a life or non-life foreign insurer must maintain assets in Thailand of not less than the amount of the capital funds required pursuant to relevant Thai regulations. In addition, life insurers are required to maintain

capital funds at the greater of 2% of their insurance reserve and 50 million Thai Baht, and non-life insurers are required to maintain capital funds at the greater of 10% of total net premiums received in the previous calendar year and 30 million Thai Baht. In its Early Intervention Guidelines, the OIC requires insurers to maintain capital funds of more than 150% of the amount required by law. An insurer that fails to maintain capital funds in line with these guidelines and does not take corrective action to address the deficiency will be subject to sanctions in the form of a range of restrictions on its investment and other business activities.

The 2008 amendments to the Life Insurance Act and the Non-Life Insurance Act require the implementation of risk-based capital adequacy tests by 2011.

### **Reserve and asset management requirements**

The OIC requires a life insurance company to allocate a portion of its premium income to an insurance reserve for policies that remain in force. The insurance reserve may consist of a mixture of different classes of assets. The assets in the insurance reserve must match the insurer's liabilities as they come due over the duration of its policies. The types of assets that a life insurance company must place in its insurance reserve and the rules, conditions and basis for assessing the value of assets placed in the insurance reserve are regulated by the OIC.

Thai regulations require every life insurer to place a security deposit with the OIC of not less than 20 million Thai Baht, which may consist of a mix of cash and certain types of bonds, treasury bills and similar specified instruments. Every life insurer is also required to place 25% of its insurance reserves with the OIC. Non-life insurers are also required to place a security deposit with the OIC of not less than 3.5 million Thai Baht for each type of insurance business they undertake (for example, fire insurance, marine and transportation insurance) which may consist of a mix of cash and certain types of bonds, treasury bills and similar specified instruments. Every non-life insurer is also required to place 15% of its insurance reserves with the OIC (this proportion is scheduled to rise to 25% in 2012).

Under the Life Insurance Act of Thailand, Non Life Insurance Act of Thailand and relevant bankruptcy laws of Thailand, in the event that an insurer goes bankrupt, policyholders entitled to receive payment under their insurance policies have preferential rights to the assets placed with the OIC and have the right to receive payment from such assets as secured creditors. The amount which a policyholder may receive from the assets placed with the OIC and statutory fund is capped as 1 million Baht. Policyholders would also have preferential rights over the other assets of the insurer and the right to receive payment from such assets subject to the rights of secured creditors and certain other classes of preferred creditors.

### **Statutory fund**

Life insurance companies are required to contribute to a central life insurance fund intended to compensate policyholders in the event that an insurer is declared bankrupt or has its licence revoked. The OIC requires insurers to make payments twice a year into this central life insurance fund. The current amount payable is 0.1% of the premium income received in the six months prior to the payment date.

Non-life insurers are also required to contribute to a central non-life insurance fund to compensate policyholders in the event of bankruptcy or revocation of an insurer's licence. The OIC requires non-life insurers to make payments twice a year into this central non-life insurance fund. The current amount payable is 0.25% of premium income received in the six months prior to the payment date.

### **Reinsurance**

When a life insurer wishes to cede its insurance liability under a policy by entering into a reinsurance treaty, it may only reinsure in respect of the net amount at risk that is outstanding on the policy as of each anniversary of the policy during its term.

A copy of every reinsurance treaty that an insurer enters into must be submitted to the OIC within 30 days of the date of its execution. Life insurers should also inform the OIC in the event a reinsurance treaty is amended or terminated and provide details of the same. The OIC may, if it deems it appropriate, request a life insurer to submit the reinsurer's annual report as to the reinsurer's financial and business condition in the previous year.

Similar rules apply to non-life insurers except that copies of facultative reinsurance treaties need not be provided, but a non-life insurer must report to the OIC quarterly on its facultative reinsurance. A non-life insurer must obtain OIC approval before obtaining financial reinsurance.

The OIC has proposed new reinsurance regulations which will require an insurer to adopt a formal reinsurance management strategy and submit it at regular intervals to the OIC for approval. The regulations will also prohibit an insurer from obtaining certain reinsurance without OIC approval, including finite risk reinsurance, financial

reinsurance and other alternative risk transfer arrangements, and impose limitations on reinsurance that may be placed overseas based on the credit rating of the overseas reinsurers.

### **Regulation of products**

Insurance policies, including their related documents and endorsements, must be in the form approved by the OIC. The use of non-approved policy documentation may result in policyholders having the option to terminate the policy with a full refund of premiums or to continue to benefit under the policy as written (or as amended by the order of the OIC). Marketing materials for an insurance policy are deemed to form part of the policy with any inconsistency between the marketing materials and policy to be construed in favour of the policyholder or beneficiary.

The premium rates for an insurance policy are also subject to the approval of the OIC. A notification issued by the OIC sets out the factors that it will take into account in determining premium rates.

The OIC prohibits all insurers from underwriting policies denominated in currencies other than Thai Baht but insurers may access reinsurance from overseas that is denominated in foreign currencies.

Life insurance policies are also affected by the eligibility criteria imposed by the Revenue Department of the Ministry of Finance on tax deductibility of premiums.

### **Regulation of agents and brokers**

Insurance agents and brokers are licensed by the OIC. The OIC imposes caps on the commission rates that insurers may pay to insurance agents and brokers. The OIC prohibits insurers from paying commissions to other persons.

The OIC imposes general obligations on insurance agents and brokers in relation to their dealings with customers. It also imposes specific requirements on telephone sales, including restrictions on hours of operation, pre-vetting the types of policies that may be marketed, recording requirements and a 30-day cooling-off period, and on bancassurance.

### **Restrictions on foreign insurers**

Expansion of the branch office network of a foreign insurer in Thailand is restricted pursuant to the Life Insurance Act of Thailand. Consequently, a foreign insurer currently may not open additional branch offices in Thailand.

Thai insurance companies generally must be at least 75% Thai-owned. The Insurance Commission may allow up to 49% foreign ownership and, where an insurer's condition or operation is likely to place policyholders or the public in jeopardy, the Minister of Finance may (on advice from the Insurance Commission) allow up to 100% foreign ownership.

### **Restrictions on dividends and distributions**

Although there are no formal limitations on dividends or other distributions by a Thai insurer or the Thai branch of a foreign insurer, the approval of the Bank of Thailand is required for remittances outside Thailand. In practice, the Bank of Thailand will typically consult with the OIC before permitting a Thai insurer or the Thai branch of a foreign insurer to make any remittances outside Thailand.

### **Financial reporting requirements**

A life insurer or non-life insurer is required to prepare and submit monthly and annual reports and interim quarterly and audited annual financial statements to the OIC in respect of both its branch offices and operations as a whole. A branch office of a foreign life insurance company must comply with the additional requirement of submitting an annual report of its parent company within five months of the end of the parent company's fiscal year. In addition, a certified actuarial report must be submitted annually by all insurers. An insurer is also required to post summary financial information on its website and at its head office and branch offices.

### **Philippines — Pru Life Insurance Corporation of UK, The Philippine American Life and General Insurance Company (“Philamlife”)**

Pru Life Insurance Corporation of UK is licensed and regulated by the Insurance Commission (the “IC”) as a life insurance company. Philamlife, on the other hand, is only one of three insurers in the Philippines with a licence to conduct both life and general insurance activities.

The Insurance Code of the Philippines, as amended, (“Insurance Code”) gives the power to supervise and regulate the operations and business of insurance companies to the IC. The IC is a government agency under the Department

of Finance, and is headed by the Insurance Commissioner. The IC is a part of the Anti-Money Laundering Council together with the Bangko Sentral ng Pilipinas and the Securities and Exchange Commission (“SEC”).

The mandate of the IC is to regulate and supervise the insurance industry in accordance with the provisions of the Insurance Code in order to ensure that adequate insurance protection is available to the public at a fair and reasonable cost and to ensure the financial stability of the insurance industry so that all legitimate claims of the insured public are met promptly and equitably. The objectives of the IC are to promote growth and financial stability of insurance companies, to develop professionalism in the insurance services industry, to develop insurance consciousness among the general populace, to establish a sound national insurance market, and to safeguard the rights and interests of the insured.

The IC issues licences to insurance companies, reinsurance companies, agents, general agents, resident agents, underwriters, brokers, adjusters and actuaries. It also has the authority to suspend or revoke such licences under certain circumstances and after observance of the required procedure under the IC Rules of Procedure.

The Insurance Code empowers the IC to adjudicate insurance claims and complaints involving any loss, damage or liability where the amount involved does not exceed Php 100,000.00 for any single claim. Decisions or orders of the IC may be appealed to the Court of Appeals. Moreover, informal and administrative complaints against malpractices by insurance companies or agents may also be filed with the IC. The IC is available to render assistance in settling any controversy between an insurance company and a policyholder relating to insurance.

#### **India — ICICI Prudential Life Insurance Company Limited, AIA India**

ICICI Prudential Life Insurance Company Limited (Prudential’s joint venture with ICICI) and AIA India (AIA’s joint venture with Tata Sons Limited) are authorised to carry on long-term insurance business in India. It is currently intended that the AIA Group’s equity interest in the joint venture with Tata Sons Limited will be disposed of either before or around the time of completion of the Acquisition.

Insurance is subject to federal regulation in India. The primary legislation is the Insurance Act, 1938, and the Insurance Regulatory & Development Authority Act, 1999. The Insurance Regulatory & Development Authority (the “IRDA”) is the key regulator for both the ICICI Prudential life insurance operation and AIA India insurance operations in India.

The IRDA’s duties include the issue of certificates of registration to insurance companies, and it has a mandate to protect the interests of the policyholder, to regulate, promote and ensure the orderly growth of the insurance industry. Regulatory direction is currently focusing on corporate governance and disclosures to stakeholders. IRDA’s regulations also encourage the sale of insurance to customers in rural parts of India.

In his Budget speech on 26 February 2010 the Finance Minister of India stated that a Financial Stability and Development Council will be set up, to strengthen and institutionalise the mechanism for maintaining financial stability without prejudice to the autonomy of regulators. It is proposed that this Council would monitor macro-prudential supervision of the economy, including the functioning of large financial conglomerates, and address inter-regulatory coordination issues. It will also focus on financial literacy and financial inclusion.

#### **Indonesia — PT. Prudential Life Assurance, PT. AIA Financial**

PT. Prudential Life Assurance and PT. AIA Financial are authorised to carry on long-term (for an indefinite period) insurance business in Indonesia.

The insurance industry is regulated by the Insurance Bureau under the Capital Market Supervisory Board and Financial Institution of the Ministry of Finance. Previously, insurance companies in Indonesia were supervised by the Directorate of Insurance under the Directorate General of Financial Institutions of the Ministry of Finance (the “MoF”). In December 2005, the Government of Indonesia merged the Capital Market Supervisory Board and Directorate General of Financial Institutions under a single Capital Markets Supervisory Board & Financial Institution (the “Bapepam LK”). The current role of the Bapepam LK is to act as a supervisory board, with responsibility over capital markets, pensions funds, insurance and other non-banking financial institutions with the objective to manage risks in the financial sector, as well as to increase consumer protection and market confidence and promote transparency and strong financial business practices and standards.

The MoF issued decrees on business conduct, auditing, solvency, and the licensing of insurance companies. These decrees were supplemented by implementing regulations issued by the Bapepam LK.

The local Life Insurance Association (the “AAJI”) continues to act as a conduit between insurers and the MoF and Bapepam LK in terms of the development of new regulations and guidelines.

The implementation of anti-money laundering controls in the insurance industry is monitored by the Indonesian Financial Transaction Reports and Analysis Center (the “PPATK”). The PPATK is an institution with the mission of preventing and eradicating money laundering in Indonesia. The Money Laundering Criminal Act Law (UU-TPPU) is the governing statute that establishes and empowers the PPATK as the key authority in the anti-money laundering regime in Indonesia.

The Prudential Group’s and the AIA Group’s operations in Indonesia are authorised to distribute life insurance products with either conventional or Shariah principles. Whilst the regulations for life products with conventional principles are fully developed (in accordance to current market conditions), the government has promulgated new regulations in relation to life products with Shariah principles. In addition, to accommodate significant developments in the Indonesian insurance industry over the past few years, the government is taking proactive measures to revisit Law No. 2 of 1992 on Insurance Business. Meetings with various insurance associations have been conducted by the Government over the past year to obtain input from local as well as joint venture insurance companies. The amendment of Law No. 2 of 1992 on Insurance Business is expected to be promulgated in 2011.

#### **Japan — PCA Life Insurance Company Limited (“PCA Life Japan”)**

The Financial Services Agency of Japan (the “JFSA”) regulates insurance companies and other financial institutions. In particular, the Insurance Business Division of the JFSA specifically undertakes the supervision of insurance companies. The fundamental principles underlying insurance regulation are set out in the Insurance Business Law. PCA Life Japan is licensed by the Prime Minister of Japan (who delegates most of the supervisory functions to the JFSA) as a life insurance company. Please refer to paragraph 4.1 of Part VII of this prospectus for recent developments in relation to PCA Life Japan.

On 1 April 2010, the Commercial Code of Japan was revised and the “insurance contract law” became a separate piece of legislation from the Commercial Code of Japan, now known as the “Insurance Act”.

In response to the recent financial crisis, the JFSA revised the “solvency margin ratio”, an indicator for regulatory purposes, to introduce stricter rules for the calculation of capital and risk measurements and to ensure its appropriateness by involving an appointed actuary. The new standard is to become effective for the fiscal year ending on 31 March 2012. However, reporting of the solvency margin ratio on the new basis will be required for the fiscal year ending on 31 March 2011 for monitoring purposes. This latter amendment is still under deliberation and the finalised rules have not been published by the JFSA.

#### **Vietnam — Prudential Vietnam Assurance Private Limited, AIA Vietnam**

Prudential Vietnam Assurance Private Limited and AIA Vietnam are licensed and regulated by the Ministry of Finance of Vietnam (the “MOF”) as life insurance companies. Currently, the applicable law does not permit an insurance company to operate both life and non-life insurance at the same time, unless a life insurance company conducts personal health and protection care insurance as a supplement to life insurance.

The MOF is responsible for carrying out state administration of insurance business for and on behalf of the Government. The Insurance Division of the MOF specifically undertakes the supervision of insurance companies. The fundamental principles of the operation of insurance companies are set out in the Insurance Business Law.

The first insurance regulation that was implemented in Vietnam was the governmental decree on insurance No. 100/CP which was issued in late 1993. As the Vietnamese insurance market grew, the first law on insurance business, the Insurance Business Law, was passed in 2000 by the National Assembly of Vietnam. In 2001, the Government promulgated further regulations relating to the implementation of the Insurance Business Law.

At the end of 2007, many of the current insurance regulations were revised and a number of new regulations were introduced, including: minimum legal capital requirements for insurance enterprises, equivalent to VND 600 billion, security deposit requirements equivalent to 2% of legal capital, new regulations for investment-linked products such as universal life and unit-linked products. The MOF has also provided specific regulations on establishing new insurance companies, modification of licences or opening/closure of insurers’ branches/representative offices and agent recruitment and training.

Generally, the Insurance Business Law and its guiding regulations focus mainly on administrative supervision of insurance operations. In practice, the Insurance Business Law reserves most of its items for insurance contracts (the terms and conditions of policy) in order to protect policyholders’ interests. Furthermore, the MOF has set a proactive insurance supervisory agenda on controlling the solvency of insurance companies in order to take timely intervention to the insurance market by issuing the new regulation on bankruptcy procedures for insurers, securities, financial institutions in late 2008.

By a letter dated 9 October 2008 from the MOF, and following the AIG Events, regular updates to the MOF have been requested regarding the business and financial situation of the AIG Group (including, for these purposes the AIA Group) and the impact on AIG's Vietnamese subsidiaries.

### **Other Asian and Australasian markets**

In addition to the regulatory frameworks discussed above, regulatory requirements also apply to the insurance businesses of the AIA Group's local operating units in Australia, New Zealand, Macau and Brunei. Each local operation is respectively subject to the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority, the Ministry of Economic Development of New Zealand, the Macau Monetary Authority through its Insurance Supervisory Department and the Brunei Ministry of Finance.

The operations of the AIA Group in these geographical markets are subject to their respective relevant local insurance regulatory requirements, including requirements with respect to solvency, asset management, financial reporting and reinsurance. The operations have been duly licensed in each of these geographical markets by the relevant regulatory authorities. In common with the actions of certain other regulators in relation to the AIA Group, following the AIG Events correspondence was issued to AIA Brunei by the Brunei Ministry of Finance requiring that its consent be obtained before assets are transferred or transactions are entered into with connected parties.

## **2. Regulation of investment and funds businesses and other regulated operations**

The Prudential Group and the AIA Group conduct, and the Enlarged Group will conduct, investment and fund businesses through subsidiaries or joint ventures in the following countries in Asia: The People's Republic of China, Dubai (Dubai International Financial Centre), Hong Kong, Republic of India, Japan, Republic of Korea, Malaysia, the Philippines, Republic of Singapore, Taiwan, Thailand and Socialist Republic of Vietnam. All operations are authorised and licensed by the relevant authorities, or exempted from licensing under the relevant regulations.

### **Hong Kong**

#### **Overview**

Certain types of products and services offered by the Prudential Group and the AIA Group in Hong Kong are regulated under separate statutory regimes by other regulatory bodies. These include the Mandatory Provident Fund Schemes Ordinance (Chapter 485 of the Laws of Hong Kong) (the "MPFSO") and the Occupational Retirement Schemes Ordinance (Chapter 426 of the Laws of Hong Kong) (the "ORSO"), both administered by the Mandatory Provident Fund Schemes Authority (the "MPFA") for compulsory Mandatory Provident Fund ("MPF") and voluntary ORSO retirement schemes. In addition, the selling of MPF and ORSO products by agents is regulated by the MPFA. The MPFA is responsible for the licensing and supervision of trustees who wish to administer MPF or ORSO schemes and MPF intermediaries.

The Securities and Futures Ordinance (the "SFO") and other subsidiary legislation comprise the laws in Hong Kong relating to certain investment-linked products including MPF and ORSO retirement schemes, securities dealing, investment advisory and investment management services. The Hong Kong Securities and Futures Commission (the "HKSF") is the statutory body responsible for the administration of the SFO and the related subsidiary legislations and rules.

The Hong Kong branch of PAC is regulated by the HKSF for its operations relating to investment-linked products. It is also registered with the MPFA as a MPF corporate intermediary.

Prudential Asset Management (Hong Kong) Limited ("PAMHK"), incorporated in Hong Kong, is ultimately a wholly-owned subsidiary of Prudential. PAMHK is licensed with the HKSF and is authorised to carry out Type 1 (Dealing in Securities), Type 4 (Advising on Securities) and Type 9 (Asset Management) regulated activities in Hong Kong.

PAMHK is registered with the China Securities Regulatory Commission ("CSRC") as a QFII (Qualified Foreign Institutional Investors) licence holder.

BOCI-Prudential Asset Management Limited ("BOCIP"), incorporated in Hong Kong, is a joint venture between Prudential Corporation Holdings Limited (36%) and BOCI Asset Management Limited (64%). BOCIP is licensed with the HKSF, and is authorised to carry out Type 1, Type 4, Type 5 (Advising on Futures Contracts), Type 6 (Advising on Corporate Finance) and Type 9 regulated activities in Hong Kong. It is also registered with the MPFA as an MPF intermediary. BOCIP offers a comprehensive range of investment products, including MPF products, pension funds, retail unit trusts, institutional mandates and other advisory funds. It also offers private investors and institutional clients investment portfolios and charity fund management services. As one of the pioneers in the asset

management industry in Hong Kong, BOCIP launched a series of capital guaranteed funds linked to various underlying indices or baskets of stocks with varying currencies and maturities, as well as certain exchange traded funds which are listed in Hong Kong.

BOCI-Prudential Trustee Limited is a joint venture between Prudential Corporation Holdings Limited (36%) and BOC Group Trustee Company Limited (64%). The company is incorporated in Hong Kong and is an approved trustee under the MPFSO and an associated entity to the BOCIP under the SFO.

In relation to the AIA Group's retirement scheme business in Hong Kong, AIA-B, in addition to being an authorised insurer under the ICO, is an intermediary registered with the MPFA and AIA-T is an approved trustee under the MPFSO. AIA Wealth Management Company limited is licensed by the HKSFC and is authorised to carry out Type 1 and Type 4 regulated activities. AIA-PT and AIA-CM are each registered with the MPFA as MPF corporate intermediaries. AIA-PT also acts as trustee of certain pooled retirement schemes for which it has been registered with the MPFA as a trustee pursuant to the ORSO.

### **Regulation under the MPFSO and ORSO**

Companies that operate compulsory retirement schemes in Hong Kong are regulated under the MPFSO. The MPFA shares responsibility with other regulatory bodies for supervision of the institutions, such as banks and insurance companies, that act as MPF intermediaries that provide MPF products to customers. The MPFSO includes rules on prudential management and the permissible investments that may be made using scheme funds, accounting and reporting requirements and the powers of the MPFA to intervene and terminate a trustee's administration of a scheme. Voluntary retirement schemes are subject to regulation under the ORSO. The MPFA is also the supervisory body for ORSO schemes. The ORSO requires schemes to be registered with the MPFA and imposes reporting requirements and rules on the types of assets in which a scheme may invest. In addition, the marketing and promotion of MPF and ORSO scheme products requires SFC approval, as these products involve investment in securities. In addition to these reporting requirements, the MPFA requested, in 2008 following the AIG Events, that prior notice be given of the following types of events in respect of AIA-T and AIA-PT:

- 1) declaration or payment of dividends to shareholders;
- 2) granting of advances, loans or credit facilities to any parties;
- 3) incurrence of major cash outflow arising from extraordinary events or non-operating activities; and
- 4) any incidents which may have an adverse impact on the liquidity or financial position of either company.

### **Regulation under the SFO**

Companies that wish to conduct business in regulated activities (as stipulated in the SFO) which include, but are not limited to, Type 1 (Dealing in Securities), Type 4 (Advising on securities) and Type 9 (Asset Management) in Hong Kong must be licensed to do so under the SFO, and the marketing and promotion of certain financial products and schemes that involve investment in securities is also regulated under the SFO. Licensed corporations under the SFO are subject to certain requirements which include, but are not limited to, financial adequacy and reporting and directors, senior management and individuals responsible for carrying out the regulated activities in Hong Kong must satisfy suitability and qualification requirements and be approved by the HKSFC.

The operation, marketing and promotion of investment-linked products and schemes, including long-term insurance schemes by insurers, is subject to authorisation by the SFC in accordance with Part IV of the SFO and related codes and guidelines issued by the SFC that require certain information to be disclosed to potential investors and impose restrictions on the content of advertisements and the claims that can be made with respect to risks and potential returns on an investment.

## **Japan**

PCA Asset Management Limited ("PCAAM") is registered with the Kanto Local Finance Bureau to engage in (a) second financial instruments business, (b) investment management business, (c) investment advisory & agency business and (d) ancillary business under the Financial Instruments and Exchange Law ("FIEL") which became effective as of 30 September 2007.

PCAAM is a member of the Investment Trusts Association, Japan and also a member of the Japan Securities Investment Advisers Association. Both the associations are self-regulatory bodies under FIEL. PCAAM is required to comply with the policies and regulations issued by these associations, which are authorised to conduct on and off-

site inspection in addition to the inspection conducted by the Securities and Exchange Surveillance Commission which is part of the FSA.

Under its registration in respect of second financial instruments business, PCAAM focuses on explaining the products. PCAAM does not set up or maintain customer accounts for purposes of settlement, which are to be opened at relevant sales companies. The investment advisory & agency business is limited to the investment advisory business excluding agency business.

## **Korea**

Prudential conducts fund business in Korea through an indirect, wholly owned subsidiary, PCA Investment Trust Management Co. Ltd. The bodies responsible for the regulation of asset management companies, investment advisers and discretionary management companies are the Financial Services Commission (“FSC”) and its executive arm, the Financial Supervisory Service (“FSS”).

AIA Korea holds an asset management business licence, issued pursuant to the Financial Investment Services and Capital Markets Act, which authorises AIA Korea to carry on asset management business related to variable life insurance. Pursuant to this licence, AIA Korea may establish and terminate investment trusts and manage investment trust assets with respect to variable insurance policies.

Traditionally, the FSC in Korea operates in a prescriptive way, with a significant amount of detailed regulation that asset management companies must comply with. In recent years, the style of regulation of the indirect investment industry has been changing in line with the trend towards liberalisation of financial services. In particular, the regulator is focusing on deregulation in asset management and product design activities and shifting towards a principles-based regulatory regime.

## **Taiwan**

The body responsible for regulation of the Securities Investment Trust Enterprises (“SITE”), Securities Investment Consulting Enterprises (“SICE”) and discretionary investment business is the Securities and Futures Bureau (“SFB”) under the Financial Supervisory Commission (“FSC”). The SFB is responsible for promulgating laws, regulations and policies in relation to these business areas.

PCA Securities Investment Trust Co., Ltd is registered as a SITE with the FSC. It is compulsory that all SITEs are members of the Securities Investment Trust and Consulting Association (“SITCA”), which is a self-regulatory organisation (“SRO”). SITE and SICE may not commence business without being admitted as members of the Association. SROs support the regulatory and administrative operations entrusted to the SFB by adopting self-regulatory rules and overseeing self-regulation by its members, establishing a membership disciplinary framework and carrying out matters that the SFB has authorised it to handle, such as previewing product filing documents before submission for the SFB’s final review. The SRO also acts as liaison between the SFB and its members for matters of business development.

## **China**

CITIC-Prudential Fund Management Company Limited, a joint venture between Prudential and CITIC Group (China International Trust and Investment Corporation), is regulated by the China Securities Regulatory Commission (“CSRC”). The CSRC supervises the establishment of fund management companies (“FMCs”) and the launch of securities investment funds.

The legislative framework of China’s fund industry comprises the China Securities Investment Funds Law (the “Fund Law”) and a set of ancillary regulations (the “Fund Regulations”). While the Fund Law and Fund Regulations spell out the rules and requirements which must be adhered to by all FMCs, the supervisory approach of CSRC, to a certain extent, is also principles-based. The Chinese authorities aim to protect the legitimate rights and interests of investors and other relevant parties, and thereby to promote the healthy development of securities investment funds and securities markets.

## **India**

ICICI Prudential Asset Management Company Limited (“the AMC”), a joint venture between Prudential and ICICI, is approved by the Securities and Exchange Board of India (“SEBI”) under SEBI (Mutual Funds) Regulations, 1996 to act as Investment Manager of ICICI Prudential Mutual Fund (the “Fund”). The Fund was set up as a Trust sponsored by Prudential (through its wholly-owned subsidiary Prudential Corporation Holdings

Ltd) and ICICI. ICICI Prudential Trust Limited (the “Trust Company”), a company incorporated under the Companies Act, 1956, is the Trustee to the Fund.

Mutual funds in India are regulated by the guidelines and statutes promulgated under the SEBI (Mutual Funds) Regulations, 1996, the Indian Trusts Act, 1882, relevant provisions of the Companies Act 1956 and other applicable laws. Any change of control of the AMC by virtue of 10% or more voting rights in the AMC or the right to appoint a majority of directors entitled to exercise control of the AMC will require the prior approval of the SEBI and the grant of an option to unit holders to exit the Schemes at the prevailing net asset value without any exit load.

As specified by the Indian Trusts Act 1882 and reiterated by the SEBI regulations, all mutual funds are required to be in the form of trusts. The trustee functions are carried out by separately established trust companies or boards of trustees. In all cases, the trust deed must be approved by the SEBI. The AMC has obtained registration from the SEBI to act as a Portfolio Manager under SEBI (Portfolio Managers) Regulations 1993.

Also, SEBI, via its letter dated 31 May 2005, conveyed that it had no objection to the AMC undertaking Advisory Services to Offshore Funds. The AMC has commenced the provision of Advisory Services.

The AMC also received a mandate from the Central Board of Trustees, Employees Provident Fund Organisation to act as a Portfolio Manager for the Funds of Employees Provident Fund, Staff Provident Fund and Pension and Gratuity Fund.

## **Philippines**

Philam Asset Management, Inc. (“PAMI”) was incorporated on 12 October 1971 and is a 99.78% owned subsidiary of a Philippine resident insurance company, The Philippine American Life and General Insurance Company, which is in turn a subsidiary of AIA Hong Kong.

PAMI is regulated by the Securities and Exchange Commission (the “SEC”), which grants the registration of investment managers or advisers for investment companies (i.e. mutual funds). As an investment manager and adviser to mutual funds, PAMI is required to manage the resources and operations of the said funds in accordance with the provisions of the Investment Company Act (Republic Act No. 2629) and its implementing rules and regulations.

Investment managers or advisers that hold a licence from the Monetary Board to engage in trust and other fiduciary business would, in addition to SEC regulation, be subject to further regulation by the Bangko Sentral ng Pilipinas (“BSP”). Pursuant to Monetary Board Resolution No. 1758 dated 10 December 1999, investment managers or advisers that perform purely agency functions in respect of the mutual funds that they manage are outside the coverage of the BSP’s jurisdiction, provided that: (i) the investment managers do not perform trust or quasi-banking functions and are not bank subsidiaries or affiliates; (ii) the products of the investment manager are not sold, and advertisements and material covering such products are not made or distributed in bank premises.

## **Singapore**

Prudential Asset Management (Singapore) Limited (“PAMS”), an indirect wholly-owned subsidiary of Prudential plc, holds a Capital Markets Services (“CMS”) licence, to conduct the regulated activities of fund management and dealing in securities, issued by the Monetary Authority of Singapore under the Securities and Futures Act, Chapter 289 of Singapore. PAMS is also an exempt financial adviser under the Financial Advisers Act, Chapter 110 of Singapore. PAMS is included under the Central Provident Fund Investment Scheme (“CPFIS”) and may manage unit trusts included under the CPFIS. In addition, PAMS is registered with the Securities and Exchange Commission, US, under the Investment Advisers Act of 1940; the Financial Services Commission of South Korea, as a Cross-border Investment Advisor under the Capital Market Consolidation Act and the Securities and Exchange Board of India (“SEBI”) under the SEBI (Foreign Institutional Investors) Regulations, 1995. Further, PAMS is relying on the Class Order Exemption CO 03/1102 from the Australian Securities and Investments Commission for exemption from the need to hold an Australian financial services licence for provision of services to wholesale clients in Australia.

Prudential Property Investment Management (Singapore) Pte. Ltd. (“Prupim SGP”) is an indirect wholly-owned subsidiary of Prudential plc. It is a real estate fund management company, and operates in Singapore as an exempt fund manager and exempt financial adviser under the Securities and Futures Act and the Financial Advisers Act respectively.

As an exempt fund manager and exempt financial adviser, Prupim SGP provides services to not more than 30 qualified investors (for fund management services) and accredited investors (for financial advisory services).

As a company registered under the Singapore Insurance Act, AIA Singapore, is an exempt financial adviser under the Financial Advisers Act in relation to (a) advising others (other than advising on corporate finance within the meaning of the Securities and Futures Act), either directly or through publications or writings, or by issuing or promulgating research analyses or research reports, concerning life policies and (b) arranging of any contract of insurance in respect of life policies, other than a contract of reinsurance. As an exempt financial adviser, AIA Singapore is subject to certain conduct of business and other requirements applicable under the Financial Advisers Act and its related regulations, notices, guidelines, practice notes and codes.

As a company registered under the Singapore Insurance Act, AIA Singapore is also exempt under section 99(1)(d) the Securities and Futures Act from the requirement to hold a capital markets services licence in respect of fund management for the purpose of carrying out insurance business. On 30 September 2005, AIA Singapore notified the Monetary Authority of Singapore of its commencement of business in respect of dealing in securities and fund management. However, as AIA Singapore is exempt under section 99(1)(d) only in respect of fund management for the purpose of carrying out insurance business, it has commenced business under that section in respect of fund management for the purpose of carrying out insurance business. While the Securities and Futures Act does not specifically impose additional ongoing compliance requirements applicable to registered insurers who carry on activities regulated under the Securities and Futures Act, the Monetary Authority of Singapore has circulated draft amendments to the Securities and Futures (Licensing and Conduct of Business) Regulations that propose to apply certain regulations under the Securities and Futures (Licensing and Conduct of Business) Regulations to registered insurers who are exempt from holding a capital markets service licence in respect of their business in any regulated activity under the Securities and Futures Act (that is, fund management for the purpose of carrying out insurance business) as those provisions apply to the holder of a capital markets services licence.

### **Malaysia**

Prudential Fund Management Berhad (“PFMB”) was incorporated in November 2000 and is a wholly-owned subsidiary of a Malaysian incorporated company, Nova Sepadu Sdn Bhd, which is in turn a subsidiary of the Prudential Group.

Prudential Al Wara’ Asset Management Berhad (“WARA”) was incorporated in June 2009 and is a wholly-owned subsidiary of Prudential Corporation Holdings Limited. WARA is an Islamic Shariah-compliant asset management company. Both PFMB and WARA are regulated by the Securities Commission (the “SC”), which is a statutory body formed under the Securities Commission Act 1993 (“SCA”) which reports to the Minister of Finance. It has the power to investigate and enforce the areas within its jurisdiction. Among many other things, SC regulates all matters relating to unit trust schemes and supervises licensed persons dealing in assets and fund management activities and products. The Guidelines on Unit Trust Funds issued by the SC set out requirements to be complied with by any person intending to establish a unit trust fund in Malaysia and issue, offer or invite any person to subscribe or purchase units of a unit trust fund. Underpinning all its functions is the SC’s ultimate responsibility of protecting the investor. Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia.

### **Dubai**

Prudential Asset Management Limited (“PAMD”) was incorporated in the Dubai International Financial Centre (“DIFC”) in September 2006. PAMD is an ultimately wholly-owned subsidiary of Prudential plc.

PAMD is regulated by the Dubai Financial Services Authority (“DFSA”), which is the independent regulator for DIFC. PAMD holds a licence for Dealing in Investments as Agent, Managing Assets, Arranging Credit or Deals in Investments, Advising on Financial Products or Credit, Arranging Custody, Operating a Collective Investment Fund, Providing Fund Administration and Operating an Islamic Window and has a Retail Endorsement on its licence.

The supervisory approach of DFSA, to a large extent, is risk-based.

### **Thailand**

The Office of the Securities and Exchange Commission of Thailand is responsible for licensing companies that deal in securities and also for regulating products and funds involving investment in securities, such as provident funds. AIA (Life) Thailand holds a Private Fund Licence, which enables it to provide provident fund management services, and a Securities Brokerage (Limited Broker Dealer and Underwriter) Licence, which enables it to sell investment-linked products.

As a branch of a foreign company, AIA (Life) Thailand is also regulated by the Department of Business Development of the Ministry of Commerce. AIA (Life) Thailand holds a foreign business licence certificate for the conduct of a provident fund management business. It does not require a foreign business licence or certificate for the conduct of a securities brokerage business.

## **Vietnam**

Prudential Vietnam Fund Management Private Limited Company (“PVN FMC”) was established and currently operates under Business Registration Certificate No. 410400113 issued by the Department of Planning and Investment of Ho Chi Minh City on 24 May 2005 and Licence No. 03/UBCK-GPHDQLQ dated 26 May 2005 and Decision No. 459/QD-UBCK dated 13 August 2007 by the State Securities Commission of Vietnam (SSC) for operation in securities investment fund management and securities portfolio management.

Prudential Vietnam Assurance Private Limited is the sole owner of PVN FMC.

PVN FMC is regulated by the State Securities Commission of Vietnam (“SSC”), which is overseen by the Ministry of Finance (“MOF”). Given its mandate, which is to establish and develop the securities markets, the SSC supervises the organisation, and operation of securities investment funds and fund management companies.

In late 2007, the Prudential Group also opened a separate consumer finance business in Vietnam authorised by the State Bank of Vietnam.

## **B. UK SUPERVISION AND REGULATION**

### *The Financial Services and Markets Act 2000*

The Prudential Group’s insurance and investment businesses in the United Kingdom are regulated by the FSA, the statutory regulator granted powers under the FSMA 2000. In addition, those businesses are subject to various United Kingdom laws (for example, the Data Protection Act 1998 in relation to the processing of customer data and various Pension Acts) some of which require the relevant Prudential entity to be licensed or registered.

### *Risk-based regulation*

The FSA employs a risk-based regulatory approach to supervision under the FSMA 2000 pursuant to which each regulated firm’s risk is assessed by the FSA using a risk assessment methodology known as ARROW (Advanced, Risk-Responsive Operating Framework). This is a high-level review aimed at assessing the significance of a particular risk posing threats to the FSA’s statutory objectives under the FSMA 2000. These objectives relate to maintaining market confidence, the protection and enhancement of the stability of the UK financial system, promoting public awareness, securing consumer protection and the reduction of financial crime.

The ARROW framework, supported by a ‘close and continuous’ relationship, is the core of the FSA’s risk-based approach to regulation. Using this process, the FSA will consider the particular risks a firm might pose to its statutory objectives by assessing the impact and probability of particular risks materialising.

Prudential is regarded by the FSA as a high impact firm in view of the nature and complexity of its business and as such receives ARROW assessments at least once in every two-year regulatory period. The last ARROW assessment across the Prudential Group (including Prudential UK) was conducted in July 2008, and the final letter setting out the results of the assessment and the accompanying Risk Mitigation Program which sets out the intended outcomes and follow-up work associated with the assessment was received by the Prudential Group in December 2008. An updated version was provided (for both the Prudential Group and UK businesses) in October 2009. The FSA has informed Prudential that, in light of the Acquisition and the differences between the Enlarged Group and the existing Prudential Group, the next cycle of ARROW activity is likely to be deferred so as to commence towards the end of 2010.

Between ARROW visits, the FSA meets regularly with members of senior management and persons holding controlled functions to understand developing strategy and challenges and key issues arising and in particular any significant risks identified and how the Prudential Group is mitigating these. This ‘close and continuous’ monitoring is supported by focused (relating to a firm or group) and themed (relating to the industry or market as a whole) visits where appropriate. In advance of discussions, the FSA request relevant mandatory management information at prescribed intervals, which helps to frame the agenda for these meetings.

### *Overview of FSMA 2000 regulatory regime*

#### Single regulator

The FSA is currently the single regulator for all authorised persons with respect to regulated activities in the financial services sector. In this regard, the FSA is authorised to make rules and issue guidance in relation to a wide sphere of activity encompassing the governance of a firm, the way it conducts its business and the prudential supervision of firms.

### Permission to carry on “Regulated Activities”

Under the FSMA 2000, no person may carry on or purport to carry on a regulated activity by way of business in the United Kingdom unless he is an authorised person or is an exempt person. A firm which is authorised by the FSA to carry on regulated activities becomes an authorised person for the purposes of the FSMA 2000. “Regulated activities” are currently prescribed in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended) and include insurance and investment business, as well as certain other activities such as establishing, operating and winding up stakeholder or personal pension schemes, the mediation of general insurance and certain mortgage mediation and lending activities. When authorising a firm, the FSA will limit the permissions it grants to the regulated activities in which the firm is intending to engage.

### Authorisation procedure

In granting an application by a firm for authorisation, the FSA may delineate the scope of, and include such restrictions on, the grant of permission as it deems appropriate. In granting or varying the terms of a firm’s permissions, the FSA must ensure that the firm meets certain threshold conditions, which, among other things, require the firm to have adequate resources for the carrying on of its business, and to be a fit and proper person, having regard to all the circumstances.

Once authorised, and in addition to continuing to meet the threshold conditions for authorisation, firms are obliged to comply with the FSA’s “Principles for Businesses”, which are high level principles for conducting financial services business in the United Kingdom.

Moreover, the FSMA 2000 obliges firms to secure the FSA’s prior approval of the appointment of individuals performing certain important functions within a firm or on its behalf with respect to the carrying on of regulated activities (approved persons).

### Principles for Businesses

An authorised firm will be subject to a range of ongoing regulatory requirements from the FSA, including compliance with general principles as well as more specific conduct of business rules and financial resources requirements. A key feature of the FSA regime is the existence of 11 “Principles for Businesses”, by which all firms are expected to abide. These cover key areas such as the firm’s relationship with the FSA and the need to act with integrity as well as to treat customers fairly.

In the wake of the recent financial crisis, the FSA has announced and has followed a new strategy of “intensive supervision” and a move to what it has described as “outcomes-focused regulation”. This has been coupled with a publicly announced strategy of “credible deterrence”, involving an increased focus on its enforcement activities.

### ***Application of FSMA 2000 regulatory regime to the Prudential Group***

Each of the Prudential Group’s principal UK insurance and investment businesses is subject to regulation and supervision by the FSA in the carrying on of its regulated activities. The following discussion considers, in turn, the main features of the FSMA 2000 regime applicable to the Group’s insurance and investment businesses in the United Kingdom.

### ***Regulation applicable to the Prudential Group’s insurance and investment businesses***

#### Supervision of management and change of control of authorised firms

The FSA closely supervises the management of authorised firms through the “approved persons” regime, under which any appointment of persons who hold a “controlled function” including functions that enable the exercise of significant influence over an authorised firm must be preapproved by the FSA.

The FSA also regulates the acquisition and increase of control over UK authorised firms. Under the FSMA 2000, any person proposing to acquire control of or increase control over an authorised firm must first obtain the consent of the FSA. The assessment process and assessment criteria for this process are set out in the FSMA 2000. In considering whether to grant or withhold its approval to the acquisition of control, the FSA must consider, among other things, the suitability of the person seeking consent and seek to ensure the sound and prudent management of the UK authorised person.

“Control” for these purposes includes a holding of 10% or more in the share capital or entitlement to 10% or more of the exercise of voting power of an authorised firm or its parent undertaking. When determining a person’s level of control, that person’s holding of shares or entitlement to exercise voting power will be aggregated with the holdings

or entitlements of any person with whom he is “acting in concert”. A person will be treated as increasing his control over an authorised firm, and therefore requiring further approval from the FSA, if the level of his shareholding or entitlement to voting power in the authorised firm or, as the case may be, its parent undertaking, increases by any threshold step. The threshold steps occur on the acquisition of 10%, 20 %, 30% and 50% of the shares or voting power in an authorised firm or its parent undertaking.

The Acquisitions Directive was introduced across the EU on 21 March 2009, establishing EU-wide procedural and evaluation criteria for the prudential assessment of acquisitions and increases of holdings in the financial sector. The Financial Services and Markets Act 2000 (Controllers) Regulations 2009 gave effect to the Acquisitions Directive in the UK by making various changes to the FSMA 2000.

### Intervention and enforcement

The FSA has extensive powers to investigate and intervene in the affairs of an authorised firm. The FSMA 2000 imposes on the FSA statutory obligations to monitor compliance with the requirements imposed by, and to enforce the provisions of, the FSMA 2000, related secondary legislation and the rules made thereunder.

The FSA’s enforcement powers, which may be exercised against both authorised firms and approved persons, include public censure, imposition of unlimited fines and, in serious cases, the variation or revocation of permission to carry on regulated activities or of an approved person’s approved status. In addition, the FSA may vary or revoke an authorised firm’s permission if it is desirable to protect the interests of consumers or potential consumers, or if the firm has not engaged in regulated activity for 12 months, or if it is failing (or is likely to fail) to meet the threshold conditions for authorisation. The FSA has further powers to obtain injunctions against authorised persons and to impose or seek restitution orders where persons have suffered loss. Once the FSA has made a decision to take enforcement action against an authorised or approved person (other than in the case of an application to the court for an injunction or restitution order), the person affected may refer the matter to the Financial Services and Markets Tribunal. Breaches of certain FSA rules by an authorised firm may also give a private person who suffers loss as a result of the breach a right of action against the authorised firm for damages.

In addition to its ability to apply civil sanctions for market abuse, the FSA has the power to prosecute criminal offences arising under the FSMA 2000, insider dealing under Part V of the Criminal Justice Act 1993 and breaches of money laundering regulations. The FSA has indicated that it is prepared to prosecute more cases in the criminal courts where appropriate.

The FSA, although not a creditor, may seek administration orders under the Insolvency Act 1986 (as amended), present a petition for the winding-up of an authorised firm or have standing to be heard in the voluntary winding-up of an authorised firm. It should be noted that insurers carrying on long-term insurance business cannot voluntarily be wound up without the consent of the FSA.

### FSA Conduct of Business Rules

The FSA’s Conduct of Business Rules apply to every authorised firm carrying on regulated activities and regulate the day-to-day conduct of business standards to be observed by authorised persons in carrying on regulated activities. The Conduct of Business Rules incorporate the requirements of the Markets in Financial Investments Directive (“MiFID”) which relate to investment business, and now place greater reliance on principles and higher-level rules.

The scope and range of obligations imposed on an authorised firm under the Conduct of Business Rules varies according to the scope of its business and the range of its clients. Generally speaking, however, the obligations imposed on an authorised firm by the Conduct of Business Rules will include the need to classify its clients according to their level of sophistication, provide them with information about the firm, meet certain standards of product disclosure, ensure that promotional material which it produces is clear, fair and not misleading, assess suitability when advising on certain products, manage conflicts of interest, report appropriately to its clients and provide certain protections in relation to client assets.

### Treating Customers Fairly

The FSA’s Treating Customers Fairly initiative (“TCF”) is an important example of its principles-based approach to regulation. This initiative is based upon Principle 6 of the FSA’s Principles for Businesses (that a firm must pay due regard to the interests of its customers and treat them fairly).

Although the FSA has, with the exception of rules relating to with-profits policyholders, refrained from making detailed rules on how to comply with TCF, it has published a number of case studies providing an indication of its

expectations of authorised firms in the areas of product development, complaints handling, financial promotions and systems and controls. TCF assessments of firms will be incorporated into the ARROW assessment process.

### Prudential supervision

As set out above, in order to maintain authorised status under the FSMA 2000, a firm must continue to satisfy the threshold conditions, which, among other things, require the firm to have adequate resources for the carrying on of its business. The FSA has published detailed rules relating to the maintenance of minimum levels of regulatory capital for all authorised firms including insurance and investment businesses in the Prudential Standards section of its Handbook. The capital adequacy requirements set out in the Handbook which include the type of capital held must be satisfied at all times by authorised firms.

The FSA's regulatory capital rules for insurers and investment firms are primarily contained in the FSA's General Prudential Sourcebook ("GENPRU"), Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") and Prudential Sourcebook for Insurers ("INSPRU"). Although it has been the intention in recent years of the FSA to move towards a unified prudential regime for FSA authorised firms, the FSA has been obliged to revise this approach and its rules to accommodate developments at an international level, including EU legislation relating to the regulatory capital requirements for investment firms and financial groups.

### The Financial Ombudsman Service

Authorised firms must have appropriate complaints handling procedures and the principles of complaints handling are defined in the FSA Handbooks. However, once these procedures have been exhausted, qualifying complainants may turn to the Financial Ombudsman Service which is intended to provide speedy, informal and cost-effective dispute resolution of complaints made against authorised firms by individuals and small-business customers. The Ombudsman is empowered to order firms to pay fair compensation for loss and damage and may order a firm to take such steps as the Ombudsman determines to be just and appropriate in order to remedy a complaint. The Financial Ombudsman Service is funded by levies and case fees payable by businesses covered by the Ombudsman.

### The Financial Services Compensation Scheme ("FSCS")

The FSCS is intended to compensate individuals and small businesses for claims against an authorised firm where the authorised firm is unable or unlikely to be able to meet those claims (generally, when it is insolvent or has gone out of business). The scheme is divided into five sub-schemes of deposits, investments, insurance mediation, insurance business (life and general) and home finance, reflecting the different kinds of business undertaken by authorised firms. The scheme is funded by contributions from industry participants referable to the particular sub-schemes so as to minimise cross-subsidy between authorised persons whose businesses are not similar. The recent defaults by a number of deposit-takers have led to a large payout by the FSCS, which have been funded mainly by loans from the Bank of England and HM Treasury to the FSCS. The interest costs on the loans will be funded out of the deposits sub-scheme alone. However, the repayment of the loans is likely to be funded to an extent by the 'general pool' with such payments commencing 2011/12. The 'general pool' is in part funded by levies on the Insurance sub-scheme in which Prudential sits.

The FSA has committed to start a comprehensive review of the FSCS funding model and intends to consult with firms and other relevant industry bodies in 2010/2011.

### ***Regulation of insurance business***

Effecting and carrying out contracts of insurance as principal are regulated activities for the purposes of the FSMA 2000, and the carrying on of such regulated activities is referred to as insurance business. Some of Prudential's subsidiaries, including PAC, Prudential Annuities Limited, Prudential Retirement Income Limited, Prudential Pensions Limited, Prudential Holborn Life Limited and Prudential (AN) Limited carry on insurance business in the United Kingdom with the permission of the FSA and are regulated by the FSA under the FSMA 2000.

### Conduct of business requirements for insurance business

The Conduct of Business rules issued by the FSA apply differing requirements to the sale of general and long-term insurance contracts, as well as applying certain requirements to transactions in other designated investments. Authorised firms which advise and sell to private customers packaged products such as life insurance policies are subject to detailed conduct of business obligations relating to product disclosure, assessment of suitability, the range and scope of the advice which the firm provides, and fee and remuneration arrangements.

The FSA launched a Retail Distribution Review (the “RDR”) in 2006 with the specific aim of improving the retail investment market. In June 2009 the FSA published a consultation paper containing proposals for implementing the RDR with proposals seeking to: (i) improve the clarity with which firms describe their services to consumers; (ii) address the potential for adviser remuneration to distort consumer outcomes; and (iii) increase the professional standards of advisers. Detailed proposals for enhancing the professionalism of investment advisers under the RDR were published by the FSA in December 2009 and a further consultation paper in this area is expected to be published in the third quarter of 2010. In relation to the first two elements of the RDR, on 26 March 2010 the FSA published a policy statement presenting final rules. These rules include requiring firms to describe services as either “independent” or “restricted” and updating the FSA’s rules on what is expected of a firm that describes its advice as being independent. The FSA is also proceeding with proposals to introduce a system of “Adviser Charging”, which will involve all firms that give investment advice to retail clients setting their own charges. Once the rules come into effect, adviser firms will no longer be able to receive commissions set by product providers in return for recommending their products, but will have to operate their own charging tariffs in accordance with the FSA’s new rules. The proposals are expected to take effect at the end of 2012.

### Capital requirements for insurers

The FSA’s rules which govern the prudential regulation of insurers are found in INSPRU, GENPRU and the Interim Prudential Sourcebook for Insurers (“IPRU (INS)”). Overall, the requirements of GENPRU are intended to align the capital adequacy requirements for insurance businesses more closely with those of banking and investment firms and building societies, for example, by addressing tiers of capital, rather than looking at net admissible assets. Solvency II, described further below, is the European Commission’s project to reform prudential regulation of insurers. A framework directive for the new regime was approved by the European Parliament on 22 April 2009, the final text was adopted by the European Council on 10 November 2009 and the planned implementation date for the regime is 31 October 2012.

The FSA’s rules now require an insurer to prepare and submit to the FSA its own assessment of its capital requirements, known as an individual capital assessment (“ICA”), based on the risks it faces. The FSA will use the ICA in order to form its own view of a firm’s capital requirements. If the FSA considers that the firm does not hold adequate capital resources, it will issue individual capital guidance (“ICG”) which it can impose as a requirement.

The rules also require that insurance companies maintain assets sufficient to meet the relevant capital requirement at all times in respect of both any long-term insurance and general insurance undertaken by the insurance company, the calculation of which requirement in any particular case being dependent on the type and amount of insurance business a company writes. The method of calculation of the capital requirement is set out in GENPRU and the level of an insurer’s capital resources is also determined in accordance with the rules set out in that Sourcebook. Failure to maintain the required capital resources requirement is one of the grounds on which wide powers of intervention conferred upon the FSA may be exercised.

Under the rules in GENPRU, an insurer must hold capital resources equal at least to the Minimum Capital Requirement (the “MCR”). Insurers with with-profits liabilities of £500 million or more must hold capital equal to the higher of MCR and the Enhanced Capital Requirement (the “ECR”). The ECR is intended to provide a more risk responsive and “realistic” measure of a with-profits insurer’s capital requirements, whereas the MCR is broadly speaking equivalent to the previously required minimum margin under the IPRU (INS) and satisfies the minimum EU standards.

Determination of the ECR involves the comparison of two separate measurements of the firm’s financial resources requirements, which the FSA refers to as the “twin peaks” approach. The term twin peaks is meant to reflect the fact that capital is determined by reference to the higher of the two bases for calculating liabilities (regulatory or realistic). The regulatory basis reflects strict contractual liabilities whereas the realistic one includes more discretionary but expected benefits, including those required to treat customers fairly.

Long-term business assets and liabilities — those assets and liabilities relating to, broadly, life and health insurance policies — must be segregated from the assets and liabilities attributable to non-life insurance business or to shareholders. Separate accounting and other records must be maintained and a separate fund must be established to hold all receipts of long-term business.

The extent to which long-term fund assets may be used for purposes other than long-term business is restricted by the rules in INSPRU. Only the “established surplus”—the excess of assets over liabilities in the long-term fund, as determined by an actuarial investigation — may be transferred so as to be available for other purposes. Restrictions also apply to the payment of dividends by the insurance company, as described below. The rules in INSPRU require,

in addition to the capital requirements referred to above, the maintenance of sufficient assets in the separate long-term insurance fund to cover the actuarially determined value of the insurance liabilities.

### Actuarial functions

The rules in the FSA's Supervision Manual require that every insurance company that carries on long-term business must appoint one or more actuaries to perform the "actuarial function" in respect of all classes of its long-term insurance business and, if it has any with-profits business, the "with-profits actuary function" in respect of all classes of that with-profits business.

The actuary performing the "actuarial function" must prepare at least annually, a report for the company's directors quantifying the company's long-term liabilities attributable to the insurance company's long-term insurance business, determining the value of any excess over those liabilities of the assets representing the long-term insurance fund and, where any rights of long-term policyholders to participate in profits relate to particular parts of such a fund, a valuation of any excess of assets over liabilities in respect of each of those parts.

The actuary performing the "with-profits actuary function" must advise the firm's management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the with-profits business of the firm in respect of which he has been appointed. He must also, at least once a year report to the firm's governing body on key aspects (including those aspects of the firm's application of its Principles and Practices of Financial Management ("PPFM") on which the advice described has been given) of the discretion exercised in respect of the period covered by his report affecting those classes of with-profits business of the firm.

All firms that carry out with-profits business are required to publish the PPFM that are applied in the management of their with-profits funds.

### Distribution of profits and with-profits business

The Interim Prudential Sourcebook for Insurers provides that, once an allocation of surplus in a with-profits fund has been made to policyholders, no transfer of assets representing any part of a subsequent surplus can be made, to shareholders or otherwise, unless either the "relevant minimum" (as defined in the Interim Prudential Sourcebook for Insurers) of the surplus has been allocated to policyholders or a statutory notification procedure has been followed. Calculation of the relevant minimum is based upon the percentage of the relevant surplus previously allocated to eligible policyholders.

There has been considerable public debate about the rights and legitimate expectations of with-profits policyholders to assets forming part of an insurance company's surplus, particularly where such assets do not derive from the payment of current policyholders' premiums but are rather "inherited" from previous generations of policyholders or from other entities. In 2008, the Treasury Select Committee of the House of Commons conducted an inquiry into the inherited estate held by life assurance companies, one of the recommendations of which was that the FSA consult on a redesign of the regulatory system for with-profits funds.

The FSA confirmed in July 2009 that proprietary life insurance companies will not be able to meet future compensation and redress payments from their with-profits funds. Following two previous consultations, the FSA confirmed a rule change meaning that liabilities arising from operational failures (including mis-selling) after the rule came into effect from 31 July 2009 should be met by shareholder funds rather than policyholder funds. Under FSA rules prior to 31 July 2009, compensation and redress could be paid from assets attributable to shareholders or from the inherited estate of a firm's with-profits fund (if any).

### Treating Customers Fairly and with-profits business

One of the areas of focus of the FSA's TCF initiative has been with-profit business. The FSA has issued specific rules on this area in relation to with-profits policyholders, which address, among other things, the costs charged to a with-profits fund by the firm managing the fund; penalties and charges levied on policyholders who surrender their policies early, the need for funds to be managed with the objective of ensuring that maturity payouts fall within a target range set for the fund; and the provision of information to with-profits policyholders or potential policyholders in a format that they can more readily understand—through the introduction of "Consumer Friendly Principles and Practices of Financial Management" ("CFPPFMs").

### Reporting requirements

The main financial reporting rules for insurers are contained in the Interim Prudential Sourcebook for Insurers. Insurance companies must file a number of items with the FSA, including their audited annual accounts and balance

sheets and life insurers annual reports from the actuary performing the actuarial function. Returns enumerating policy sales are submitted by firms, including insurance companies on a quarterly basis. Non-insurance companies must also file quarterly returns which include details of sales, numbers of advisers, tests of capital adequacy, balance sheets and profit and loss accounts.

#### Transfer of insurance business

Before any transfer of insurance business may take place, the FSMA 2000 requires a scheme of transfer to be prepared and approved by the High Court.

#### Winding-up rules

The general insolvency laws applicable to UK companies are modified in certain respects in relation to insurance companies. Since the introduction of the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 (the “2002 Order”), now amended, insurance companies in the United Kingdom have been subject, with some modifications, to the administration regime contained in Part II of the Insolvency Act 1986.

Additionally, in the United Kingdom, all FSA authorised insurance companies, except for pure reinsurers, are subject to the Insurers (Reorganisation and Winding-up) Regulations 2004 (as amended).

These Regulations provide, among other things, that direct insurance claims will have priority over the claims of other unsecured creditors (with the exception of preferred creditors), including reinsurance creditors, on a winding-up by the court or a creditors’ voluntary winding-up of the insurance company. Furthermore, instead of making a winding-up order when an insurance company has been proved unable to pay its debts, a UK court may, under section 377 of the FSMA 2000, reduce the amount of one or more of the insurance company’s contracts on terms and subject to conditions (if any) which the court considers fit. Where an insurance company is in financial difficulties but not in liquidation, the FSCS may take measures for securing the transfer of all or part of the business to another insurance company.

Section 376 of the FSMA 2000 provides further insolvency protection to policyholders of insurance companies effecting or carrying out contracts of long-term insurance. Unless the court orders otherwise, a liquidator must carry on the insurer’s business so far as it consists of carrying out the insurer’s contracts of long-term insurance with a view to it being transferred as a going concern to a person who may lawfully carry out those contracts. In carrying on the business, the liquidator may agree to the variation of any contracts of insurance in existence when the winding-up order is made, but must not effect any new contracts of insurance.

#### EU Directives on groups

The Prudential Group is subject to the capital adequacy requirements of the Insurance Groups Directive (“IGD”) as implemented in the FSA rules. The IGD pertains to groups whose activities are primarily concentrated in the insurance sector, and has applied to the Prudential Group from December 2007, following the sale of Egg Banking during 2007. Prior to this, the Prudential Group was required to meet the requirements of the Financial Conglomerates Directive (“FCD”) as implemented in the FSA rules, as the Prudential Group was classified as an insurance conglomerate.

The Prudential Group’s move during 2007 from being treated as an insurance conglomerate to being treated as an insurance group under the FSA rules did not have a significant impact on the Prudential Group, as the FSA’s prudential requirements pertaining to insurance groups are very similar to those applying to insurance conglomerates.

As lead supervisor of the Prudential Group under the IGD, the FSA supervises the Prudential Group on a group basis in addition to supervising the UK insurance companies within the Prudential Group individually. This is referred to in the IGD as supplementary supervision and encompasses such matters as general supervision over intra-group transactions (including, inter alia, loans, guarantees and off-balance sheet transactions, investments, reinsurance, retrocession and cost sharing agreements), group risk management processes and internal control mechanisms, and reporting and accounting procedures. In accordance with the IGD, the FSA requires the calculation of group capital resources on a consolidated basis and requires that such group capital resources are equal to or in excess of the Prudential Group’s group capital resources requirement (each as calculated in accordance with INSPRU). As lead supervisor of the Prudential Group under the IGD, the FSA also plays a co-ordinating role amongst EU regulators under the IGD. Due to the geographically diverse nature of the Prudential Group’s operations, the application of these requirements to the Prudential Group is complex. In particular, for the purposes of calculating the group capital requirement and actual group capital resources under INSPRU, for many of the Asian operations, the assets,

liabilities and capital requirements have to be recalculated based on FSA regulations as if the companies were directly subject to FSA regulation.

### New EU solvency framework

The European Commission is continuing to develop a new prudential framework for insurance companies, 'the Solvency II project' that will update the existing life, non-life, re-insurance and insurance groups directives. The main aim of this framework is to ensure the financial stability of the insurance industry and protect policyholders through establishing solvency requirements better matched to the true risks of the business. Solvency II adopts a three-pillar approach to prudential regulation which is similar to the "Basel II" approach which has already been adopted in the banking sector in Europe. These pillars are quantitative requirements (Pillar 1); qualitative requirements (Pillar 2); and supervisory and reporting disclosure (Pillar 3).

Although the Solvency II directive has similarities to the current UK regime set out in GENPRU and INSPRU in terms of its risk-based approach to the calculation of capital resources requirements and use of capital tiering, there are also many differences both in terms of substance and terminology.

A key aspect of Solvency II is the focus on a supervisory review at the level of the individual legal entity. Insurers will be encouraged to improve their risk management processes and will be allowed to make use of internal economic capital models to calculate capital requirements if approved by the FSA. In addition, Solvency II requires firms to develop and embed an effective risk management system as a fundamental part of running the firm.

Solvency II is being developed in accordance with the Lamfalussy four-level process. The "Level 1" directive was formally approved by the European Parliament on 22 April 2009 and the final text was adopted by the European Council on 10 November 2009 and sets out a framework which will be supplemented by further and more detailed technical implementing measures at "Level 2". At "Level 3" non-binding standards and guidance will be agreed between national supervisors and at "Level 4" the European Commission will monitor compliance by Member States and take enforcement action as necessary. Separately to Solvency II, proposed changes to the European supervisory architecture, which are yet to be finalised, are likely to mean that, in addition, binding technical standards will be produced at "Level 3".

The European Commission expects to legally adopt Level 2 implementing measures by the end of 2011. The planned implementation date for the new regime is 31 October 2012.

### ***Regulation of investment business***

Certain of Prudential's subsidiaries are authorised by the FSA to carry on investment business. These entities are subject to regulation and supervision by the FSA and must comply with the FSA Conduct of Business and Prudential Rules made under the FSMA 2000.

### Conduct of business requirements for investment businesses and the Markets in Financial Instruments Directive ("MiFID")

MiFID, unlike its predecessor legislation, the Investment Services Directive, sets out detailed and specific requirements in relation to organisational and conduct of business matters for investment firms and regulated markets. In particular, MiFID and its implementing measures make specific provision in relation to, among other things, organisational requirements, outsourcing, client categorisation, conflicts of interest, best execution, client order handling and suitability and appropriateness, and investment research and financial analysis, pre- and post-trade transparency obligations and transaction reporting and make substantial changes to the responsibility for the supervision of cross-border investment services provided by firms in exercise of their single market passport rights.

### Capital requirements for investment businesses

The FSA's capital requirements for investment businesses are also contained in the Prudential Standards section of its Handbook, primarily in GENPRU and BIPRU. These rules implement the requirements of European Union legislation relating to the prudential supervision of investment firms, including the Capital Adequacy Directive (Directive 93/6/EEC), as re-cast by the Capital Requirements Directive (Directive 2006/49/EC).

### Liquidity requirements for investment businesses

In October 2009 the FSA published its final rules on the liquidity requirements expected of BIPRU firms, which are designed to enhance firms' liquidity risk management practices. The qualitative aspects of the new rules, which affect the systems and controls that firms are required to have in place to deal with liquidity risk, came into force on

1 December 2009. The quantitative aspects of the new rules are subject to staggered implementation. The rules require changes to firms' business models and include an updated quantitative regime (in the form of Individual Liquidity Adequacy Standards (ILAS)) coupled with a narrow definition of liquid assets, enhanced systems and control requirements and more frequent reporting requirements.

#### *Alternative Investment Fund Managers Directive (AIFMD)*

The European Commission has published a draft Alternative Investment Fund Managers Directive designed to regulate private equity and hedge funds. As currently drafted, the Directive may have significant consequences for funds which are not a "UCITS". This could, in turn, materially increase compliance and regulatory costs for certain funds.

The Directive is subject to consultation and potential revision and redrafting, so the final text remains uncertain and it is not expected to come into effect until 2011.

#### *US Supervision of M&G Investment Management*

One of the Prudential's UK subsidiaries, M&G Investment Management Limited, is also regulated by the United States' Securities and Exchange Commission (the "SEC") so that it can act as investment adviser to a number of US mutual funds.

#### *FSA Supervision Arrangements for the Enlarged Group*

Prudential has agreed arrangements with the FSA for the future supervision of the Enlarged Group. These arrangements are designed to meet the objective that the Enlarged Group has adequate capital and appropriate systems and controls judged against the Enlarged Group's business model and the risks associated with that business model. The arrangements reflect the FSA's intention to maintain a programme of pro-active supervisory engagement and dialogue with the management and control functions of the Enlarged Group. This will include periodic meetings between the FSA and senior management of the Enlarged Group and the regular delivery to the FSA of certain high level management information on the Enlarged Group's financial performance and on other matters, such as the Enlarged Group's capital and liquidity positions and risk management issues. After completion of the Acquisition the FSA will continue to act as lead supervisor of the Prudential Group and to exercise the supplementary group supervision under the IGD to which the Prudential Group is and will continue to be subject (see under "EU Directives on groups" above). The FSA will also undertake an enhanced level of consolidated supervisory oversight of the Enlarged Group and specifically of the combined Prudential Corporation Asia and the AIA Group. This will include additional visits to the operations of the Enlarged Group in Asia, additional information on those operations being provided to the FSA and detailed reviews of the Enlarged Group's governance, risk management and systems and controls in Asia. The FSA expects to have more frequent dialogue with Asian regulators on a bilateral basis. The FSA will also work closely with the Hong Kong OCI and other Asian regulators in the supervision of the Enlarged Group.

In addition, Prudential has agreed further supervisory arrangements with the FSA relating to the Enlarged Group's UK regulated firms. These will involve: (i) the appointment of at least two independent non-executive directors to the board of PAC; (ii) the transfer of the business of PAC's branch in Hong Kong to one or more non-UK Hong Kong regulated insurance companies in the Enlarged Group, subject to the agreement of the FSA and the Hong Kong OCI, including as to the terms of the split of the inherited estate, and to the completion of the Hong Kong court process by which this "domestication" of PAC's branch in Hong Kong will be achieved; (iii) a requirement that prior agreement is obtained from the FSA before PAC provides liquidity support to other members of the Enlarged Group; and (iv) regular monitoring and reporting to the FSA of actual and potential intra-group exposures of the UK regulated firms in the Enlarged Group. The FSA has also indicated that in the future it will be less likely to allow the UK regulated firms in the Prudential Group to take credit in their solo capital assessments for contingent capital support from elsewhere in the Prudential Group than is currently the case.

Prudential has agreed with the FSA that, in view of the risks associated with current market circumstances and the potential risks associated with the Acquisition, at, and for some time after, completion of the Acquisition it would be appropriate for Prudential to hold an enhanced level of capital. Prudential agreed that it would have, or would have a committed source of additional capital that would provide it with, group capital resources equal to not less than 150% of its group capital resources requirement (each as calculated according to the FSA's rules in INSPRU) after making allowance for certain stressed circumstances having occurred. The arrangements for financing the Acquisition (the Rights Issue, the issue of New Prudential Shares, Mandatory Convertible Notes and Tier 1 Notes to AIA Aurora, and the subordinated debt issued pursuant to the Bond Offerings or drawn under the Hybrid Capital Facility or subscribed for by AIA Aurora under the Subordinated Note Commitment Letter) and the contingent

subordinated debt financing facility described in section 5 of Part VI of this prospectus (*Information about the Enlarged Group*) are designed to ensure that this requirement is met.

## C. US AND BERMUDAN SUPERVISION AND REGULATION

### 1. US regulation

#### Overview

The Prudential Group conducts its US insurance activities through Jackson, a stock life insurance company licensed to transact its insurance business in, and subject to regulation and supervision by, the District of Columbia, the Cayman Islands and 49 of the 50 states. Jackson operates a subsidiary, Jackson National Life Insurance Company of New York, in the state of New York. The extent of such regulation varies, but most jurisdictions have laws and regulations governing the financial aspects of insurance companies, including standards of solvency, reserves, reinsurance and capital adequacy and the business conduct of insurance companies. In addition, statutes and regulations usually require the licensing of insurers and their agents and the approval of policy forms and related materials. These statutes and regulations in a US insurance company's state of domicile (Michigan in the case of Jackson) also regulate the investment activities of insurers.

Insurance regulatory authorities in the jurisdictions in which Jackson does business require it to file detailed quarterly and annual financial statements, and these authorities have the right to examine its operations and accounts. In addition, Jackson is generally subject to federal and state laws and regulations that affect the conduct of its business. New York and Michigan require their state insurance authorities to conduct an examination of an insurer under their jurisdiction at least once every five years. The New York insurance authorities completed a triennial examination of Jackson National Life of New York in 2010 for the examination period of 1 January 2006 through 31 December 2008. Michigan insurance authorities completed an examination of Jackson in 2010 for the period 1 January 2005 through 31 December 2008. Initial verbal feedback indicated that there were no material findings but the final examination reports have not yet been issued by either the Michigan or New York authorities.

Jackson's ability to pay shareholder dividends is limited under Michigan insurance law. The Commissioner of the Michigan Office of Financial and Insurance Regulation (the "Michigan Insurance Commissioner") may limit, or not permit, the payment of shareholder dividends if the Michigan Insurance Commissioner determines that an insurer's surplus, as regards policyholders, is not reasonable in relation to its outstanding liabilities and is not adequate to meet its financial needs as required by Michigan insurance law. Jackson must report any shareholder dividends to the Michigan Insurance Commissioner before they can be paid. In the case of an extraordinary shareholder dividend or distribution, an insurer may not pay the dividend or distribution until 30 days after the Michigan Insurance Commissioner has received notice of the declaration and has not disapproved, or has approved, the payment within that period. For this purpose, an extraordinary dividend or distribution means any dividend or distribution of cash or other property where the fair market value, together with that of other dividends or distributions that an insurer made within the preceding twelve months, exceeds the greater of 10% of the insurer's surplus, as regards policyholders as of 31 December of the immediately preceding year, or the net gain from operations of the insurer, not including realised capital gains, for the prior year. In 2007, 2008 and 2009, Jackson paid shareholder dividends of US\$246.0 million, US\$313.10 million, and US\$250.0 million, respectively.

State regulators also require prior notice or regulatory approval of changes in control of an insurer or its holding company and of certain material transactions with affiliates. Under New York and Michigan insurance laws and regulations, no person, corporation or other entity may acquire control of an insurance company or a controlling interest in any parent company of an insurance company, unless that person, corporation or entity has obtained the prior approval of the regulator. For the purpose of each of New York and Michigan law, any person acquiring, directly or indirectly, 10% or more of the voting securities of an insurance company is presumed to have acquired "control" of the company. To obtain approval of any change in control, the proposed acquirer must file an application with the New York Superintendent of Insurance or the Michigan Insurance Commissioner, as appropriate. This application requires the proposed acquirer to disclose, among other information, its background, financial condition, the financial condition of its affiliates, the source and amount of funds by which it will effect the acquisition, the criteria used in determining the nature and amount of consideration to be paid for the acquisition, proposed changes in the management and operations of the insurance company and other related matters. The Michigan Insurance Commissioner can grant an exemption from filing an application in an acquisition does not have the effect of changing or influencing control.

### **Guaranty associations and similar arrangements**

Each of the 50 states of the United States, the District of Columbia and the Commonwealth of Puerto Rico has laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. These associations and arrangements provide certain levels of protection to policyholders from losses under insurance policies issued by insurance companies that become impaired or insolvent. Typically, these associations levy assessments, up to prescribed limits, on member insurers on a basis that is related to the member insurer's proportionate share of the business in the relevant jurisdiction of all member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Some jurisdictions permit member insurers to recover assessments that they paid through full or partial premium tax offsets, usually over a period of years. The Prudential Group estimated its reserve for future guarantee fund assessments for Jackson to be £18.1 million (US\$26.0 million) at 31 December 2008. The Prudential Group estimated its reserve for future guarantee fund assessments for Jackson to be £15.4 million (US\$24.9 million) as at 31 December 2009. The Prudential Group believes this reserve to be adequate for all anticipated payments for known insolvencies.

### **Asset valuation reserve**

State regulators generally require that insurers establish an asset valuation reserve that consists of two components: a "default component" to provide for future credit-related losses on fixed income investments and an "equity component" to provide for losses on all types of equity investments. The asset valuation reserve establishes statutory reserves for fixed maturity securities, equity securities, mortgage loans, real estate and other invested assets. The reserve is designed to provide for a normalised level of future losses based on the credit rating of each individual investment. The level of reserves is based on both the type of investment and its rating. Contributions to the reserve may result in a slower growth in surplus or a reduction in Jackson's unassigned surplus, which, in turn, may reduce funds available for shareholder distributions. The extent of the impact of the asset valuation reserve on Jackson's statutory surplus depends in part on the future composition of the investment portfolio.

### **Interest maintenance reserve**

State regulators generally require that insurers establish an interest maintenance reserve to defer non-credit-related realised capital gains and losses, net of taxes, on fixed income investments (primarily bonds and mortgage loans) which are amortised into net income over the estimated remaining periods to maturity of the investments sold and to defer material gains or losses, net of taxes, resulting from market value adjustments on policies and contracts backed by assets carried at book value. The extent of the impact of the interest maintenance reserve on earnings and surplus depends on the amount of future interest rate-related realised capital gains and losses on fixed maturity investments and deferred gains or losses resulting from market value adjustments on policies and contracts backed by assets that are valued at book value.

### **The National Association of Insurance Commissioners ratios**

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners annually calculates 12 financial ratios to assist state regulators in monitoring the financial condition of insurance companies. A usual range of results for each ratio is used as a benchmark and departure from the usual range on four or more of the ratios can lead to inquiries from individual state insurance departments. In 2009, all of Jackson's ratios fell within the usual range. In 2008, Jackson had one ratio fall outside the usual range for which there were no regulatory consequences.

### **Policy and contract reserve sufficiency analysis**

State insurance laws require life insurance companies to conduct annually an analysis of the sufficiency of its life and annuity reserves. A qualified actuary must submit an opinion that states that the reserves, when considered in the light of the assets that an insurance company holds with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurance company. If a qualified actuary cannot provide such an opinion, then the insurance company must set up additional reserves by moving funds from surplus. The 2009 opinion has been submitted to the Michigan Office of Financial and Insurance Regulation without any qualifications.

### **Jackson's capital and surplus**

Michigan insurance law requires Jackson, as a domestic stock life insurance company, to maintain at least US\$7,500,000 in unimpaired capital and surplus. In addition, insurance companies are required to have sufficient capital and surplus to be safe, reliable and entitled to public confidence. As a licensed insurer in the District of

Columbia and every state but New York, where it operates through a subsidiary, Jackson is subject to the supervision of the regulators of each jurisdiction. In connection with the continual licensing of Jackson, regulators have discretionary authority to limit or prohibit the new issuance of business to policyholders when, in their judgement, the regulators determine that such insurer is not maintaining minimum surplus or capital or if the further transaction of business will be hazardous to policyholders. Jackson has received approval from the Michigan Office of Financial and Insurance Regulation regarding the use of a permitted accounting practice. This permitted practice allows Jackson to carry interest rate swaps at book value as if statutory hedge accounting were in place instead of at fair value as would have been otherwise required. The permitted practice is effective 31 December 2009 and expires 1 October 2010, unless extended by the Michigan Insurance Commissioner. The effects of this permitted practice may not be considered by the company when determining the surplus available for dividends, nor the nature of dividends as ordinary or extraordinary.

### **Risk-based capital**

The National Association of Insurance Commissioners has developed risk-based capital standards for life insurance companies as well as a model act for state legislatures to enact. The model act requires that life insurance companies report on a formula-based, risk-based capital standard that they calculate by applying factors to various asset, premium and reserve items. The formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk and business risk. The National Association of Insurance Commissioners designed the formula as an early warning tool to identify potentially inadequately capitalised companies for purposes of initiating regulatory action. The National Association of Insurance Commissioners intended the formula as a regulatory tool only and did not intend it as a means to rank insurers generally. The model act imposes broad confidentiality requirements on those engaged in the insurance business (including insurers, agents, brokers and others) and on state insurance departments as to the use and publication of risk-based capital data.

Any state adopting the model act gives the state insurance commissioner explicit regulatory authority to require various actions by, or take various actions against, insurance companies whose adjusted capital does not meet minimum risk-based capital standards. The Michigan Office of Financial and Insurance Regulation takes into account the National Association of Insurance Commissioners' risk-based capital standards to determine compliance with Michigan insurance law.

At 31 December 2009, due in part to the permitted practice noted in "Jackson's Capital and Surplus" above, Prudential's total adjusted capital under the National Association of Insurance Commissioners' definition substantially exceeded Michigan standards.

### **Regulation of investments**

Jackson is subject to state laws and regulations that require diversification of its investment portfolio, limit the amount of investments in certain investment categories such as below investment grade fixed income securities, common stock, real estate and foreign securities and forbid certain other types of investments altogether. Jackson's failure to comply with these laws and regulations would cause investments exceeding regulatory limitations to be treated by the Michigan Insurance Commissioner as non-admitted assets for purposes of measuring surplus and, in some instances, the Michigan Insurance Commissioner could require divestiture of non-qualifying investments.

### **USA Patriot Act**

The USA Patriot Act, enacted in 2001, includes numerous provisions designed to fight international money laundering and to block terrorist access to the US financial system. The US Treasury Department has issued a number of regulations implementing the Patriot Act that apply certain of its requirements to financial institutions including broker dealers and insurance companies. Among other things, the regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. Jackson and, to the extent applicable, certain of its affiliates, has established policies and procedures to ensure compliance with the Patriot Act's provisions and the Treasury Department regulations.

### **Securities laws**

Jackson, certain of its affiliates and certain policies and contracts that Jackson issues are subject to regulation under the federal securities laws administered by the US Securities and Exchange Commission ("the SEC".)

The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations. Jackson may also be subject to similar laws and regulations in

the states in which it provides investment advisory services, offers the products described above or conducts other securities-related activities.

Jackson National Asset Management, LLC (“JNAM”) is registered with the SEC as an investment adviser pursuant to the Investment Advisers Act of 1940, as amended (the “Investment Advisers Act”). JNAM is registered as a transfer agent pursuant to the Securities Exchange Act of 1934, as amended (the “Securities Exchange Act”). The investment companies (mutual funds) for which JNAM serves as an investment adviser are subject to SEC registration and regulation pursuant to the Securities Act of 1933, as amended (the “Securities Act”), and the Investment Company Act of 1940, as amended (the “Investment Company Act”). In addition, each variable annuity and variable life product sponsored by Jackson is subject to SEC registration and regulation pursuant to the Securities Act and the Investment Company Act, and applicable state insurance and securities laws. Each variable annuity and variable life product are organised as separate accounts that are unit investment trusts.

Curian Capital, LLC and Jackson Investment Management LLC are registered with the SEC pursuant to the Investment Advisers Act and are also registered or notice filed in all applicable states.

Curian Clearing, LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Curian Clearing, LLC is a member firm of the Financial Industry Regulatory Authority (the “FINRA”).

Jackson National Life Distributors, LLC is registered as a broker-dealer with the SEC pursuant to the Securities Exchange Act, and is registered as a broker-dealer in all applicable states. In addition, Jackson National Life Distributors, LLC is a member firm of the FINRA.

National Planning Holdings, Inc. (“NPH”) owns four retail broker dealers, being IFC Holdings, Inc. (doing business as INVEST Financial Corporation) (“IFC”), Investment Centers of America, Inc (“ICA”), National Planning Corporation (“NPC”) and SII Investments, Inc. (“SII”). These entities are registered as broker-dealers, investment advisers, and insurance agencies (or affiliated with insurance agencies), and are licensed and qualified to transact business pursuant to their respective registration on licensure with the SEC and state securities and insurance authorities, and membership with FINRA and the Municipal Securities Rulemaking Board. NPC, SII, and ICA are also members of the National Futures Association (“NFA”). Membership of the NFA is required for commodities and futures trading.

The Group also conducts certain of its US institutional investment management activities through PPM America, Inc., which is registered with the SEC as an investment adviser under the Investment Advisers Act. PPM America serves as the investment adviser to Jackson and as an adviser or sub-adviser to other US, UK and Asian entities affiliated with Prudential, other institutional clients such as CDOs or similar structured vehicles and private investment funds (in which PPM America affiliates such as Prudential UK entities and Jackson are generally investors), US mutual funds and other foreign-pooled investment vehicles primarily sponsored by affiliated entities, UK based unit trusts or OEICs, a SICAV and similar vehicles sponsored by affiliates, unaffiliated US and foreign institutional accounts, as well as a limited number of trusts of individuals and their family members. Currently, only a limited number of PPM America clients are unaffiliated or have underlying investors who are unaffiliated institutions, trusts or individuals. The US mutual funds for which PPM America serves as sub-adviser are subject to regulation under the Securities Act and the Investment Company Act, and other similar vehicles organised outside of the US may also be subject to regulation under applicable local law.

PPM America and certain of its subsidiaries are subject to various levels of regulation under the federal securities laws that the SEC administers as well as state securities laws. In connection with providing investment advisory services to certain of its clients, PPM America may also be subject to regulation under applicable foreign laws.

To the extent that PPM America or the NPH broker-dealers maintain accounts with assets of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (“ERISA”), or the Internal Revenue Code, they may be subject to certain restrictions imposed by ERISA or the Internal Revenue Code. Such restrictions are summarised in “Employee Benefit Plan Compliance” in the Section below. The US Department of Labor (the “Department of Labor”) and the US Internal Revenue Service have interpretive and enforcement authority over the applicable provisions of ERISA and the Internal Revenue Code.

### **Employee benefit plan compliance**

Jackson issues certain types of general account stable value products, such as GICs and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. Many of these plans are retirement plans that are subject to the fiduciary standards of ERISA and that are tax-qualified under the Internal

Revenue Code. As such, Jackson may be subject to certain restrictions imposed by ERISA and taxes imposed by the Internal Revenue Code. These restrictions include:

- the requirement under ERISA that fiduciaries must perform their duties solely in the interests of ERISA plan participants and beneficiaries,
- the requirements under ERISA that fiduciaries may not engage in “conflict of interest” transactions, and
- the requirements under ERISA that a fiduciary may not cause a covered plan to engage in certain “prohibited transactions” with certain persons who provide services to the plan or are affiliated with the plan sponsor or a plan service provider.

In general, the Internal Revenue Code imposes taxes on persons involved in certain of the transactions described above.

The Department of Labor and the Internal Revenue Service have interpretive and enforcement authority over the applicable provisions of ERISA and the Internal Revenue Code.

In the instance where an insurer issues a guaranteed benefit policy to a plan, ERISA provides that the insurer need not become a fiduciary with respect to the plan solely as a result of the issuance of the policy. Under Section 401 of ERISA, a guaranteed benefit policy means an insurance policy to the extent such policy provides for benefits the amount of which the insurer guarantees.

In 1993, in *John Hancock Mutual Life Insurance Company v. Harris Trust & Savings Bank*, the US Supreme Court held that a portion of the funds held under a certain type of general account annuity contract did not constitute a “guaranteed benefit policy” within the meaning of ERISA, a holding which potentially exposes insurers with similar types of contracts to the application of ERISA’s fiduciary and prohibited transaction provisions in connection with the management of assets in their general accounts.

Although no assurances can be given, Jackson believes that none of its contracts is of the type to which the holding in *Harris Trust* would be applicable. Moreover, the Department of Labor has issued PTE 95-60, which generally exempts external, unaffiliated investment transactions from ERISA’s prohibited transaction provisions. If the *Harris Trust* holding is applied to its contracts, Jackson would be subject to ERISA’s fiduciary and prohibited transaction provisions described above.

### **Financial services regulatory and legislative issues**

Proposals to change the laws and regulations governing the financial services industry are frequently introduced in the US Congress, in the state legislatures and before the various regulatory agencies. The likelihood and timing of any proposals or legislation, and the impact they might have on Jackson, its subsidiaries, or other Prudential subsidiaries doing business in the US, cannot be determined at this time.

State legislatures and/or state insurance regulatory authorities frequently enact laws and/or regulations that significantly affect insurers supervised by such authorities. Although the US federal government does not directly regulate the insurance business, federal initiatives may also have an impact on the insurance industry.

Within the US government, the US Senate continues work to achieve a bipartisan financial regulatory reform bill. Senator Christopher Dodd, Chairman of the Senate Banking Committee presented his financial reform proposal entitled “Restoring American Financial Stability Act of 2010” on 15 March 2010, and the bill was passed out of the Senate Banking Committee on 22 March 2010, Negotiations among Senate members continue, and substantial amendment of the proposal is expected, but the current view is that the proposal will pass sometime between May and August 2010.

The proposal creates a “Financial Stability Oversight Council” that will identify large, interconnected bank holding companies or non-bank financial companies, including insurers and their holding companies, whose distress or failure could threaten the financial stability of the US. Such firms would be subject to a higher degree of regulatory scrutiny. The proposal also creates an “Orderly Liquidation Fund” and, while large insurers with consolidated assets exceeding \$50 billion could be required to pay into the fund, all insolvent insurers would be rehabilitated or liquidated under State law. There is a possibility that the legislation will be amended so that insurers are exempted from paying the fund assessments. The proposal also creates an “Office of National Insurance” whose primary responsibility will be to serve as a federal public policy resource on insurance issues, and represent the US on international insurance matters. This provision is not expected to be substantially amended.

Many Democrats support the Obama Administration’s proposal for an independent Consumer Financial Protection Agency, but several Republicans strongly oppose this idea and have suggested housing a new consumer protection entity within the Federal Reserve or the Federal Deposit Insurance Corporation. The Senate Banking Committee Chairman’s tentative embrace of housing this entity within the Federal Reserve met with particularly sharp criticism

from several Senate Banking Committee Democrats. These Senators, along with the House Financial Services Committee Chairman, objected to giving additional consumer responsibility to the Federal Reserve.

The US President has in the past proposed to increase the taxes levied against the insurance industry to increase the federal budget revenues. In February 2009, President Obama proposed a 2.9% tax on so-called unearned income from certain investments, including annuities. The industry has been very successful in resisting these proposals on the grounds that an increase in taxes on insurance companies or insurance policies would have a negative affect on US citizens saving for their retirement. The insurance industry is very vigilant in monitoring these proposals and taking action to oppose them, as well as to support proposals that would provide more favourable tax treatment for certain annuity products.

A coalition of national insurance and banking organisations has supported the introduction of US federal legislation that would allow insurance companies to obtain a federal charter as a regulatory alternative to a state charter. A coalition of insurers has been formed that is opposed to the so-called optional federal charter. Prudential cannot predict whether any federal charter or any other federal (or state) legislative initiative to change the nature or scope of the regulation of the insurance industry will be enacted into law.

Federal and state regulators have focused on the mutual fund and variable annuity and insurance product industries including the broker-dealer system. As a result of publicity relating to widespread perceptions of industry abuses, including fraudulent and anti-competitive practices among insurance brokers and mutual funds, there have been numerous regulatory inquiries and proposals for legislative and regulatory reforms. It is difficult to predict at this time whether changes resulting from industry investigations and/or new laws and regulations will affect the Group's insurance or investment management businesses, and, if so, to what degree.

Federal regulators have determined that fixed indexed annuities, previously regulated by the states, should instead be regulated at the federal level. In early 2009, the SEC issued a release adopting a new rule (151A) that will bring fixed-indexed annuities under the jurisdiction of the federal regulatory system. This rule will apply prospectively to annuities that are issued on or after 12 January 2011. Subsequent to adoption, Rule 151A became the subject of litigation. In late 2009, the US Court of Appeals for the D.C. Circuit ordered the litigants (the SEC and Old Mutual US, et al) to submit briefs on the appropriate remedy for the SEC's failure to consider the rule's effect on efficiency and competition when promulgating the rule. Old Mutual argued that the rule should be vacated or stayed. The SEC disagreed but offered a two-year stay of the rule. In early 2010, the court directed Old Mutual to file an additional brief addressing the SEC's proposal to defer the effective date of Rule 151A for 2 years if and from the time the rule is reissued. Practically speaking, the SEC's offer to stay the rule, if implemented, will likely move the effective date of the rule from 12 January 2011 to mid-2012 or late 2012. The court is currently considering the supplemental briefs. Jackson is well positioned to operate under this change of regulatory structure.

## **2. Bermudan regulation**

### **Overview**

AIA-B is regulated in respect of its insurance business in Bermuda by the BMA. The Insurance Act 1978 and related regulations (the "Insurance Act of Bermuda") govern the conduct of insurance business in or from within Bermuda and provide for a system of registration for insurers administered by the BMA. The Insurance Act of Bermuda also grants to the BMA powers to supervise, investigate and intervene in the affairs of insurance companies. The Insurance Act of Bermuda imposes, *inter alia*, solvency margins and liquidity ratios, as well as auditing and reporting requirements on Bermuda insurance companies.

AIA-B is registered in Bermuda as a Class 3 general business and long-term insurer under the Insurance Act of Bermuda and, as such, is licensed to conduct both general and long-term business, which includes life insurance business. AIA-B has held its Class 3 and long-term insurance licence since 1 January 1996. AIA-B is classified as a "section 24(6) composite" under the Insurance Act of Bermuda.

### **Regulation by the BMA under the Insurance Act of Bermuda**

The Insurance Act of Bermuda requires all insurers to maintain certain minimum solvency margins and liquidity ratios and imposes auditing and reporting requirements on Bermuda insurance companies.

The Insurance Act of Bermuda gives the BMA broad powers to supervise, investigate and intervene in the affairs of an insurer. For example, if it appears to the BMA that the insurer is in breach of a provision of the Insurance Act of Bermuda or there is significant risk of that insurer becoming insolvent, then the BMA may give the insurer such directions (without limitation) as appear to it to be desirable for safeguarding the interests of clients and potential clients. In addition, if it appears to the BMA that the business of an insurer is being so conducted that there is a

significant risk of the insurer becoming insolvent it may, if it considers it appropriate, direct the insurer to maintain in, or transfer to and keep in the custody of, a specified bank, assets of the insurer of such value and description as are specified in the direction.

Pursuant to the Insurance Act of Bermuda, the BMA may also, in respect of an insurance group, determine whether it is appropriate for it to be the group supervisor of that group. Before making such a determination, and where the insurance group is headed by a parent company which is not incorporated in Bermuda, the BMA will consider whether, for example, the insurance group is directed and managed from Bermuda. Where the BMA determines that group supervision is appropriate it may, on its own initiative or on the application of the insurance group, exclude from group supervision any company that is a member of an insurance group where it is satisfied, for example, that the inclusion of the company would be inappropriate with respect to the objectives of group supervision.

Where the BMA determines that group supervision is appropriate, the BMA will appoint a specified insurer that is a member of the insurance group to be the “designated insurer” in respect of that insurance group. The BMA has the following functions with regard to group supervision:

- coordination of the gathering and dissemination of relevant or essential information for going concerns and emergency situations, including the dissemination of information which is of importance for the supervisory task of other competent authorities;
- supervisory review and assessment of the financial situation of insurance groups;
- assessment of compliance of insurance groups with the rules on solvency and of risk concentration and intra-group transactions as may be prescribed by or under the Insurance Act of Bermuda;
- assessment of the system of governance of insurance groups, as may be prescribed by or under the Insurance Act of Bermuda, and whether the members of the administrative or management body of participating companies meet the requirements set out therein;
- planning and coordination, through regular meetings held at least annually or by other appropriate means, of supervisory activities in going concerns as well as in emergency situations, in cooperation with the competent authorities concerned and taking into account the nature, scale and complexity of the risks inherent in the business of all companies that are part of insurance groups;
- coordination of any enforcement action that may be taken against insurance groups or any of their members; and
- planning and coordinating, as required, meetings of colleges of supervisors, to be chaired by the BMA where it acts as the group supervisor, to facilitate the exercise of the functions set out above.

In addition to the above broad powers of intervention with respect to an insurer and the function it has with respect to an insurance group’s supervision, the BMA also has the power to require the insurer or designated insured to provide the BMA with such information (including documents of the insurer) and reports (including unpublished reports) from an insurer as the BMA may reasonably require with respect to matters that are likely to be material to its functions under the Insurance Act of Bermuda in relation to the insurer or the insurance group, as the case may be.

The BMA may also appoint an inspector with powers to investigate the affairs of an insurer if it believes that an investigation is required in the interests of the insurer’s policyholders or persons who may become policyholders.

The BMA may cancel an insurer’s registration on grounds specified in the Insurance Act of Bermuda, including (i) the failure of that insurer to comply with its obligations under the Insurance Act of Bermuda, or (ii) the failure of that insurer to satisfy the minimum criteria required for registration as an insurer, as set out in the Schedule to the Insurance Act of Bermuda.

The BMA may present a petition for the winding-up of an insurer on various grounds, including: (i) it is unable to pay its debts, (within the meaning of Sections 161 and 162 of the Bermuda Companies Act 1981); (ii) it has failed to satisfy an obligation under the Insurance Act of Bermuda; or (iii) it has failed to produce or file statutory financial statements and the BMA is unable to ascertain its financial position.

### *Long-term business*

In addition to the requirements imposed on AIA-B by virtue of its general business, the Insurance Act of Bermuda imposes conditions and restrictions on AIA-B by virtue of AIA-B carrying on long-term business. For example, pursuant to Part IV of the Bermuda Insurance Act 1978, AIA-B must maintain its accounts in respect of its long-term business separate from any accounts it has in respect of its general (i.e. other) business. Further, all receipts of AIA-B’s long-term business must be carried to, and form part of, a special fund with an appropriate name, referred to in the Insurance Act of Bermuda as the ‘long-term business fund’. Accordingly, AIA-B is required to maintain books

of account and other records such that the assets of its long-term business fund and the liabilities of its long-term business can be readily identified at any time. No payment from AIA-B's long-term business fund may be made, directly or indirectly, other than for a purpose of AIA-B's long-term business; this is so notwithstanding any arrangement for its subsequent repayment out of receipts of business other than the long-term business, except in so far as such payment can be made out of any surplus certified by the AIA-B's approved actuary to be available for distribution otherwise than to policyholders.

AIA-B is restricted from carrying on long-term business at any time if it does not have an actuary approved by the BMA at that time.

The Insurance Act of Bermuda imposes certain restrictions and conditions on the transfer of long-term business: any scheme under which the whole or any part of the long-term business of a long-term business insurer is to be transferred to another insurer shall be void unless it is made in accordance with section 25 of the Insurance Act of Bermuda and the Court has sanctioned the scheme thereunder.

The Insurance Act of Bermuda also imposes certain restrictions and conditions on the winding-up of an insurer that carries on long-term business. For example, a long-term business insurer may not be wound up voluntarily. In addition, section 36 of the Insurance Act of Bermuda applies in any winding-up of an insurer which immediately before the winding-up was carrying on or entitled to carry on long-term business. Section 36 provides that on any such winding-up:

- (a) the assets in the insurer's long-term business fund shall be available only for meeting the liabilities of the insurer attributable to its long-term business; and
- (b) other assets of the insurer shall be available only for meeting the liabilities of the insurer attributable to its other business.

Where the value of the assets in paragraph (a) or (b) exceeds the amount of the liabilities mentioned in that paragraph, however, the restriction imposed does not apply to so much of those assets as represents the excess.

In addition, a liquidator must, unless the Supreme Court of Bermuda orders otherwise, carry on the long-term business of the insurer with a view to its being transferred as a going concern to another insurer, whether an existing insurer or an insurer formed for that purpose; and, in carrying on that business as aforesaid, the liquidator may agree to the variation of any contracts of insurance in existence when the winding-up order is made, but may not effect any new contracts of insurance. Where the insurance business or any part of the insurance business of an insurer has been transferred to an insurer under an arrangement in pursuance of which the first mentioned insurer (the subsidiary insurer) or the creditors thereof has or have claims against the insurer to which the transfer was made (the principal insurer), then, if the principal insurer is being wound up by or under the supervision of the Supreme Court of Bermuda, the Supreme Court must, subject to section 28 of the Insurance Act of Bermuda, order the subsidiary insurer to be wound up in conjunction with the principal insurer, and may by the same or any subsequent order appoint the same person to be liquidator for the two insurers, and make provision for such other matters as may seem to the Supreme Court of Bermuda to be necessary, with a view to the insurers being wound up as if they were one insurer.

### **Capital requirements**

Class 3 insurers that are also licensed to carry on long-term business are required to maintain a fully paid up share capital of at least US\$370,000. In addition, the Insurance Act of Bermuda provides that the statutory assets of an insurer must exceed its statutory liabilities by an amount greater than the prescribed minimum solvency margin.

With respect to its general business, an insurer is required to maintain a minimum solvency margin equal to the greatest of:

- US\$1,000,000;
- 20% of net premiums written, where the net premiums written do not exceed US\$6,000,000; or, where the net premiums written do exceed US\$6,000,000, US\$1,200,000 plus 15% of net premiums written over US\$6,000,000; and
- 15% of loss and loss expenses provisions, and other general business insurance reserves.

“net premiums written” means, in relation to a Class 3 insurer, the net amount, after deductions of any premiums ceded by the insurer for reinsurance, of the premiums written by the insurer in that year in respect of general business.

The minimum solvency margin requirement in respect of an insurer's long-term business is US\$250,000, i.e. a long-term business insurer's assets must exceed its long-term statutory liabilities by not less than US\$250,000.

As a section 24(6) composite, AIA-B is required to maintain the value of its relevant assets at not less than 100% of the amount of its relevant liabilities.

Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable, reinsurance balances receivable and any funds held in a ceding reinsurance arrangement (if applicable). There are certain categories of assets, which, unless specifically permitted by the BMA, do not qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates, and real estate and collateral loans.

The relevant liabilities are the aggregate of the total general business insurance reserves and total other liabilities less deferred income tax sundry liabilities and letters of credit, guarantees and other instruments.

There is no minimum liquidity ratio in respect of an insurer's long-term insurance business; however, and as stated above, an insurer that carries on long-term business must appoint an approved actuary who must provide an actuarial report annually.

### **Financial reporting requirements**

All insurers are required to prepare and file with the BMA annual statutory financial statements and returns for each financial year in respect of their insurance business as stipulated in the Insurance Act of Bermuda, including a balance sheet, an income statement, a statement of capital and surplus, an independent auditor's report, a declaration of statutory ratios and a certificate of solvency in the prescribed form. Composite insurers are also required to submit with their statutory financial returns an opinion from an approved loss reserve specialist in respect of their general business loss and loss expense provisions and an opinion from an approved actuary in respect of their outstanding liabilities on account of their long-term business. The loss reserve specialist will typically be a qualified casualty actuary and the appointed actuary will typically be a qualified life actuary. Both the loss reserve specialists and the appointed actuaries must be approved by the BMA.

AIA-B has been granted a Direction under section 56 of the Insurance Act of Bermuda by the BMA which exempts AIA-B from the financial reporting requirements of sections 15 to 18 of the Insurance Act of Bermuda, conditional upon AIA-B filing with the BMA, in each financial year, its Financial Statements and Returns filed with the Insurance Regulatory Authorities in Hong Kong, and a Certificate of Compliance of Good Standing obtained from the Insurance Regulatory Authorities in Hong Kong. The Direction was granted under section 56 with respect to AIA-B's financial years ended 30 November 2007, 2008 and 2009. It is intended that AIA-B will re-apply in relation to the financial years ended 30 November 2010, 2011 and 2012.

### **Restrictions on dividends and distributions**

An insurer is prohibited from declaring or paying any dividends during any financial year if it is, or by virtue of paying such dividends would be, in breach of its relevant minimum solvency margin or liquidity ratio. If an insurer has failed to meet its minimum solvency margin or minimum liquidity ratio (in relation to the insurer's general business) on the last day of any financial year, it will be prohibited from declaring or paying any dividends during the next financial year without the approval of the BMA.

A Class 3 insurer also licensed to carry on long-term business is prohibited from reducing by 15% or more its total statutory capital as set out in its previous year's financial statements without the approval of the BMA.

### **Shareholder controllers disclosure**

The BMA requires any person who, directly or indirectly, is able to exercise a significant influence over the management of an insurer (or its parent) by virtue of: (a) holding shares in the insurer (or its parent); or (b) an entitlement to exercise, or control the exercise of, the voting power at any general meeting of the insurer or its parent on 10%, 20%, 33% and 50% of such shareholding or control, as the case may be, to notify the BMA within a prescribed timeframe (45 days) of becoming such a "shareholder controller". In the event the BMA determines that the person is not "fit and proper" to be such a shareholder controller, the BMA may give notice objecting to such persons and require the holder to reduce its holding and direct, among other things, that voting rights attaching to those shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offence.

### **Undertakings given by American International Company Limited**

Following the AIG Events, by a letter of undertaking dated 18 December 2008, American International Company Limited in its capacity as the licensed Insurance Manager of, amongst other entities, AIA-B, gave certain undertakings to the BMA. These include American International Company Limited undertaking:

1) to ensure that AIA-B would seek prior approval from the BMA before entering into transactions outside the normal course of business; and

2) to submit a daily basis report to the BMA on: (i) transfers of more than US\$1,000,000 per transaction or an aggregate amount of greater than US\$1,000,000 per day from AIA-B to another jurisdiction other than where the fund originated; (ii) transactions of greater than US\$15,000,000 whether incoming or outgoing; (iii) all material issues having an impact threshold of equal to or greater than 10% of AIA-B's total statutory capital and surplus. The BMA has confirmed in writing that this undertaking will be released upon completion of the Acquisition.

## PART XI

### SELECTED FINANCIAL INFORMATION

#### 1. Summary financial information for Prudential

##### *IFRS basis results*

You should read the summary of historical consolidated financial information set out below in conjunction with the financial information set out in Part XIV (*Historical Financial Information for Prudential*). The consolidated financial information of Prudential and the parent company financial information has been prepared and approved by the Directors in accordance with IFRS as issued by the International Accounting Standards Board (“IASB”) and as endorsed by the EU. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRS have not been endorsed by the EU. As at 31 December 2009, there were no unendorsed standards effective for the three years ended 31 December 2009 affecting the consolidated financial information of Prudential or the parent company financial information, and there was no difference between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to Prudential. Accordingly, Prudential’s financial information for the three years ended 31 December 2009 is prepared in accordance with IFRS as issued by the IASB.

This summary of historical financial information includes a selection of information for the years ended 31 December 2007, 31 December 2008 and 31 December 2009 and has, unless otherwise stated, been extracted without material adjustment from the consolidated financial information set out in Section B of Part XIV of this prospectus.

Operating profit based on longer-term investment returns is a supplemental measure of results and is the basis on which management regularly review the performance of the Prudential Group’s segments as defined by IFRS 8. This measure, reported in the consolidated financial information set out in Part XIV, excludes the recurrent items of short-term fluctuations in investment returns and the shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes. It also excludes the effect of disposal and results of the Taiwan agency business, for which the sale process was completed in June 2009. Operating profit based on longer-term investment returns is different from profit before tax as reported in the consolidated financial information set out in Part XIV of this prospectus.

##### *Summary of historical IFRS financial information*

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m (except per share amounts)</u>		
Total IFRS basis operating profit based on longer-term investment returns <sup>(Note 2)</sup> . . .	1,152	1,283	1,405
Short-term fluctuations in investment returns			
• Insurance operations . . . . .	(50)	(1,408)	166
• IGD hedge costs <sup>(Note 3)</sup> . . . . .	—	—	(235)
• Other operations . . . . .	(1)	(313)	105
	(51)	(1,721)	36
Shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(1)	(13)	(74)
Profit/(loss) before loss on sale and results of Taiwan agency business . . . . .	1,100	(451)	1,367
Loss on sale and results of Taiwan agency business <sup>(Note 4)</sup> . . . . .	(37)	1	(621)
<b>Profit (loss) before tax from continuing operations attributable to shareholders</b> . . . . .	<b>1,063</b>	<b>(450)</b>	<b>746</b>
Tax (charge) credit attributable to shareholders’ profit . . . . .	(354)	59	(55)
Discontinued operations (net of tax) . . . . .	241	—	(14)
Minority interests . . . . .	(3)	(5)	(1)
<b>Profit (loss) after tax attributable to equity holders of the Company</b> . . . . .	<b>947</b>	<b>(396)</b>	<b>676</b>
<b>Basic earnings (loss) per share</b> <sup>(Note 1)</sup> . . . . .	<b>38.7p</b>	<b>(16.0)p</b>	<b>27.0p</b>
<b>Dividends per share declared and paid in reporting period</b> . . . . .	<b>17.42p</b>	<b>18.29p</b>	<b>19.20p</b>
<b>IFRS Shareholders’ equity, excluding minority interests</b> . . . . .	<b>6,062</b>	<b>5,058</b>	<b>6,271</b>

##### *Summary balance sheet*

A summary balance sheet for the Prudential Group is included at Section 9 of Part XII of this prospectus.

### **European Embedded Value basis supplementary results**

In addition to IFRS basis results, the Prudential Group also prepared results in accordance with the European Embedded Value (“EEV”) Principles and Guidelines issued by the Chief Financial Officers’ Forum of European Insurance Companies. The EEV basis is a value-based method of reporting in that it reflects the change in value of in-force long-term business over the account period.

You should read the summary of the Prudential Group’s EEV basis supplementary results set out below in conjunction with the information set out in Section C of Part XIV of this prospectus.

This historical European Embedded Value basis supplementary information in relation to Prudential in this Part XI has, unless otherwise stated, been extracted without any modification from the European Embedded Value Basis Supplementary Information set out in Section C of Part XIV of this prospectus. The EEV basis results are not determined in accordance with IFRS or any other generally accepted accounting principles, and should not be considered as alternatives to performance measures derived in accordance with IFRS. Other insurance companies may calculate EEV basis or similar results differently, and consequently, the Prudential Group’s presentation of these results may not be readily comparable to other companies’ figures.

### **Summary of European Embedded Value (EEV) basis results**

	<u>2008</u>	<u>2009</u>
	<u>£m (except</u>	<u>per share</u>
		<u>amount)</u>
Total EEV basis operating profit from continuing operations based on longer-term investment returns <sup>(Note 2)</sup> . . . . .	2,865	3,090
Short-term fluctuations in investment returns . . . . .	(4,967)	351
Mark to market value movements on core borrowings . . . . .	656	(795)
Shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(14)	(84)
Effect of changes in economic assumptions and time value of cost and options and guarantees . . . . .	(398)	(910)
Profit on sale and results of Taiwan agency business <sup>(Note 4)</sup> . . . . .	<u>(248)</u>	<u>91</u>
Profit (loss) before tax from continuing operations. . . . .	<u>(2,106)</u>	<u>1,743</u>
Operating earnings per share from continuing operations after related tax and minority interests . . . . .	85.1p	88.8p
Basic earnings (loss) per share <sup>(Note 1)</sup> . . . . .	(54.1)p	49.8p
EEV Shareholders’ equity, excluding minority interests . . . . .	14,956	15,273

#### **Notes:**

- (1) Basic (loss)/earnings per share based on a weighted average of 2,445 million, 2,472 million and 2,501 million shares in 2007, 2008 and 2009 respectively.
- (2) The results shown above distinguish ‘operating profits based on longer-term investment returns’ from ‘profits before tax’. The reconciling items are presented in accordance with the Prudential Group’s policy as described in the Prudential Group’s financial information and supplementary information. Items excluded from operating profit bases on longer-term investment returns represent primarily the effects of altered investment market conditions (short-term fluctuations) and actuarial and other gains and losses on defined benefit pension schemes. For EEV, the operating profits based on longer-term investment returns figure also excludes the mark to market value movements on core borrowings, the effect of changes in economic assumptions and the time value of the cost of options and guarantees.
- (3) During the severe equity market conditions experienced in the first quarter of 2009, the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operations hedging programmes.
- (4) In June 2009 Prudential Group completed the sale of its Taiwan agency business. In order to facilitate comparisons of the Prudential Group’s businesses, the effect of disposal and the results of the Taiwan agency business are shown separately from operating profit based on longer term investment returns for all periods presented.

## **2. Summary financial information for AIA Group**

### **IFRS basis results**

You should read the summary of historical consolidated financial information set out below in conjunction with the AIA Group historical financial information set out in Part XV (*Historical Financial Information for AIA Group*).

The long term nature of the AIA Group’s operations means that, for management’s decision making and internal performance management purposes, the AIA Group evaluates its results and its operating segments using a financial performance measure referred to as ‘operating profit’. The AIA Group defines operating profit before tax and after tax respectively as profit excluding non-operating items, defined as AIA investment experience and investment

income and expense related to investment-linked contracts together with corresponding changes in insurance and investment contract liabilities in respect of investment-linked contracts and participating funds. Non-operating items also include any other significant items that management considers to be non-operating income and expenses.

### Summary of historical IFRS financial information for AIA Group

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	US\$ millions (except earnings per share)		
IFRS basis operating profit . . . . .	1,742	1,943	1,835
Non-operating investment return . . . . .	837	(2,412)	665
Gain on recapture of reinsurance from former parent company . . . . .	—	447	—
Other non-operating items . . . . .	<u>219</u>	<u>64</u>	<u>80</u>
	1,056	(1,901)	745
Profit before tax . . . . .	2,798	42	2,580
Tax (expense)/credit attributable to shareholders' profits . . . . .	(579)	347	(506)
Tax attributable to policyholders' returns . . . . .	<u>(70)</u>	<u>90</u>	<u>(137)</u>
Net profit . . . . .	<u><u>2,149</u></u>	<u><u>479</u></u>	<u><u>1,937</u></u>
<i>Net profit attributable to:</i>			
Shareholders of AIA Group Limited . . . . .	2,133	473	1,916
Non-controlling interests . . . . .	16	6	21
Earnings per share (basic and diluted) (US\$) . . . . .	0.18	0.04	0.16
IFRS Shareholders' equity, excluding non-controlling interests . . . . .	13,616	9,176	15,252

Operating profit used historically by the AIA Group differs from that used by Prudential, as explained in Part IV of this prospectus.

### Summary balance sheet

A summary balance sheet for the AIA Group is included at Section 6 of Part XIII of this prospectus.

### European Embedded Value (EEV) basis supplementary results

The EEV information below has been prepared in accordance with the EEV principles issued by the CFO Forum of European Insurance Companies. The results are prepared for "covered business", as defined by the EEV principles.

The basis of preparation, methodology and assumptions are as described in the Consulting Actuaries Report set out in Section C of Part XV of this prospectus. The EEV basis results are not determined in accordance with IFRS or any other generally accepted accounting principles, and should not be considered as alternatives to performance measures derived in accordance with IFRS. Other insurance companies may calculate EEV basis or similar results differently, and consequently, the AIA Group's presentation of these results may not be readily comparable to other companies' figures.

### As at 30 November 2009

<u>US\$ millions</u>	<u>Free Surplus</u>	<u>Required capital</u>	<u>Adjusted net worth</u>	<u>Value of in-force business after tax and before cost of capital</u>	<u>Cost of capital</u>	<u>Value of in-force business after tax and after cost of capital</u>	<u>Embedded value</u>
Total on Hong Kong statutory basis . . . . .	4,022	3,742	7,765	15,552	1,364	14,188	21,953

### 2009

<u>US\$ millions</u>	<u>New business premiums</u>		<u>Annual premium and contribution equivalents (APE)</u>	<u>Present value of new business premiums (PVNBP)</u>	<u>Pre-tax new business contribution<sup>(1)</sup></u>	<u>Tax<sup>(2)</sup></u>	<u>Post-tax new business contribution</u>	<u>Pre-tax new business margin</u>	
	<u>Single</u>	<u>Regular</u>						<u>APE</u>	<u>PVNBP</u>
Total on Hong Kong statutory basis . . . . .	1,443	1,949	2,094	10,761	837	227	610	40%	7.8%

- (1) Pre tax new business contribution is taken as the reported value of new business, adding back the present value of local tax for all countries other than Singapore, Malaysia, Hong Kong and Philippines. For Hong Kong and Philippines, tax is premium driven and is treated as an expense, hence is not included as shareholder tax. For Singapore and Malaysia, the corporate tax rate is used for grossing up as the cash-flow taxes include policyholder tax.
- (2) The tax rates assumed in the value of new business reflect the corporate tax rate relevant to the AIA entity in question and allows for the impact of tax on income on the capital requirements where relevant. For Thailand, the corporate tax rate on profits is 30%, but due to the fact that the tax is accelerated and is payable before the statutory profits are made, the implied effective tax rate is significantly higher than 30%.
- (3) For Hong Kong, Group office expenses are the same before tax as after tax as only premium tax is payable.

The EEV methodology used for AIA differs in some respects to that used by Prudential as described in the Consulting Actuaries' Report set out in Section C of Part XV of this prospectus.

### 3. Summary pro-forma information

#### *IFRS basis information*

The unaudited pro forma IFRS income statement has been prepared to illustrate the effect on Prudential as if the Transactions had taken place on 1 January 2009. The unaudited pro forma IFRS net asset statement has been prepared to illustrate the effect on the net assets of Prudential as if the proposed Transactions had taken place on 31 December 2009. The unaudited pro forma IFRS income statement and unaudited pro forma IFRS net asset statement have been prepared for illustrative purposes and because of their nature address a hypothetical situation and, therefore, do not represent the Enlarged Group's actual financial result or financial position following the Transactions.

The unaudited pro forma IFRS income statement and unaudited pro forma IFRS net asset statement of the Enlarged Group does not constitute financial statements.

The following represents a summary of the information contained in the unaudited pro forma IFRS income statement and unaudited pro forma IFRS net asset statement as set out in Part XVI of this prospectus. This summary should be read in conjunction with the financial information and notes set out in Part XVI.

#### *Unaudited pro forma IFRS net assets*

	Prudential Group as at 31 December 2009 £m	Adjustments			Pro forma Enlarged Group £m
		AIA Group as at 30 November 2009 \$m	AIA Group as at 30 November 2009 £m	Purchase and Rights Issue adjustments £m	
<b>Equity</b>					
Shareholders' equity . . . . .	6,271	15,252	9,294	7,953	23,518
Minority interests . . . . .	32	80	49	0	81
<b>Total equity . . . . .</b>	<b>6,303</b>	<b>15,332</b>	<b>9,343</b>	<b>7,953</b>	<b>23,599</b>

#### *Unaudited pro forma IFRS profit*

	Prudential Group as at 31 December 2009 £m	Adjustments			Pro forma Enlarged Group £m
		AIA Group Year Ended 30 November 2009 \$m	AIA Group Year Ended 30 November 2009 £m	Purchase adjustments £m	
<b>Profit (loss) from continuing operations after tax . . . . .</b>	691	1,937	1,246	(375)	1,562
Discontinued operations (net of tax) . . . . .	(14)	—	—	—	(14)
<b>Profit for the year . . . . .</b>	<b>677</b>	<b>1,937</b>	<b>1,246</b>	<b>(375)</b>	<b>1,548</b>

#### *Unaudited supplementary analysis of IFRS profit before tax attributable to shareholders*

The Prudential Group provides supplementary analysis of profit before tax attributable to shareholders that distinguishes operating profit based on longer term investments returns from other constituent elements of the total profits. Details of the basis of preparation of this analysis are included in notes A3 and A4 to the financial information on Prudential as set out in Part XIV of this prospectus.

The following table shows an estimated analysis of the pro forma profit before tax attributable to shareholders of the Enlarged Group.

	Prudential Group Year Ended 31 December 2009 £m	Adjustments			Pro forma Enlarged Group £m
		AIA Group Year Ended 30 November 2009 \$m	AIA Group Year Ended 30 November 2009 £m	Purchase adjustments £m	
Operating profit based on longer-term investment returns . . . . .	<u>1,405</u>	<u>1,836</u>	<u>1,181</u>	<u>(380)</u>	<u>2,206</u>
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	<u>36</u>	<u>687</u>	<u>442</u>	<u>—</u>	<u>478</u>
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	<u>(74)</u>	<u>9</u>	<u>6</u>	<u>—</u>	<u>(68)</u>
Loss on sale and results for Taiwan agency business . . . . .	<u>(621)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(621)</u>
Restructuring and separation costs . . . . .	<u>—</u>	<u>(89)</u>	<u>(57)</u>	<u>—</u>	<u>(57)</u>
Expenses of combination other than for issue of rights issue shares and debt instruments . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>(100)</u>	<u>(100)</u>
Profit from continuing operations before tax attributable to shareholders . . . . .	<u>746</u>	<u>2,443</u>	<u>1,572</u>	<u>(480)</u>	<u>(1,838)</u>

**EEV basis information**

**Unaudited pro forma net worth and value-in-force on a European Embedded Value basis**

The unaudited pro forma information set out below has been prepared to illustrate the effect on the Embedded Value net worth and value-in-force of Prudential Group as if the proposed Transactions had taken place on 31 December 2009. The pro forma information has been prepared for illustrative purposes only and because of its nature addresses a hypothetical situation and, therefore, does not represent the Enlarged Group's actual financial result or financial position following the Transactions.

The pro forma financial information has been prepared on the European Embedded Value (EEV) basis and on the basis that the Transactions took place on 31 December 2009. Both the EEV methodology adopted by Prudential plc and the EEV methodology adopted for AIA Group are in accordance with the EEV principles and guidance issued in May 2004 by the European Insurers' CFO forum and expanded by the additional guidance on EEV disclosures issued in October 2005 except for certain disclosure points referred to in the Consulting Actuaries' Report on AIA as set out in Part XV of this document.

This summary should be read in conjunction with the all the financial information and notes set out in Part XVI.

	Prudential Group year ended 31 December 2009 £m	Adjustments			Pro forma Enlarged Group £m
		AIA Group year ended 30 November 2009 \$m	AIA Group year ended 30 November 2009 £m	Purchase and Rights Issue adjustments £m	
Total net assets — EEV basis . . . . .	15,273	21,953	13,377	3,870	32,520

**Unaudited aggregated EEV value of new business**

The value of new business for the twelve months to 31 December 2009 (for the Asian operations of the Prudential Group) and 30 November 2009 (for the AIA Group) are shown in the following table. Exchange rates used are average exchange rates for the year to 31 December 2009 and 30 November 2009 for the Prudential Group and the AIA Group, respectively.

	2009 £m							2009	
	New business premiums		Annual premium and contribution equivalents (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution		Post-tax new business contribution	Pre-tax new business margin	
	Single	Regular			Tax			APE	PVNBP
<b>Prudential Group (A)</b> . . . . .	14,495	1,447	2,896	21,195	1,607	(476)	1,131	56%	7.6%
<b>Prudential Group — Total Asian operations (B)</b> . . . . .	842	1,177	1,261	6,245	713	(180)	533	57%	11.4%
<b>AIA Group — Total (C)*</b> . . . . .	879	1,188	1,276	6,557	510	(138)	372	40%	7.8%
<b>Total Asian operations (B) + (C)</b> . . . . .	<u>1,721</u>	<u>2,365</u>	<u>2,537</u>	<u>12,802</u>	<u>1,223</u>	<u>(318)</u>	<u>905</u>	<u>48%</u>	<u>9.6%</u>
<b>Total Prudential Group AIA Group (A) + (C)</b> . . . . .	<u>15,374</u>	<u>2,635</u>	<u>4,172</u>	<u>27,752</u>	<u>2,117</u>	<u>(614)</u>	<u>1,503</u>	<u>51%</u>	<u>7.6%</u>

\* Based on required capital and reserving consistent with Hong Kong statutory levels and after an allowance for Group expenses

## PART XII

### OPERATING AND FINANCIAL REVIEW OF THE PRUDENTIAL GROUP

The following review should be read in conjunction with Part VII (*Information about the Prudential Group*) and the Prudential Group's consolidated financial information and the related notes to the Prudential Group's consolidated financial information set out in Part XIV (*Historical Financial Information for Prudential Group*).

Unless otherwise indicated, the financial data set out in this Part XII has been extracted without material adjustment from the historical financial information for the Prudential Group as reported on by KPMG Audit Plc set out in Part XIV of this prospectus or from the Prudential Group's unaudited accounting records, operating systems and other information prepared by Prudential. Investors should read the whole prospectus and not only rely on key or summarised information in this Part XII. The Prudential Group's financial information has been prepared in accordance with IFRS, which may differ in material respects from generally accepted accounting principles in other jurisdictions, including the United States. A summary of the critical accounting policies which have been applied to these statements is set out in the sections below entitled "Critical accounting policies" and "Critical estimates and judgements". The results discussed below are not necessarily indicative of the results to be expected in any future periods. This discussion contains forward-looking statements based on current expectations, which involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in these forward-looking statements due to a number of factors, including those set out in Part II (*Risk Factors*).

#### 1. Business overview

The Prudential Group is an international retail financial services group with significant operations in Asia, the US and the UK. The Prudential Group's aim is to promote the financial well-being of its customers and their families, with a particular focus on saving for retirement and security in retirement.

The Prudential Group is structured around four main business units: Prudential Corporation Asia, Jackson, Prudential UK insurance operations and M&G. These are supported by central functions which are responsible for leading Prudential Group strategy, cash and capital management, leadership development and succession, reputation management and other core group functions.

Prudential Corporation Asia is the leading European-based life insurer in Asia in terms of market coverage and the number of top five market positions. Prudential has life insurance and asset management operations in 13 markets covering China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand, Vietnam and the United Arab Emirates. On 6 January 2010 the Prudential Group announced it had entered into an agreement to acquire from UOB its 100% interest in UOB Life Assurance in Singapore for a total cash consideration of SGD428 million (approximately £192 million), subject to a post-completion adjustment to reflect the net asset value as at the completion date. This acquisition accompanied the announcement of a long-term strategic partnership with UOB. Through this partnership Prudential's life insurance products will be distributed through UOB Group's 414 bank branches across Singapore, Indonesia and Thailand.

Jackson provides retirement savings and income solutions in the mass and mass-affluent segments of the US market, primarily to retirees and those nearing retirement.

Prudential UK insurance operations is a leading provider of retirement savings and income solutions and life assurance in the UK and believes it has a strong combination of competitive advantages, including its significant longevity experience, multi-asset management capabilities and its brand and financial strength. Prudential UK provides a range of financial products and services, including annuities, corporate pensions, with-profits and unit-linked bonds, savings and investment products, protection and health insurance products.

M&G is the Prudential Group's UK and European fund management business and has £174 billion of assets under management as at 31 December 2009, of which £104 billion relates to the Prudential Group's long-term business funds. M&G aims to maximise profitable growth by operating in markets where it has leading positions and competitive advantages, including the markets for retail fund management, institutional fixed income, pooled life and pension funds, property and private finance.

#### 2. Principal factors affecting Prudential Group's results of operations

The Prudential Group's results of operations are affected, to a greater or lesser degree, by a variety of factors, including demographics, general economic and market conditions, government policy and legislation and regulation, as discussed in greater detail below. In addition, changes in interest rates and returns from equity, real estate and other investments as well as volatility in these items may affect the Prudential Group's profitability.

See Part II (*Risk Factors*) for more information on risks associated with these and other factors. In addition, changes to the composition of its businesses and the execution of its growth strategy may result in increased variation in profits from year to year.

### **General economic and market conditions**

After the severe difficulties encountered by the world economy and financial markets in the second half of 2008, the Prudential Group entered 2009 with a deliberately defensive position. The Prudential Group recognised early on the implications of the new economic climate and focused its strategy on capital conservation and cash generation. The Prudential Group prioritised value over volume and allocated capital strictly to the products and channels with the highest rates of return and shortest payback periods. This led the Prudential Group to reduce significantly its volumes of wholesale business, allowing it to grow the relatively more profitable retail sales by 11% in a year when many companies saw a contraction or stagnation of sales. This disciplined approach meant that, as conditions started to improve, the Prudential Group's capital strength allowed it to capture a more than proportionate share of many of its target markets.

Through the Prudential Group's international, selective and disciplined approach it maintains a diverse portfolio of businesses, which embrace countries at different stages of economic development, but which all share one key attribute: the opportunity for the Prudential Group to build a market-leading operation with prospects for sustainable, long-term, profitable growth and a superior rate of return on capital.

Prudential's financial strength is fundamental to its strategy and as a result of its disciplined risk management approach and targeted group-wide actions to grow and protect its capital, the Prudential Group is emerging from the global economic downturn with greater strength demonstrated by its increased IGD capital. Prudential believes that this capital strength has been instrumental in the Prudential Group's ability to invest in profitable growth in 2009, especially in its chosen markets in Asia and US.

Particular features for the Prudential Group's geographic areas of operations are shown below:

#### ***Asia***

Asia is home to 60% of the world's population and, given its impressive economic transformation over the last few years, the region now has an increasingly significant role in the global economy. This is translating into the rapid emergence of an increasingly urbanised and wealthy mass affluent sector that generates outstanding growth potential in retail financial services as people look to protect their financial well-being and manage their savings in more sophisticated and efficient ways. In addition, Asia's growing and increasingly middle class population face a growing need for financial advice and products to help people save for retirement, secure an income during retirement and protect their financial well-being throughout life.

The word 'Asia' is used extensively and broadly to describe what is, in fact, a highly diverse region of the world. This diversity exhibits itself in a myriad of ways: culture, religion, politics, wealth and distribution of wealth and not least, language. Furthermore, within the financial services sector there are complex legal and regulatory environments which vary materially by country. These are important considerations for any business with aspirations to develop businesses in Asia. While there are undoubtedly commonalities and opportunities for synergy across the region, a 'one size fits all' approach will generally produce suboptimal results. The Prudential Group's own diversity in terms of geographic presence, distribution channels and products continues to be a key factor in the success of its life insurance and asset management businesses.

The concept that Asian economies are decoupling from Western economies is a point for continued debate, but external indicators suggest that Asia is recovering more quickly from the recent global financial crisis. Sound fundamentals coupled with aggressive stimuli have enabled most Asian economies to outperform the developed Western markets over the course of 2009. So long as inflation remains under control, the Prudential Group expects that the Asian central banks are likely to resist currency appreciation and maintain low interest rates. The Prudential Group also anticipates that capital flows into Asia should increase as Asia's GDP growth continues to outpace the rest of the world.

In Asia, the Prudential Group continued to benefit in 2009 from its focus on regular premium products, as sales of single premium products suffered amid the market dislocation experienced in the first half of the year. In addition, the breadth of offering enabled the Prudential Group to refocus its energies on higher-margin health and protection products, and also on with-profits for the more cautious investor.

Overall, the Prudential Group believes that its strategy, and the consistency with which it executes it, are the core factors that differentiate it from its peers.

## US

The United States is the world's largest retirement savings market, and is continuing to grow rapidly. As 78 million baby boomers<sup>(59)</sup> reach retirement age, their retirement assets will shift from asset accumulation to income distribution. There are already US\$2 trillion of assets generating retirement income in the US — and this amount is forecast to rise to some US\$7 trillion by 2029<sup>(60)</sup>.

During 2009, the US financial services industry continued to face an array of challenges. After the S&P 500 index fell to a 12-year low in March, it rebounded and ended the year up 23.5% (compared to a 38.5% decline in 2008). Governmental interest rates increased but remained at historic lows, and rating agencies downgraded the financial strength ratings of many of the largest US insurance companies.

Further uncertainty arose early in the year as several companies scaled back their product offerings due to capital constraints which, combined with the financial strength downgrades, caused consumers to question the long-term financial stability of product providers. At the same time, tightening credit spreads and the rally in equity markets throughout the last nine months of the year created more favourable market conditions for the sale of variable annuities. These developments in the annuity market provided a competitive advantage to companies with strong financial strength ratings and a relatively consistent product set.

The Prudential Group's US business, Jackson, benefited significantly from this flight to quality in the US annuity market. Jackson's strategy continues to target increasing volumes in variable annuities in line with the goal of capital preservation. As Jackson focused on optimising the balance between new business profits and capital consumption, no institutional sales were made during the full year of 2009.

Jackson was predominantly a spread-based business until recently, with the majority of its assets invested in fixed income securities. Recently its fee-based business has become more prominent and now represents a significant part of Jackson's business mix.

In general, Jackson's results are heavily affected by fluctuations in economic and market conditions, especially interest rates, credit conditions and equity markets. The profitability of Jackson's spread-based business depends in large part on its ability to manage interest rate spreads, as well as the credit and other risks inherent in its investment portfolio. Jackson designs its US products and manages the investments supporting this business to reduce interest rate sensitivity. This has the effect of moderating the impact on the Prudential Group's results of changes in prevailing interest rates.

Changes in interest rates either upward or downward, including changes in the difference between the levels of prevailing short-term and long-term rates, can expose Jackson to the risk of not earning anticipated spreads between the rate earned on investments and the rate credited on its policies. For example, if interest rates go up and/or competitors offer higher crediting rates, withdrawals on annuity contracts may increase as policyholders seek higher investment returns elsewhere. In response, Jackson could (i) raise its crediting rates to stem withdrawals, decreasing its spread; (ii) sell assets which may have depressed values in a high interest rate environment, creating realised investment losses; or (iii) pay out existing cash which would otherwise have earned interest at the higher interest rates. Moreover, to the extent that Jackson holds illiquid private placements and commercial mortgages, there is a risk that it will incur losses if it needs to sell those assets.

Conversely, if interest rates decrease, withdrawals from annuity contracts may decrease relative to original expectations, creating more cash than expected to be invested at lower rates. Jackson may have the ability to lower the rates it credits to policyholders as a result, but may be forced to maintain crediting rates for competitive reasons or because there are minimum interest rate guarantees in certain contracts. In either case, the spread earned by Jackson would be lowered.

The profitability of Jackson's fee-based business depends in large part on its ability to manage equity market risk. As the investment return on the separate account assets is attributed directly to the contract holders, Jackson's profit arises from the fees charged on the contracts, less the expenses incurred, which include the costs of guarantees. In addition to being a profitable book of business in its own right, the variable annuity book also provides an opportunity to utilise the offsetting equity risk among various lines of business to manage Jackson's equity exposure in a cost-effective fashion. Jackson believes that the internal management of equity risk coupled with the utilisation of external derivative instruments where necessary, continues to provide a cost-effective method of managing equity exposure. Profits in the variable annuity book of business will continue to be subject to the impact of market movements both on sales and allocations to the variable accounts and the effects of the economic hedging

(59) Source: US Census Bureau

(60) Source: Tiburon Strategic Advisers, LLC

programme. While Jackson hedges its risk on an economic basis, the nature and duration of the hedging instruments, which are recorded at fair value through the income statement, will fluctuate and produce some accounting volatility.

Jackson continues to believe that, on a long-term economic basis, its equity exposure remains well managed.

## **UK**

In 2009, Prudential UK performed strongly against a challenging background of difficult capital markets, volatile equity markets and widespread economic uncertainty which led to consumers looking for greater certainty and security through trusted and financially strong brands. Prudential UK believes that the business has a good combination of competitive advantages including its longevity experience, multi-asset investment capabilities, strong brand and financial strength. These helped put Prudential UK in a robust position to generate attractive returns across its businesses.

The UK is characterised by an ageing population and the concentration of wealth in the mass affluent and high net worth sectors, a combination that positions the retirement and near-retirement segment as the fastest growing in the marketplace. Low savings rates and high levels of consumer debt, coupled with an increasing shift in responsibility for providing retirement income away from Government and employers towards individuals, have resulted in individuals in the UK being inadequately provided for during increasingly long periods of retirement.

Prudential UK has a significant pipeline of internal vestings into its annuity business from maturing individual and corporate pension policies, which is expected to remain strong at least over the next ten years. Management has based this assessment on a combination of analysis of the projected value of maturities of in-force business (after allowing for lapses) used within the Prudential Group's actuarial valuation models as at 31 December 2008 and analysis of the Selected Retirement Date contained with the policy data for a population covering approximately 75% of in-force pension business. Prudential UK is one of the largest annuity providers in the UK market, with approximately 1.5 million annuities in payment as at 31 December 2009. Looking ahead, the UK annuities market is expected to grow in the near-term, and Prudential UK believes it is well positioned to maintain a significant share of this market.

In the United Kingdom, where Prudential's with-profits fund invests in debt and other fixed income securities, equity securities and real estate, shareholders' profits under IFRS are strongly related to the bonuses it declares. The most important influences on the bonus rates are the overall rate of return earned on investments and Prudential's expectation of future investment returns. Further information on with-profits products is provided in section 5.1 below. In addition, the shareholders' profits under IFRS are significantly influenced by the contribution from the growing shareholder backed annuity business. The key factors affecting the profitability of this business are described in note D2 to the consolidated financial information set out in Part XIV of this prospectus.

## **Government policy and legislation**

Changes in government policy or legislation applying to companies in the financial services and insurance industries in any of the jurisdictions in which the Prudential Group operates, particularly in Asia, the United Kingdom and the United States, may adversely affect the result of its operations. These include possible changes in the tax treatment of financial products and services, government pension arrangements and policies, the regulation of selling practices and solvency standards.

These changes may affect the Prudential Group's existing and future business by, for example, causing customers to cancel existing policies, requiring the Prudential Group to change its range of products and services, redesign its technology or other systems, retrain staff, pay increased tax or incur other costs.

## **Regulation**

In recent years, the insurance sectors in the markets in which the Prudential Group operates have seen considerable regulatory change. Failure to comply with local regulation may result in sanctions, which could take the form of a financial penalty.

Additional regulation, scrutiny and related costs have put pressure on the margins on new business. In the United States, Jackson has been the subject of class action litigation which are discussed in more detail in paragraph 18 of Part XIX of this prospectus. Whilst the outcome of such matters cannot be predicted with certainty, Prudential believes that the ultimate outcome of such litigation and regulatory issues will not have a material adverse effect on the Prudential Group's financial condition, result of operations, or cash flows. Changes in pension, financial services and tax regulation could have an impact on the Prudential Group's results.

## **Exchange rates**

Due to the geographical diversity of the Prudential Group's businesses, it is subject to the risk of exchange rate fluctuations. The Prudential Group's international operations in Asia, the United States and Europe, which represent a significant proportion of total group income and expenses, generally write policies and invest in the same local currency, which although limiting the effect of exchange rate fluctuations on local operating results, can lead to fluctuations in the Prudential Group's consolidated financial information upon translation of results into pounds sterling.

### **3. Critical accounting policies**

The consolidated financial information of the Prudential Group and the parent company financial information have been prepared and approved by the Directors in accordance with IFRS as issued by the IASB and as endorsed by the EU. EU-endorsed IFRS may differ from IFRS as issued by the IASB if, at any point in time, new or amended IFRS have not been endorsed by the EU. As at 31 December 2009, there were no unendorsed standards effective for the three years ended 31 December 2009 affecting the consolidated financial information of the Prudential Group or the parent company financial information, and there was no difference between IFRS endorsed by the EU and IFRS issued by the IASB in terms of their application to the Prudential Group. Accordingly, the Prudential Group's financial information for the three years ended 31 December 2009 is prepared in accordance with IFRS as issued by the IASB. It is the Group's policy to adopt mandatory requirements of new or altered EU-adopted IFRS standards where required, with earlier adoption applied where permitted and appropriate in the circumstances.

The preparation of this financial information requires the Prudential Group to make estimates and judgements that affect the reported amounts of assets, liabilities, and revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Prudential Group evaluates its estimates, including those related to long-term business provisioning, the fair value of assets and the declaration of bonus rates. The Prudential Group bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially give rise to different results under different assumptions and conditions. The Prudential Group believes that its critical accounting policies are limited to those described below.

The critical accounting policies in respect of the items discussed below are critical for the Prudential Group's results in so far as they relate to the Prudential Group's shareholder-financed business. In particular, this applies for Jackson, which is the largest shareholder-backed business in the Prudential Group. The policies are not critical in respect of the Prudential Group's with-profits business. This distinction reflects the basis of recognition of profits and accounting treatment of unallocated surplus of with-profits funds.

Additional explanation is provided below and in cross-referenced notes within the consolidated financial information set out in Part XIV of this prospectus as to why the distinction between with-profits business and shareholder-backed business is relevant.

The items discussed below and in cross-referenced notes within the consolidated financial information set out in Part XIV of this prospectus explain the effect of changes in estimates and the effect of reasonably likely changes in the key assumptions underlying these estimates as of the latest statement of financial position date so as to provide analysis that recognises the different accounting effects on profit and loss or equity. In order to provide relevant analysis that is appropriate to the circumstances applicable to the Prudential Group's businesses, the explanations refer to types of business, fund structure, the relationship between asset and policyholder liability measurement, and the differences in the method of accounting permitted under IFRS 4 for accounting for insurance contract assets, policyholder liabilities and unallocated surplus of the Prudential Group's with-profits funds.

#### **Insurance contract accounting**

With the exception of certain contracts described in note D1 to the consolidated financial information set out in Part XIV of this prospectus, the contracts issued by Prudential Group's life assurance business are classified as insurance contracts and investment contracts with discretionary participating features. As permitted by IFRS 4, assets and liabilities of these contracts are accounted for under previously applied GAAP. In limited circumstances the Prudential Group has chosen to apply a more relevant or reliable measure. The following paragraphs explain how the current Prudential Group applies this policy. Except as described below, in respect of UK regulated with-profits funds where the basis applied has been improved to a more relevant or reliable measure (also as permitted

under IFRS 4), the modified statutory basis (“MSB”) of reporting as set out in the revised Statement of Recommended Practice (“SORP”) issued by the Association of British Insurers (“ABI”) has been applied to the Prudential Group’s UK and overseas operations.

In 2005, the Prudential Group chose to improve its IFRS accounting for UK regulated with-profits funds by the voluntary application of the UK accounting standard FRS 27, ‘Life Assurance’. Under this standard, the main accounting changes that were required for UK with-profits funds were:

- derecognition of deferred acquisition costs and related deferred tax; and
- replacement of MSB liabilities with adjusted realistic basis liabilities.

The results included in the consolidated financial information set out in Part XIV of this prospectus reflect this basis.

Unallocated surplus represents the excess of assets over policyholder liabilities for the Prudential Group’s with-profits funds that have yet to be appropriated between policyholders and shareholders. The Prudential Group has opted to account for unallocated surplus wholly as a liability with no allocation to equity.

This treatment reflects the fact that shareholders’ participation in the cost of bonuses arises only on distribution. Shareholder profits on with-profits business reflect one-ninth of the cost of declared bonus.

For the Prudential Group’s current overseas operations, the application of the MSB (which permits the use of local GAAP in some circumstances) varies depending upon the basis of accounting applied prior to IFRS adoption or acquisition by the Prudential Group, and whether adjustments to the basis or a more appropriate method should be applied. For Jackson, applying the MSB as applicable to overseas operations, which permits the application of local GAAP in some circumstances, the assets and liabilities of insurance contracts are accounted for under insurance accounting prescribed by US GAAP. For the assets and liabilities of insurance contracts of Prudential Group’s current Asian operations, the local GAAP is applied with adjustments, where necessary, to comply with UK GAAP. For the operations in Taiwan, Vietnam and Japan, countries where local GAAP is not appropriate in the context of the previously applied MSB, accounting for insurance contracts is based on US GAAP. For participating business the liabilities include provisions for the policyholders’ interest in realised investment gains and other surpluses that, where appropriate, and in particular for Vietnam, have yet to be declared as bonuses.

The usage of these bases of accounting has varying effects on the way in which product options and guarantees are measured. For UK regulated with-profits funds, options and guarantees are valued on a market consistent basis. The basis is described in note D2(F)(ii) to the consolidated financial information set out in Part XIV of this prospectus. For other operations a market consistent basis is not applied under the accounting basis described in note A4 to the consolidated financial information set out in Part XIV of this prospectus. Details of the guarantees, basis of setting assumptions, and sensitivity to altered assumptions are described in notes D3 and D4 to the consolidated financial information set out in Part XIV of this prospectus.

### **Valuation and accounting presentation of fair value movements of derivatives and debt securities of Jackson**

Under IAS 39, derivatives are required to be carried at fair value. Unless net investment hedge accounting is applied, value movements on derivatives are recognised in the income statement. With the exception of value movements on derivatives held for variable annuities and other equity related hedging activities, the value movements on derivatives held by Jackson are separately identified within the short-term fluctuations in investment returns identified as part of the Prudential Group’s segment results described below and in note B1 to the consolidated financial information set out in Part XIV of this prospectus. Derivative value movements in respect of equity risk within variable annuity business and other equity related hedging activities are included within the operating profit based on longer-term investment returns.

For derivative instruments of Jackson, the Prudential Group has considered whether it is appropriate to undertake the necessary operational changes to qualify for hedge accounting so as to achieve matching of value movements in hedging instruments and hedged items in the performance statements. In reaching the decision a number of factors were particularly relevant.

These were:

- IAS 39 hedging criteria have been designed primarily in the context of hedging and hedging instruments that are assessable as financial instruments that are either stand-alone or separable from host contracts, rather than, for example, duration characteristics of insurance contracts;
- the high hurdle levels under IAS 39 of ensuring hedge effectiveness at the level of individual hedge transactions;

- the difficulties in applying the macro hedge provisions under IAS 39 (which are more suited to banking arrangements) to Jackson's derivative book;
- the complexity of asset and liability matching of US life insurers such as those with Jackson's product range; and
- whether it is possible or desirable, without an unacceptable level of costs and constraint on commercial activity, to achieve the accounting hedge effectiveness required under IAS 39.

Taking account of these considerations the Prudential Group has decided that, except for certain minor categories of derivatives, it is not appropriate to seek to achieve hedge accounting under IAS 39. As a result of this decision, the total income statement results are more volatile as the movements in the value of Jackson's derivatives are reflected within it.

Under IAS 39, unless carried at amortised cost (subject to impairment provisions where appropriate) under the held-to-maturity category, debt securities are also carried at fair value. The Prudential Group has chosen not to classify any financial assets as held-to-maturity. Debt securities of Jackson are designated as available-for-sale with value movements, unless impaired, being recorded as movements within other comprehensive income. Impairments are recorded in the income statement.

### **Presentation of results before tax**

The total tax charge for the Prudential Group reflects tax that in addition to relating to shareholders' profits is also attributable to policyholders and unallocated surplus of with-profits funds and unit linked policies. This is explained in more detail in note F5 to the consolidated financial information set out in Part XIV of this prospectus.

However, pre-tax profits are determined after transfers to or from unallocated surplus of with-profits funds. These transfers are in turn determined after taking account of tax borne by with-profits funds. Consequently, reported profit before the total tax charge is not representative of pre-tax profits attributable to shareholders. In order to provide a measure of pre-tax profits attributable to shareholders the Prudential Group has chosen to adopt an income statement presentation of the tax charge and pre-tax results that distinguishes between policyholder and shareholder components.

### **Segmental analysis of results and earnings attributable to shareholders**

The Prudential Group uses operating profit based on longer-term investment returns as the segmental measure of its results. The basis of calculation is disclosed in the paragraph in this section entitled "Analysis of IFRS basis operating profit based on longer-term investment returns and IFRS total profit".

For shareholder-backed business, with the exception of debt securities held by Jackson and assets classified as loans and receivables, all financial investments and investment property are designated as assets at fair value through profit and loss. Short-term fluctuations in investment returns on such assets held by with-profits funds do not affect directly reported shareholder results. This is because (i) the unallocated surplus of with-profits funds is accounted for as liabilities and (ii) excess or deficits of income and expenditure of the funds over the required surplus for distribution are transferred to or from unallocated surplus. However, for shareholder-backed businesses the short-term fluctuations affect the result for the year and the Prudential Group provides additional analysis of results to provide information on results before and after short-term fluctuations in investment returns.

## **4. Critical accounting estimates and judgements**

### **Investments**

#### ***Determining the fair value of financial investments when the markets are not active***

The Prudential Group holds certain financial investments for which the markets are not active. These can include financial investments which are not quoted on active markets and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. When the markets are not active, there is generally no or limited observable market data to account for financial investments at fair value. The determination of whether an active market exists for a financial investment requires management's judgement.

If the market for a financial investment of the Prudential Group is not active, the fair value is determined by using valuation techniques. The Prudential Group establishes fair value for these financial investments by using quotations from independent third parties, such as brokers or pricing services or by using internally developed pricing models. Priority is given to publicly available prices from independent sources, when available, but overall the source of pricing and/or the valuation technique is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The valuation techniques include the use of 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 and may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively affect the reported fair value of these financial investments.

The financial investments measured at fair value are classified (from 1 January 2009) into the following three level hierarchy on the basis of the lowest level of inputs that is significant to the fair value measurement of the financial investments concerned:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2: Inputs other than quoted prices included within level 1 that are observable either directly or indirectly (i.e. derived from prices).

Level 3: Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As at 31 December 2009, £5,557 million of the financial investments (net of derivative liabilities) valued at fair value were classified as level 3, which represents 3% of the total financial investments (net of derivative liabilities) carried at fair value at that date. Of these, £1,684 million are held to back shareholder non-linked business, and so changes to these valuations will directly affect shareholders' equity. Further details of the classification of financial instruments are given in note G1 to the consolidated financial information set out in Part XIV of this prospectus.

### ***Determining impairments relating to financial assets***

#### *Available-for-sale securities*

Under IAS 39, the Prudential Group has the option on purchase to account for individual financial instruments as available-for-sale. Currently, the only financial investments carried on an available-for-sale basis by the Prudential Group are represented by Jackson's debt securities portfolio. The consideration of evidence of impairment requires management's judgement. In making this determination the factors considered include, for example:

- Whether the decline of the financial investment's fair value is substantial

A substantial decline in fair value might be indicative of a credit loss event that would lead to a measurable decrease in the estimated future cash flows.

- The impact of the duration of the security on the calculation of the revised estimated cash flows

The duration of a security for maturity helps to inform whether assessments of estimated future cash flows that are higher than market value are reasonable.

- The duration and extent to which the amortised cost exceeds fair value

This factor provides an indication of how the contractual cash flows and effective interest rate of a financial asset compares with the implicit market estimate of cash flows and the risk attaching to a 'fair value' measurement. The length of time for which that level of difference has been in place may also provide further evidence as to whether the market assessment implies an impairment loss has arisen.

- The financial condition and prospects of the issuer or other observable conditions that indicate the investment may be impaired

If a loss event that will have a detrimental effect on cash flows is identified an impairment loss in the income statement is recognised. The loss recognised is determined as the difference between the book cost and the fair value of the relevant impaired securities. This loss comprises the effect of the expected loss of contractual cash flows and any additional market price driven temporary reductions in values.

For Jackson's residential mortgage-backed and other asset-backed securities all of which are classified as available-for-sale, the model used to analyse cash flows begins with the current delinquency experience of the underlying collateral pool for the structure, by applying assumptions about how much of the currently delinquent loans will eventually default, and multiplying this by an assumed loss severity. Additional factors are applied to anticipate ageing effect. After applying a cash flow simulation an indication is obtained as to whether or not the security has suffered, or is anticipated to suffer, principal or interest payment shortfall. If a shortfall applies an impairment charge is recorded.

The difference between the fair value and book cost for unimpaired securities accounted for as available-for-sale falls to be accounted for as unrealised gains or losses, with the movements in the accounting period being accounted for in other comprehensive income.

The Prudential Group's review of fair value involves several criteria, including economic conditions, credit loss experience, other issuer-specific developments and future cash flows. These assessments are based on the best available information at the time. Factors such as market liquidity, the widening of bid/ask spreads and a change in cash flow assumptions can contribute to future price volatility. If actual experience differs negatively from the assumptions and other considerations used in the consolidated financial information, unrealised losses currently in equity may be recognised in the income statement in future periods. The preceding note in this section provides explanation on how fair value is determined when the markets for the financial investments are not active. Further additional details on the impairments of the available-for-sale securities of Jackson are described in notes D3 and G5 of the consolidated financial information set out in Part XIV of this prospectus.

Impairment losses recognised on available-for-sale securities amounted to £35 million, £497 million and £630 million, for 2007, 2008 and 2009 respectively. Of this amount, 14%, 29% and 86% respectively, has been recorded on structured asset-backed securities, primarily due to reduced cash flow expectations on such securities that are collateralised by diversified pools of primarily below investment grade securities. Of the losses related to the impairment of fixed maturity securities the top five individual corporate issuers made up 57%, 27%, and 11%, for 2007, 2008 and 2009 respectively, reflecting a deteriorating business outlook of the companies concerned. The impairment issues have been recorded in "investment return" in the income statement.

In 2007, 2008 and 2009 respectively, the Prudential Group realised gross losses on sales of available-for-sale securities of £86 million, £184 million and £134 million with 46%, 55% and 60% of these losses related to the disposal of fixed maturity securities of six, six, and five (2007, 2008 and 2009 respectively) individual issuers, which were disposed of to rebalance the portfolio in the US operations in response to the unstable mortgage lending.

The effect of those reasonably likely changes in the key assumptions underlying the estimates that underpin the assessment of whether impairment has taken place depends on the factors described above. A key indicator of whether such impairment may arise in future, and the potential amounts at risk, is the profile of gross unrealised losses for fixed maturity securities accounted for on an available-for-sale basis by reference to the time periods by which the securities have been held continuously in an unrealised loss position and by reference to the maturity date of the securities concerned.

The unrealised losses in the US insurance operations statement of financial position on unimpaired securities are £439 million, £3,178 million and £966 million, for 2007, 2008 and 2009 respectively. This reflects assets with fair market value of £10,291 million, £17,422 million, and £7,254 million, for 2007, 2008 and 2009 respectively and a book value of £10,730 million, £20,600 million and £8,220 million, for 2007, 2008 and 2009 respectively.

(a) 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 as at 31 December 2007, 2008 and 2009. Book value represents cost/amortised cost of the debt securities.

Fair value of securities as a percentage of book value	2007		2008		2009	
	Fair value	Unrealised Loss	Fair value	Unrealised Loss	Fair value	Unrealised Loss
	£m		£m		£m	
Between 90% and 100% . . . . .	9,370	(274)	8,757	(431)	5,127	(169)
Between 80% and 90% . . . . .	784	(122)	4,581	(809)	1,201	(203)
Below 80% . . . . .	137	(43)	4,084	(1,938)	926	(594)
Total . . . . .	<u>10,291</u>	<u>(439)</u>	<u>17,422</u>	<u>(3,178)</u>	<u>7,254</u>	<u>(966)</u>

Included within the table above are amounts relating to sub-prime and Alt-A securities of:

Fair value of securities as a percentage of book value	2007		2008		2009	
	Fair value	Unrealised Loss	Fair value	Unrealised Loss	Fair value	Unrealised Loss
	£m		£m		£m	
Between 90% and 100% . . . . .	572	(24)	479	(27)	102	(3)
Between 80% and 90% . . . . .	132	(22)	120	(19)	160	(28)
Below 80% . . . . .	28	(10)	192	(166)	159	(88)
Total . . . . .	<u>732</u>	<u>(56)</u>	<u>791</u>	<u>(212)</u>	<u>421</u>	<u>(119)</u>

Sub-prime and Alt-A securities with unrealised losses of £37 million, £91 million and £21 million in the balance sheet as at 31 December 2007, 2008 and 2009, respectively, have been in an unrealised loss position for less than one year with the remaining securities with unrealised losses of £19 million, £121 million, and £98 million, respectively, being in an unrealised loss position for more than one year.

(b) Unrealised losses by maturity of security

	<u>2007</u> <u>Unrealised</u> <u>Loss</u> <u>£m</u>	<u>2008</u> <u>Unrealised</u> <u>Loss</u> <u>£m</u>	<u>2009</u> <u>Unrealised</u> <u>Loss</u> <u>£m</u>
Less than 1 year . . . . .	(1)	(21)	—
1 to 5 years . . . . .	(54)	(537)	(29)
5 to ten years . . . . .	(164)	(1,236)	(127)
More than ten years . . . . .	(60)	(395)	(92)
Mortgage-backed and other debt securities . . . . .	<u>(160)</u>	<u>(989)</u>	<u>(718)</u>
Total: . . . . .	<u>(439)</u>	<u>(3,178)</u>	<u>(966)</u>

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

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

<u>Aged analysis of</u> <u>unrealised losses for</u> <u>the periods indicated</u>	<u>2007</u>			<u>2008</u>			<u>2009</u>		
	<u>Non-</u> <u>investment</u> <u>grade</u>	<u>Investment</u> <u>grade</u>	<u>Total</u> <u>£m</u>	<u>Non-</u> <u>investment</u> <u>grade</u>	<u>Investment</u> <u>grade</u>	<u>Total</u> <u>£m</u>	<u>Non-</u> <u>investment</u> <u>grade</u>	<u>Investment</u> <u>grade</u>	<u>Total</u> <u>£m</u>
Less than 6 months . . .	(9)	(58)	(67)	(108)	(362)	(470)	(7)	(51)	(58)
6 months to 1 year . . . .	(21)	(115)	(136)	(125)	(1,164)	(1,289)	(25)	(59)	(84)
1 year to 2 years . . . . .	(2)	(21)	(23)	(154)	(622)	(776)	(59)	(234)	(293)
2 years to 3 years . . . . .	(34)	(140)	(174)	(15)	(91)	(106)	(125)	(199)	(324)
More than 3 years . . . . .	<u>(2)</u>	<u>(37)</u>	<u>(39)</u>	<u>(61)</u>	<u>(476)</u>	<u>(537)</u>	<u>(35)</u>	<u>(172)</u>	<u>(207)</u>
Total . . . . .	<u>(68)</u>	<u>(371)</u>	<u>(439)</u>	<u>(463)</u>	<u>(2,715)</u>	<u>(3,178)</u>	<u>(251)</u>	<u>(715)</u>	<u>(966)</u>

(d) Securities whose fair value was below 80% of the book value

As shown in table (a) above, £43 million, £1,938 million and £594 million, for 2007, 2008, and 2009 respectively, of the £439 million, £3,178 million and £966 million of gross unrealised losses as at 31 December 2007, 31 December 2008, and 31 December 2009 respectively, related to securities whose fair value was below 80% of the book value. The analysis of the £43 million, £1,938 million and £594 million for 2007, 2008 and 2009 respectively, by category of debt securities and by age analysis indicating the length of time for which their fair value was below 80% of the book value, is as follows:

<u>Category analysis</u>	<u>2007</u>		<u>2008</u>		<u>2009</u>	
	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>Loss</u> <u>£m</u>	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>Loss</u> <u>£m</u>	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>Loss</u> <u>£m</u>
Residential mortgage-backed securities						
Prime . . . . .	2	(1)	287	(115)	322	(153)
Alt-A . . . . .	27	(10)	144	(127)	77	(33)
Sub-prime . . . . .	<u>—</u>	<u>—</u>	<u>48</u>	<u>(39)</u>	<u>82</u>	<u>(55)</u>
	29	(11)	479	(281)	481	(241)
Commercial mortgage-backed securities . . . . .	4	(1)	811	(375)	87	(86)
Other asset-backed securities . . . . .	<u>4</u>	<u>(1)</u>	<u>198</u>	<u>(86)</u>	<u>183</u>	<u>(188)</u>
Total structured securities . . . . .	37	(13)	1,488	(742)	751	(515)
Corporates . . . . .	<u>100</u>	<u>(30)</u>	<u>2,596</u>	<u>(1,196)</u>	<u>175</u>	<u>(79)</u>
Total . . . . .	<u>137</u>	<u>(43)</u>	<u>4,084</u>	<u>(1,938)</u>	<u>926</u>	<u>(594)</u>

Age analysis of fair value being below 80% for the period indicated:

<u>Age analysis</u>	<u>2007</u>		<u>2008</u>		<u>2009</u>	
	<u>Fair value</u>	<u>Unrealised Loss</u>	<u>Fair value</u>	<u>Unrealised Loss</u>	<u>Fair value</u>	<u>Unrealised Loss</u>
		<u>£m</u>		<u>£m</u>		<u>£m</u>
Less than 3 months . . . . .	137	(43)	3,118	(1,364)	153	(45)
3 months to 6 months . . . . .	—	—	696	(403)	5	(3)
More than 6 months . . . . .	—	—	270	(171)	768	(546)
Total . . . . .	<u>137</u>	<u>(43)</u>	<u>4,084</u>	<u>(1,938)</u>	<u>926</u>	<u>(594)</u>

*Assets held at amortised cost*

Financial assets classified as loans and receivables under IAS 39 are initially recognised at fair value plus transaction costs. Subsequently they are carried at amortised cost using the effective interest rate method. The loans and receivables include loans collateralised by mortgages, deposits and loans to policyholders. In estimating future cash flows, the Prudential Group looks at the expected cash flows of the assets and applies historical loss experience of assets with similar credit risks that has been adjusted for conditions in the historical loss experience which no longer exist or for conditions that are expected to arise. The estimated future cash flows are discounted using the financial asset’s original or variable effective interest rate and exclude credit losses that have not yet been incurred.

The risks inherent in reviewing the impairment of any investment include the risk that market results may differ from expectations; facts and circumstances may change in the future and differ from estimates and assumptions; or the Prudential Group may later decide to sell the asset as a result of changed circumstances.

**Insurance contracts**

*Product classification*

IFRS 4 requires contracts written by insurers to be classified as either ‘insurance contracts’ or ‘investment contracts’ depending on the level of insurance risk transferred. Insurance risk is a pre-existing risk, other than financial risk, transferred from the contract holder to the contract issuer. If significant insurance risk is transferred by the contract then it is classified as an insurance contract. Contracts that transfer financial risk but not significant insurance risk are termed investment contracts. Furthermore, some contracts, both insurance and investment, contain discretionary participating features representing the contractual right to receive additional benefits as a supplement to guaranteed benefits:

- (a) that are likely to be a significant portion of the total contract benefits;
- (b) whose amount or timing is contractually at the discretion of the insurer; and
- (c) that are contractually based on asset or fund performance, as discussed in IFRS 4.

Accordingly, insurers must perform a product classification exercise across their portfolio of contracts issued to determine the allocation to these various categories. IFRS 4 permits the continued usage of previously applied GAAP for insurance contracts and investment contracts with discretionary participating features. Except for UK regulated with-profits funds, as described subsequently, this basis has been applied by the Prudential Group.

For investment contracts that do not contain discretionary participating features, IAS 39 and, where the contract includes an investment management element, IAS 18, apply measurement principles to assets and liabilities attaching to the contract.

*Valuation assumptions*

*i) Contracts of with-profits funds*

The Prudential Group’s insurance contracts and investment contracts with discretionary participating features are primarily with-profits and other protection type policies. For UK regulated with-profits funds, the contract liabilities are valued by reference to the FSA realistic basis. In aggregate, this basis has the effect of placing a value on the liabilities of UK with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances.

The basis of determining liabilities for the Prudential Group’s with-profits business has little or no effect on the results attributable to shareholders. This is because movements on liabilities of the with-profits funds are absorbed by the unallocated surplus. Except through indirect effects, or in remote circumstances as described below, changes

to liability assumptions are therefore reflected in the carrying value of the unallocated surplus, which is accounted for as a liability rather than shareholders' equity.

A detailed explanation of the basis of liability measurement is contained in note D2(f)(ii) to the consolidated financial information set out in Part XIV of this prospectus. The Prudential Group's other with-profits contracts are written in with-profits funds that operate in some of the Prudential Group's Asian operations. The liabilities for these contracts and those of Prudential Annuities Limited, which is a subsidiary company of the PAC with-profits funds, are determined differently. For these other with-profits contracts applicable to the Prudential Group's activities in 2007, 2008 and 2009, the liabilities are estimated using actuarial methods based on assumptions relating to premiums, interest rates, investment returns, expenses, mortality and surrenders. The assumptions to which the estimation of these reserves is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders.

For liabilities determined using the basis described above for UK regulated with-profits funds, and the other liabilities described in the preceding paragraph, changes in estimates arising from the likely range of possible changes in underlying key assumptions have no direct impact on the reported profit.

This lack of sensitivity reflects the with-profits fund structure, basis of distribution, and the application of previous GAAP to the unallocated surplus of with-profits funds as permitted by IFRS 4. Changes in liabilities of these contracts that are caused by altered estimates are absorbed by the unallocated surplus of the with-profits funds with no direct effect on shareholders' equity. The Prudential Group's obligations and more detail on such circumstances are described in note H14 to the consolidated financial information set out in Part XIV of this prospectus.

#### *ii) Other contracts*

Contracts, other than those of with-profits funds, are written in shareholder-backed operations of the Prudential Group. The significant shareholder-backed product groupings and the factors that may significantly affect IFRS results due to experience against assumptions or changes of assumptions vary significantly between business units. For some types of business the effect of changes in assumptions may be significant, whilst for others, due to the nature of the product, assumption setting may be of less significance. The nature of the products and the significance of assumptions are discussed in notes D2, D3 and D4 to the consolidated financial information set out in Part XIV of this prospectus. From the perspective of shareholder results the key sensitivity relates to the assumption for allowance for credit risk for UK annuity business. Prior to its disposal of the Taiwan agency business in the first half of 2009, the Prudential Group's financial results were also sensitive to the assumed future investment returns for that business.

#### *Jackson*

Jackson offers individual fixed annuities, fixed index annuities, immediate annuities, variable annuities, individual and variable life insurance and institutional products. With the exception of institutional products and an incidental amount of business for annuity certain contracts, which are accounted for as investment contracts under IAS 39, all of Jackson's contracts are accounted for under IFRS 4 as insurance contracts by applying US GAAP, the previous GAAP used before IFRS adoption. Under US GAAP the requirements of FAS 60 'Accounting and Reporting for Insurance Enterprises' and FAS 97 'Accounting and Reporting by Insurance Enterprises for certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments' apply to these contracts. The accounting requirements under these standards and the effect of changes in valuation assumptions are considered below for fixed annuity, variable annuity and traditional life insurance contracts.

Fixed annuity contracts, which are investment contracts under US GAAP terminology, are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts, namely deferred income, any amounts previously assessed against policyholders that are refundable on termination of the contract, and any premium deficiency, i.e. any probable future loss on the contract. These types of contract contain considerable interest rate guarantee features.

Notwithstanding the accompanying market risk exposure, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of Jackson's fixed annuity products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement.

Variable annuity contracts written by Jackson may provide for guaranteed minimum death, income, or withdrawal benefit features. In general terms, liabilities for these benefits are accounted for under US GAAP by using estimates of future benefits and fees under best estimate assumptions.

For variable annuity business, the key assumption is the expected long-term level of equity market returns, which for all years included in this prospectus was 8.4% per annum (gross of fund management fees) determined using a mean reversion methodology. Under the mean reversion methodology, projected returns over the next five years are flexed (subject to capping) so that, combined with the actual rates of return for the current and the previous two years the 8.4% rate is maintained. The projected rates of return are capped at no more than 15% for each of the next five years. Further details are explained in note D3(h) to the consolidated financial information set out in Part XIV of this prospectus.

These returns affect the level of future expected profits through their effects on the fee income with consequential impact on the amortisation of deferred acquisition costs as described below and the required level of provision for guaranteed minimum death benefit claims.

For traditional life insurance contracts, provisions for future policy benefits are determined using the net level premium method and assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviation.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and the guaranteed minimum death benefit reserves, the profits of Jackson are relatively insensitive to changes in insurance risk. This reflects the principally spread and fee-based nature of Jackson's business.

#### *Asian operations*

The insurance products written in the Prudential Group's Asian operations principally cover with-profits business, unit-linked business, and other non-participating business. The results of with-profits business are relatively insensitive to changes in estimates and assumptions that affect the measurement of policyholder liabilities. As for the UK business, this feature arises because unallocated surplus is accounted for by the Prudential Group as a liability. The results of Asian unit-linked business are also relatively insensitive to changes in estimates or assumptions.

Prior to its disposal in the first half of 2009, the principal non-participating business in the Prudential Group's Asian operations, for which changes in estimates and assumptions were important from year to year, was the traditional whole-life business written in Taiwan. Premium rates were set to give a guaranteed minimum sum assured on death and a guaranteed surrender value on early surrender based on prevailing interest rates at the time of policy issue. Premium rates also included an allowance for mortality and expenses. This business was therefore especially sensitive to falling interest rates. This exposure has been removed following the disposal of the Taiwan agency business. The remaining non-participating business in Asia remains sensitive to interest rates but this sensitivity is of a much lower order. Further details are provided in note D4(i) to the consolidated financial information set out in Part XIV of this prospectus.

#### **Deferred acquisition costs**

Significant costs are incurred in connection with acquiring new insurance business. Except for acquisition costs of with-profits contracts of the UK regulated with-profits funds, which are accounted for under the realistic FSA regime as described in note A4 to the consolidated financial information set out in Part XIV of this prospectus, these costs, which vary with, and are primarily related to, the production of new business, are capitalised and amortised against margins in future revenues on the related insurance policies. The recoverability of the asset is measured and the asset is deemed impaired if the projected future margins are less than the carrying value of the asset. To the extent that the future margins differ from those anticipated, then an adjustment to the carrying value of the deferred acquisition cost asset will be necessary.

The deferral and amortisation of acquisition costs is of most relevance to the Prudential Group's results for shareholder-financed long-term business of Jackson and Asian operations. The majority of the UK shareholder-backed operations is for individual and group annuity business where the incidence of acquisition costs is negligible.

#### *Jackson*

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the long-term spread between the earned rate and the rate credited to policyholders, which is based on the annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all

of which are based on a combination of Jackson's actual industry experience and future expectations. A detailed analysis of actual experience is measured by internally developed mortality studies.

For variable annuity business, the key assumption is the expected long-term level of equity market returns as described above. The level of acquisition costs carried in the statement of financial position is also sensitive to unrealised valuation movements on debt securities held to back the liabilities and solvency capital. Further details are explained in notes D3(h) and H1 to the consolidated financial information set out in Part XIV of this prospectus.

#### *Asian operations*

In 2008, a number of changes have been made to the basis of estimating the level of deferred acquisition costs, as described in note D4(h)(c) to the consolidated financial information set out in Part XIV of this prospectus.

#### **Pensions**

The Prudential Group applies the requirements of IAS 19, 'Employee Benefits' and associated interpretations including IFRIC 14 'IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', to its defined benefit pension schemes. The principal defined benefit pension scheme is the Prudential Staff Pension Scheme ("PSPS"). For PSPS the terms of the trust deed restrict shareholders' access to any underlying surplus. Accordingly, applying the interpretation of IFRIC 14, any underlying IAS 19 basis surplus is not recognised for IFRS reporting.

The financial position for PSPS recorded in the IFRS financial information reflects the higher of any underlying IAS 19 deficit and any obligation for deficit funding.

The economic participation in the surplus or deficits attaching to PSPS and the smaller Scottish Amicable Pensions Scheme ("SAPS") are shared between the PAC with-profits sub-fund ("WPSF") and shareholder operations. The economic interest reflects the source of contributions over the scheme life, which in turn reflects the activity of the members during their employment.

In the case of PSPS, movements in the apportionment of the financial position for PSPS between the WPSF and shareholders' funds in 2009 reflect the 70/30 ratio applied to the base deficit position as at 31 December 2005 but with service cost and contributions for ongoing service apportioned by reference to the cost allocation for activity of current employees. For SAPS, the ratio is estimated to be 50/50 between the WPSF and shareholders' funds.

Due to the inclusion of actuarial gains and losses in the income statement rather than being recognised in other comprehensive income, the results of the Prudential Group are affected by changes in interest rates for corporate bonds that affect the rate applied to discount projected pension payments and changes in mortality assumptions and changes in inflation assumptions.

The table below shows the sensitivity of the underlying PSPS, Scottish Amicable and M&G pension scheme liabilities as at 31 December 2009 of £4,436 million, £515 million and £223 million respectively to changes in discount rates and inflation rates.

<u>Assumption</u>	<u>Change in assumption</u>	<u>2009</u>	
		<u>Impact on scheme liabilities on IAS 19 basis</u>	
Discount rate	Decrease by 0.2% from 5.8% to 5.6%	Increase in scheme liabilities by:	
		PSPS	3.5%
		Scottish Amicable	5.2%
		M&G	4.9%
Discount rate	Increase by 0.2% from 5.8% to 6.0%	Decrease in scheme liabilities by:	
		PSPS	3.2%
		Scottish Amicable	4.8%
		M&G	4.9%
Rate of inflation	Decrease by 0.2% from 3.7% to 3.5% with consequent reduction in salary increases	Decrease in scheme liabilities by:	
		PSPS	0.9%
		Scottish Amicable	4.9%
		M&G	4.5%

The sensitivity of the underlying pension scheme liabilities to changes in discount rates and inflation rates as shown above does not directly equate to an impact on the profit or loss attributable to shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial

position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund. Further information is included in note I2 of the consolidated financial information set out in Part XIV of this prospectus.

For PSPS, the underlying surplus of the scheme of £528 million, £728 million and £513 million as at 31 December 2007, 2008 and 2009, respectively, has not been recognised under IFRIC 14. Any change in the underlying scheme liabilities to the extent that it is not sufficient to alter PSPS into a liability in excess of the deficit provision, will not have an impact on the Prudential Group's results and financial position.

In the event that a change in the PSPS scheme liabilities results in a deficit position for the scheme which is recognisable, the deficit recognised affects the Prudential Group's results and financial position only to the extent of the amounts attributable to shareholder operations. The amounts attributable to the PAC with-profits fund are absorbed by the liability for unallocated surplus and have no direct effect on the profit or loss attributable to shareholders or shareholders' equity.

This applies similarly to the Scottish Amicable scheme, whose deficit has been allocated 50% to the PAC with-profits fund and 50% to the PAC shareholders fund.

### **Deferred tax**

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 the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The taxation regimes applicable across the Prudential Group apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets. The judgements made, and uncertainties considered, in arriving at deferred tax balances in the financial information are discussed in note H4 to the Prudential Group's consolidated financial information set out in Part XIV of this prospectus.

### **Goodwill**

Goodwill impairment testing requires the exercise of judgement by management as to prospective future cash flows. Further information is disclosed in note H1 to the consolidated financial information set out in Part XIV of this prospectus.

## **5. Basis of profits**

### **5.1 UK**

The Prudential Group's results comprise an annual profit distribution to shareholders from its UK long-term with-profits fund, hereafter referred to as the with-profits fund, as well as profits from its other businesses. For most of the Prudential Group's operations, other than its UK long-term insurance businesses, the IFRS basis of accounting matches items of income and related expenditure within the same accounting period. This is achieved through the deferral of acquisition costs and application of the accruals concept.

#### ***With-profits products***

For the Prudential Group's UK insurance operations, the primary annual contribution to shareholders' profit comes from its with-profits products. With-profits products are designed to provide policyholders with smoothed investment returns through a mix of regular and final bonuses.

Shareholders' profit in respect of bonuses from with-profits products represents an amount of up to one-ninth of the value of that year's bonus declaration to policyholders. The board of directors of the subsidiary companies that have with-profits operations, using actuarial advice, determine the amount of regular and final bonuses to be declared each year on each group of contracts. The smoothing inherent in the bonus declarations provides for relatively stable annual shareholders' profit from this business.

#### ***Bonus rates***

Bonus rates are applied to with-profits policies in the UK and similar products in Singapore, Hong Kong and Malaysia. The most significant with-profits fund is in the UK where, as at 31 December 2009, liabilities to with-profits policyholders were in aggregate of £55.6 billion. Liabilities to with-profits policyholders in Asia as at 31 December 2009 were £8.8 billion. The details that follow are in respect of the UK with-profits business. The method by which bonuses for the Prudential Group's Asia with-profits business are determined is substantially similar to the method by which bonuses for the Prudential Group's UK with-profits business are determined.

The main factors that influence the determination of bonus rates are the return on the investments of the with-profits fund, the effect of inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. The overall rate of return earned on investments and the expectation of future investment returns are the most important influences on bonus rates. A high proportion of the assets backing the with-profits business are invested in equities and real estate. If the financial strength of the with-profits fund were adversely affected, then a higher proportion of fixed interest or similar assets might be held by the fund.

Further details on the determination of the two types of bonus (“regular” and “final”), the application of significant judgement, key assumptions and the degree of smoothing of investment returns in determining the bonus rates are provided below.

#### *Regular bonus rates*

For regular bonuses, the bonus rates are determined for each type of policy primarily by targeting the bonus level at a prudent proportion of the long-term expected future investment return on underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders’ transfers. However, the rates declared may differ by product type, or by the date of payment of the premium or date of issue of the policy or if the accumulated annual bonuses are particularly high or low relative to a prudent proportion of the achieved investment return.

When target bonus levels change, the PAC board of directors has regard to the overall strength of the long-term fund when determining the length of time over which it will seek to achieve the amended prudent target bonus level.

In normal investment conditions, PAC expects changes in regular bonus rates to be gradual over time, and these are not expected to exceed 1% per annum over any year. However, the directors of PAC retain the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

#### *Final bonus rates*

A final bonus, which is normally declared yearly, may be added when a claim is paid or when units of a unitised product are realised.

The rates of final bonus usually vary by type of policy and by reference to the period, usually a year, in which the policy commences or each premium is paid. These rates are determined by reference to the asset shares for the sample policies but subject to the smoothing approach, explained below.

In general, the same final bonus scale applies to maturity, death and surrender claims except that:

- the total surrender value may be impacted by the application of a Market Value Reduction (“MVR”) (for accumulating with-profits policies) and is affected by the surrender bases (for conventional with-profits business); and
- for the Scottish Amicable Insurance Fund (“SAIF”) and Scottish Amicable Life (“SAL”), the final bonus rates applicable on surrender may be adjusted to reflect expected future bonus rates.

#### *Application of significant judgement*

The application of the above method for determining bonuses requires the PAC board of directors to apply significant judgement in many respects, including in particular the following:

- Determining what constitutes fair treatment of customers: Prudential is required by UK law and regulation to consider the fair treatment of its customers in setting bonus levels. The concept of determining what constitutes fair treatment, while established by statute, is not defined.
- Smoothing of investment returns: Smoothing of investment returns is an important feature of with-profits products. Determining when particular circumstances, such as a significant rise or fall in market values, warrant variations in the standard bonus smoothing limits that apply in normal circumstances requires the PAC Board to exercise significant judgement.
- Determining at what level to set bonuses to ensure that they are competitive: The overall return to policyholders is an important competitive measure for attracting new business.

#### *Key assumptions*

As noted above, the overall rate of return on investments and the expectation of future investment returns are the most important influences in bonus rates, subject to the smoothing described below. Prudential determines the

assumptions to apply in respect of these factors, including the effects of reasonably likely changes in key assumptions, in the context of the overarching discretionary and smoothing framework that applies to its with-profits business as described above. As such, it is not possible to quantify specifically the effects of each of these assumptions or of reasonably likely changes in these assumptions.

Prudential's approach, in applying significant judgement and discretion in relation to determining bonus rates, is consistent conceptually with the approach adopted by other firms that manage a with-profits business. It is also consistent with the requirements of UK law, which require all UK firms that carry out a with-profits business to define, and make publicly available, the Principles and Practices of Financial Management ("PPFM") that are applied in the management of their with-profits funds.

Accordingly, Prudential's PPFM contains an explanation of how it determines regular and final bonus rates within the discretionary framework that applies to all with-profits policies, subject to the general legislative requirements applicable. The purpose of Prudential's PPFM is therefore to:

- explain the nature and extent of the discretion available;
- show how competing or conflicting interests or expectations of different groups and generations of policyholders, and policyholders and shareholders are managed so that all policyholders and shareholders are treated fairly; and
- provide a knowledgeable observer (e.g. a financial adviser) with an understanding of the material risks and rewards from starting and continuing to invest in a with-profits policy with Prudential.

Furthermore, in accordance with industry-wide regulatory requirements, the PAC Board has appointed:

- an Actuarial Function Holder who provides the PAC board of directors with all actuarial advice;
- a With-Profits Actuary whose specific duty is to advise the PAC board of directors on the reasonableness and proportionality of the manner in which its discretion has been exercised in applying the PPFM and the manner in which any conflicting interests have been addressed; and
- a With-Profits Committee of independent individuals, which assesses the degree of compliance with the PPFM and the manner in which conflicting rights have been addressed.

#### *Smoothing of investment return*

In determining bonus rates for the UK with-profits policies, smoothing is applied to the allocation of the overall earnings of the UK with-profits fund of which the investment return is a significant element. The smoothing approach differs between accumulating and conventional with-profits policies to reflect the different contract features. In normal circumstances, Prudential does not expect most payout values on policies of the same duration to change by more than 10% up or down from one year to the next, although some larger changes may occur to balance payout values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values, and in such situations the PAC board of directors may decide to vary the standard bonus smoothing limits in order to protect the overall interests of policyholders.

The degree of smoothing is illustrated numerically by comparing in the following table the relatively “smoothed” level of policyholder bonuses declared as part of the surplus for distribution with the more volatile movement in investment return and other items of income and expenditure of the UK component of the PAC with-profits fund for each year presented.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Net income of the fund:			
Investment return . . . . .	5,881	(14,595)	10,461
Claims incurred . . . . .	(6,512)	(7,068)	(6,253)
Movement in policyholder liabilities . . . . .	(2,307)	13,504	(3,692)
Add back policyholder bonuses for the year (as shown below) . . . . .	2,522	2,565	1,827
Claims incurred and movement in policyholder liabilities (including charge for provision for asset shares and excluding policyholder bonuses) . . . . .	(6,297)	9,001	(8,118)
Earned premiums, net of reinsurance . . . . .	4,181	2,927	3,063
Other income . . . . .	1,417	(36)	(2)
Acquisition costs and other operating expenditure . . . . .	(2,105)	(408)	(842)
Tax (charge) credit . . . . .	(24)	1,191	(640)
Net income of the fund before movement in unallocated surplus . . . . .	3,053	(1,920)	3,922
Movement in unallocated surplus . . . . .	(252)	4,769	(1,893)
Surplus for distribution . . . . .	<u>2,801</u>	<u>2,849</u>	<u>2,029</u>
Surplus for distribution allocated as follows:			
—90% policyholders’ bonus (as shown above) . . . . .	2,522	2,565	1,827
—10% shareholders’ transfers . . . . .	279	284	202
	<u>2,801</u>	<u>2,849</u>	<u>2,029</u>

### ***Unallocated surplus***

The unallocated surplus represents the excess of assets over policyholder liabilities of the Prudential Group’s with-profits funds. The annual excess or shortfall of income over expenditure of the with-profits funds after declaration and attribution of the cost of bonuses to policyholders and shareholders is transferred to, or from, the unallocated surplus through a charge or credit to the income statement. The balance retained in the unallocated surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance of the unallocated surplus is determined after full provision for deferred tax on unrealised appreciation on investments.

Changes to the level of the unallocated surplus do not directly impact shareholders’ results or funds. After allowing for differences in the basis of preparation of the financial information and UK regulatory returns, movements in the level of the unallocated surplus are broadly indicative of movements in the excess of regulatory basis assets over liabilities of the fund. Differences in the basis of preparation of financial statements and UK regulatory returns arise principally from the treatment of certain regulatory basis liabilities, such as mismatching reserves (that are accounted for as reserves within the unallocated surplus), and asset valuation differences and admissibility deductions reflected in the regulatory returns. Except to the extent of any second order effects on other elements of the regulatory returns, such changes can be expected to have a consequent effect on the excess of assets over liabilities of the fund for the purposes of solvency calculations, and the related free asset ratio which is an indicator of the overall financial strength of the fund. Similar principles apply to the Prudential Group’s Asian with-profits business.

### ***Surplus assets and their use***

The liability for unallocated surplus comprises amounts the Prudential Group expects to pay to policyholders in the future, the related shareholder transfers and surplus assets. These surplus assets have accumulated over many years from a variety of sources and provide the with-profits fund with working capital. This working capital permits the Prudential Group to invest a substantial portion of the assets of the with-profits fund in equity securities and real estate, smooth investment returns to with-profits policyholders, keep its products competitive, write new business without being constrained as to cash flows in the early policy years and demonstrate solvency.

In addition, the Prudential Group can use surplus assets to absorb the costs of significant events, such as fundamental strategic change in its long-term business and, with the consent of the UK regulator, the cost of its historical pensions mis-selling, without affecting the level of distributions to policyholders and shareholders. The

costs of fundamental strategic change may include investment in new technology, redundancy and restructuring costs, cost overruns on new business and the funding of other appropriate long-term insurance related activities, including acquisitions.

### *The “SAIF” and “PAL” funds*

The Prudential Group’s with-profits fund also includes the SAIF and the wholly-owned subsidiary, PAL. All assets of the SAIF business are solely attributable to former policyholders of Scottish Amicable Life Assurance Society (predating the acquisition of Scottish Amicable by the Prudential Group in October 1997). Since PAL is a wholly-owned subsidiary of the with-profits fund, profits from this business affect shareholders’ profits only to the extent that they affect the annual with-profits bonus declaration and resultant transfer to shareholders.

### *Accounting for with-profits business*

For with-profits business (including non-participating business of Prudential Annuities Limited which is owned by the PAC with-profits fund), adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on the annual declaration of bonuses, shareholder profit for with-profits business is unaffected. This is because IFRS basis profits for the with-profits business, which are determined on the same basis as on preceding UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year.

### *Fair value of assets*

Changes in the fair value of assets of the Prudential Group’s long-term with-profits funds will primarily be reflected in the excess of assets over liabilities recorded as the unallocated surplus. Shareholders’ profits from with-profits business and shareholders’ funds are not directly impacted by movements in the fair values of the assets. However, current investment performance is a factor that is taken into account in the setting of the annual declaration of bonuses which, in turn, affects UK shareholder profits to the extent of one-ninth of the cost of bonus.

### *Investment returns*

For with-profits business, investment returns together with other income and expenditure are recorded within the income statement. However, the difference between net income of the fund and the cost of bonuses and related statutory transfers is reflected in an amount transferred to or from the unallocated surplus within the income statement. Except to the extent of current investment returns being taken into account in the setting of a bonus policy, the investment returns of a with-profits fund in a particular year do not affect shareholder profits or with-profits funds.

## **5.2 United States**

The profit on Jackson’s business predominantly arises from spread income from interest sensitive products, such as fixed annuities, institutional products and fee income on variable annuities.

## **5.3 Asia**

The assets and liabilities of contracts classified as insurance under IFRS 4 are determined in accordance with methods prescribed by local GAAP and adjusted to comply, where necessary, with UK GAAP. Under IFRS 4, subject to the conditions of that standard, the continued application of UK GAAP in this respect is permitted.

For Asian operations in countries where local GAAP is not well established and in which the business is primarily non-participating and linked business, US GAAP is used as the most appropriate reporting basis. This basis is applied in Japan and Vietnam, and materially for 2007 and 2008, but less for 2009 following the sale of the agency business, in Taiwan. For with-profits business in Hong Kong, Singapore and Malaysia, the basis of profit recognition is bonus driven as described in the section 5.1 above.

## **6. Results of operations and financial condition**

### **Determining operating segments and performance measure of operating segments**

The Prudential Group determines and presents operating segments based on the information that internally is provided to the Group Executive Committee (“GEC”), which is the Prudential Group’s chief operating decision maker.

An operating segment is a component of the Prudential Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the

Prudential Group's other components. An operating segment's operating results are reviewed regularly by the GEC to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

The operating segments identified by the Prudential Group reflect the Prudential Group's organisational structure, which is by both geography (Asia, US, UK) and by product line (insurance operations versus asset management). The Prudential Group's operating segments as determined under IFRS 8 are:

- Insurance operations
  - Asia
  - US (Jackson)
  - UK
- Asset management operations
  - M&G
  - Asian asset management
  - US broker dealer and asset management (including Curian).

Prudential Capital has been incorporated into the M&G operating segment for the purposes of segment reporting.

The performance measure of operating segments utilised by the Prudential Group is IFRS operating profit attributable to shareholders based on longer-term investment returns. This measure excludes the recurrent items of short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. In addition, for 2009 this measure excludes the non-recurrent cost of hedging the Prudential Group IGD capital surplus included within short-term fluctuations in investment returns. In 2009, the Prudential Group sold its Taiwan agency business. In order to facilitate comparisons on a like-for-like basis, the loss on sale and the results of the Taiwan agency business during the period of ownership (including those for the 2007 and 2008 comparatives) are shown separately within the segmental analysis of profit. Segment results that are reported to the GEC include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and Asia Regional Head Office.

For the purposes of measuring operating profit, investment returns on shareholder-financed business are based on the expected longer-term rates of return. This reflects the particular features of long-term insurance business where assets and liabilities are held for the long term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance for life businesses exclusive of changes in market conditions. In determining profit on this basis, the following key elements are applied to the results of the Prudential Group's shareholder-financed operations.

#### ***Debt and equity securities***

Longer-term investment returns comprise income and longer-term capital returns. For debt securities, the longer-term capital returns comprise two elements. These are a risk margin reserve ("RMR") based charge for expected defaults, which is determined by reference to the credit quality of the portfolio, and amortisation of interest-related realised gains and losses to operating results based on longer-term investment returns to the date when sold bonds would have otherwise matured. The shareholder-backed operation for which the risk margin reserve charge is most significant is Jackson National Life. The RMR charge for Jackson is based on long-term average default and recovery data as published by Moody's. During 2009 refinements were made to the RMR process following the National Association of Insurance Commissioners ("NAIC") issuing risk-based capital valuation data for more than 20,000 RMBS securities.

Longer-term equity returns comprise aggregate long-term income and capital returns.

#### ***Derivative value movements***

Value movements for Jackson's equity-based derivatives and variable annuity product embedded derivatives are included in operating profits based on longer-term investment returns. The inclusion of these movements is so as to broadly match with the results on the Jackson variable annuity book that pertain to equity market movements, (subject to some limitations for GMDB products where US GAAP insurance accounting does not fully reflect the economic features being hedged). These accounting mismatches are magnified in a period of significant market movements.

Other derivative value movements are excluded from operating results based on longer-term investment returns. These derivatives are primarily held by Jackson as part of a broadly based hedging programme for features of Jackson's bond portfolio (for which value movements are booked directly to shareholders' equity rather than income statement) and product liabilities (for which US GAAP accounting does not reflect the economic features being hedged).

These key elements are of most importance in determining the operating results based on longer-term investment returns of Jackson.

There are two exceptions to the basis described above for determining operating results based on longer-term investment returns. These are for:

- Unit-linked and US variable annuity separate account business.

For such business, the policyholder liabilities are directly reflective of the asset value movements. Accordingly, all asset value movements are recorded in the operating results based on longer-term investment returns.

- Assets covering non-participating business liabilities that are interest rate sensitive.

For UK annuity business, policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the "operating results based on longer-term investment returns". Policyholder liabilities include a margin for credit as explained in note D2(f)(iii) of the consolidated financial information set out in Part XIV of this prospectus. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

#### ***Liabilities to policyholders and embedded derivatives for product guarantees***

Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between territories depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities are broadly equivalent in the income statement, and operating profit based on longer-term investment returns is not distorted. In these circumstances there is no need for the movement in the liability to be bifurcated between the element that relates to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (i.e. after allocated investment returns and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

#### *Asia*

##### ***Vietnamese participating business***

For the participating business in Vietnam, the liabilities include policyholders' interest in investment appreciation and other surplus. Bonuses paid in a reporting period and accrued policyholder interest in investment appreciation and other surpluses primarily reflect the level of realised investment gains above contract-specific hurdle levels. For this business operating profit based on longer-term investment returns includes the aggregate of longer-term returns on the relevant investments, a credit or charge equal to movements on the liability for the policyholders' interest in realised investment gains (net of any recovery of prior deficits on the participating pool), less amortisation over five years of current and prior movements on such credits or charges.

The overall purpose of these adjustments is to ensure that investment returns included in operating results equal longer-term returns but that in any one reporting period movements on liabilities to policyholders caused by investment returns are substantially matched in the presentation of the segmental analysis of profit before tax attributable to policyholders.

##### ***Non-participating business***

Liabilities are bifurcated so that the movement in the carrying value of liabilities is split between that which is included in operating results based on longer-term investment returns, and the residual element for the effect of using year-end rates is included in short-term fluctuations and in the income statements.

### ***Guaranteed Minimum Death Benefit product features***

For unhedged Guaranteed Minimum Death Benefit (“GMDB”) liabilities accounted for under IFRS using ‘grandfathered’ US GAAP, such as in the Japanese business, the change in carrying value is determined under FASB Accounting Standards Codification Subtopic 944-80 (formerly SOP 03-1), which partially reflects changes in market conditions. Under the Prudential Group’s supplementary basis of reporting, the operating profit reflects the change in liability based on longer-term market conditions with the difference between the charge to the operating result and the movement reflected in the total result included in short-term fluctuations in investment returns.

### ***US operations — embedded derivatives for variable annuity guarantee features***

Under IFRS, the Guaranteed Minimum Withdrawal Benefit (“GMWB”) and Guaranteed Minimum Income Benefit (“GMIB”) reinsurance are required to be fair valued as embedded derivatives. The movements in carrying values are affected by changes in the level of observed implied equity volatility and changes to the discount rate applied from year to year. For these embedded derivatives, as described in note D3(i) to the Prudential Group’s consolidated financial information set out in part XIV of this prospectus, the discount rate applied reflects AA corporate bond curve rates. For the purposes of determining operating profit based on longer-term investment returns, the charge for these features is determined using historical longer-term equity volatility levels and long-term average AA corporate bond rate curves.

### ***UK shareholder-backed annuity business***

With one exception, the operating result based on longer-term investment returns reflects the impact of all value movements on policyholder liabilities for annuity business in PRIL and the PAC non-profit sub-fund.

The exception is for the impact on credit risk provisioning of actual downgrades during the year. As this feature arises due to short-term market conditions the effect of downgrades, if any, in a particular period, on the overall provisions for credit risks is included in the category of short-term fluctuations in investment returns.

The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest applied to portfolio rebalancing to align more closely with the management benchmark.

### ***Fund management and other non-insurance businesses***

For these businesses, the particular features applicable for life assurance noted above do not apply. For these businesses, it is inappropriate to include returns in the operating result on the basis described above. Instead, it is appropriate to generally include realised gains and losses (including impairments) in the operating result with unrealised gains and losses being included in short-term fluctuations. For this purpose impairments are calculated as the credit loss determined by comparing the projected cash flows discounted at the original effective interest rate with the carrying value. In some instances it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying substance of the arrangements.

### ***Actuarial and other gains and losses on defined benefit pension schemes***

Actuarial and other gains and losses on defined benefit pension schemes principally reflect short-term value movements on scheme assets and the effects of changes in actuarial assumptions. Under the Prudential Group’s accounting policies these items are records within the income statement, rather than through other comprehensive income, solely due to the interaction of the Prudential Group’s approach to adoption of IFRS 4 for with-profits funds and the requirements of IAS 19. In analysing profit before shareholder tax the separate identification of these gains and losses is analogous to the more normal treatment of inclusion as a movement on other comprehensive income (i.e. not within profit for the period).

## Analysis of IFRS basis operating profit based on longer-term investment returns and IFRS total profit

	2007	2008	2009
	£m	£m	£m
Insurance business			
Long-term business <sup>(ii)</sup>			
Asia . . . . .	140	257	416
US <sup>(iv)</sup> . . . . .	444	406	459
UK . . . . .	524	545	606
Development expenses . . . . .	<u>(15)</u>	<u>(26)</u>	<u>(6)</u>
Long-term business profit . . . . .	1,093	1,182	1,475
UK general insurance commission <sup>(v)</sup> . . . . .	4	44	51
Asset management business			
M&G . . . . .	254	286	238
Asia asset management . . . . .	72	52	55
Curian . . . . .	(5)	(3)	(6)
US broker-dealer and asset management <sup>(iv)</sup> . . . . .	<u>13</u>	<u>10</u>	<u>10</u>
	<u>1,431</u>	<u>1,571</u>	<u>1,823</u>
Other income and expenditure <sup>(viii)</sup> . . . . .	(260)	(260)	(395)
Restructuring costs <sup>(ix)</sup> . . . . .	<u>(19)</u>	<u>(28)</u>	<u>(23)</u>
<b>Total IFRS basis operating profit based on longer-term investment returns<sup>(i)</sup> . . . . .</b>	<b>1,152</b>	<b>1,283</b>	<b>1,405</b>
Short-term fluctuations in investment returns <sup>(vi)</sup>			
Insurance operations . . . . .	(50)	(1,408)	166
IGD hedge costs . . . . .	—	—	(235)
Other operations . . . . .	<u>(1)</u>	<u>(313)</u>	<u>105</u>
Total short-term fluctuations in investment returns . . . . .	(51)	(1,721)	36
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes <sup>(vii)</sup> . . . . .	<u>(1)</u>	<u>(13)</u>	<u>(74)</u>
Profit/(loss) before loss on sale and results of Taiwan agency business . . . . .	1,100	(451)	1,367
Loss on sale and results of Taiwan agency business <sup>(iii)</sup> . . . . .	<u>(37)</u>	<u>1</u>	<u>(621)</u>
Profit (loss) before tax from continuing operations attributable to shareholders . . . . .	1,063	(450)	746
Tax (charge) credit attributable to shareholders' profit . . . . .	(354)	59	(55)
Discontinued operations (net of tax) . . . . .	<u>241</u>	<u>—</u>	<u>(14)</u>
Profit (loss) for the year . . . . .	950	(391)	677
Minority interests . . . . .	<u>(3)</u>	<u>(5)</u>	<u>(1)</u>
<b>Total profit (loss) for the year attributable to equity holders of Prudential . . . . .</b>	<b><u>947</u></b>	<b><u>(396)</u></b>	<b><u>676</u></b>

### Notes

(i) Operating profit based on longer-term investment returns.

Operating profit based on longer-term investment returns is a supplemental measure of results and is the basis on which management regularly review the performance of the Prudential Group's segments as defined by IFRS 8. For the purposes of measuring operating profit, investment returns on shareholder-financed business are based on expected long-term rates of return as discussed above. The expected long-term rates of return are intended to reflect historical rates of return and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The most significant operation that requires adjustment for the difference between actual and long-term investment returns is Jackson. The amounts included in operating results for long-term capital returns for Jackson's debt securities comprise two components. These are a risk margin reserve-based charge for long-term expected defaults, which is determined by reference to the credit quality of the portfolio, and amortisation of interest-related realised gains and losses to operating results based on longer-term results to the date when sold bonds would otherwise have matured. Consistent with the policy of including longer-term investment returns in the measure of operating profit, movements in policyholder liabilities are also, where appropriate, delineated between amounts included in operating profits and movements arising from short-term market conditions, which are recorded in short-term fluctuations in investment returns.

(ii) Effect of changes to assumptions, estimates and bases of determining life assurance liabilities.

The results of the Prudential Group's long-term business operations are affected by changes to assumptions, estimates and bases of preparation. These are described in notes D2(h), D3(h) and D4(h) contained within the consolidated financial information set out in Part XIV of this prospectus.

(iii) Sale of Taiwan agency business.

In order to facilitate comparisons of operating profit based on longer-term investment returns that reflect the Prudential Group's retained operations, the results attributable to the Taiwan business for which the sale process was completed in June 2009 are included separately within the supplementary analysis of profit.

(iv) Jackson operating results based on longer-term investment returns.

IFRS basis operating profits for US operations include the following amounts (net of related change in amortisation or deferred acquisition costs, where applicable) so as to derive longer-term investment returns:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Debt securities:			
Amortisation of interest related realised gains and losses . . . . .	31	24	47
Risk margin reserve charge for longer-term credit-related losses (see below) . . . . .	(37)	(41)	(60)
Equity type investments:			
Longer-term returns . . . . .	47	62	69

The risk margin reserve (“RMR”) charge for longer-term credit-related losses is based on an average annual RMR of 22, 23 and 27 basis points for 2007, 2008 and 2009 respectively on average book values for the year as shown below:

Moody’s rating category (or equivalent under NAIC rating of RMBS)	2007				2008				2009			
	Average book value		Annual expected losses		Average book value		Annual expected losses		Average book value		Annual expected losses	
	(US\$m)	RMR %	US\$m		(US\$m)	RMR %	US\$m		(US\$m)	RMR %	US\$m	
A3 or higher . . . . .	20,231	0.03	(6)	(3)	21,098	0.03	(6)	(3)	19,509	0.03	(5)	(3)
Baa 1, 2, 3 . . . . .	20,306	0.22	(46)	(23)	20,145	0.23	(46)	(25)	21,072	0.23	(47)	(30)
Ba 1, 2, 3 . . . . .	1,687	1.13	(19)	(9)	1,635	1.11	(18)	(10)	2,035	1.13	(23)	(15)
B1, 2, 3 . . . . .	530	2.88	(15)	(7)	514	2.80	(14)	(8)	594	2.86	(17)	(11)
Below B3 . . . . .	240	4.00	(10)	(5)	373	3.98	(15)	(8)	691	3.91	(27)	(17)
Total . . . . .	<u>42,994</u>	<u>0.22</u>	<u>(96)</u>	<u>(47)</u>	<u>43,765</u>	<u>0.23</u>	<u>(99)</u>	<u>(54)</u>	<u>43,901</u>	<u>0.27</u>	<u>(119)</u>	<u>(76)</u>
Related change to amortisation of deferred acquisition costs (see below) . . . . .			<u>20</u>	<u>10</u>			<u>23</u>	<u>13</u>			<u>25</u>	<u>16</u>
Risk margin reserve charge to operating profit for longer-term credit-related losses . . . . .			<u>(76)</u>	<u>(37)</u>			<u>(76)</u>	<u>(41)</u>			<u>(94)</u>	<u>(60)</u>

During 2009, the National Association of Insurance Commissioners (“NAIC”) changed its approach to the determination of regulatory ratings of residential mortgage backed securities (“RMBS”). This recognised the complexities associated with these investments and the limitations of the credit rating previously applied. The new ratings framework has been applied by an external third party, PIMCO, and provides regulatory rating details for more than 20,000 RMBS securities owned by US insurers at the end of 2009. Jackson has decided to use the ratings resulting from this model to determine the average annual RMR for 2009 as this is considered more relevant information for the RMBS securities concerned. If the previous approach of using Moody’s ratings by a Nationally Recognised Statistical Ratings Organisation (“NRSROs”) such as Moody’s, Standard and Poor’s or Fitch for these investments had been used this would have resulted in an annual RMR of 31 basis points for 2009, an additional £11 million of annual expected losses for the period. It should be noted that this change has no impact on the valuation applied to these securities within the IFRS balance sheet and so there is no impact on IFRS profit before tax or shareholder’s equity as a result of this change.

The longer-term rates of return for equity-type investments ranged from 8.1% to 10.1% for 2007, 6.3% to 8.4% for 2008, and 6.7% to 7.9% for 2009 depending on the type of investments. These rates are currently based on spreads over ten year US treasury rates of 400 to 600 basis points.

Market value movements on equity-based derivatives and embedded derivatives are also recorded within operating profits based on longer-term investment returns so as to be consistent with the market-related effects on fees and reserve movements for equity-based products. Market value movements on other derivatives are excluded from operating profit, and are included in short-term fluctuations in investment returns.

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

- (v) UK operations transferred its general insurance business to Churchill in 2002, with general insurance commission representing the commission receivable (net of expenses) for Prudential branded general insurance products as part of this arrangement.
- (vi) Short-term fluctuations in investment returns on shareholder-backed business.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Insurance operations			
Asia . . . . .	15	(138)	31
US . . . . .	(18)	(1,058)	27
UK . . . . .	(47)	(212)	108
Other operations			
IGD hedge costs . . . . .	—	—	(235)
Other . . . . .	(1)	(313)	105
Total . . . . .	<u>(51)</u>	<u>(1,721)</u>	<u>36</u>

### General overview of defaults

There were no default losses in 2007. The Prudential Group incurred defaults of £206 million in 2008 and £11 million in 2009 on its debt securities portfolio. Defaults in 2008 of £206 million (including losses on sale) arose primarily in respect of Lehman Brothers (£110 million) and Washington Mutual (£91 million), the majority of which arose in Jackson. The defaults of £11 million in 2009 were experienced by the UK shareholder-backed annuity business. Jackson experienced less than £1 million of default losses during 2009.

### Asian insurance operations

For 2007, the £15 million of short-term fluctuations primarily reflect strong equity market movements in Vietnam. For 2008, the fluctuations of a charge of £138 million relate mainly to £81 million for Vietnam, reflecting a significant fall in the Vietnamese bond and equity markets. The fluctuations for Asian operations in 2009 of a gain of £31 million primarily relate to strong market performance in Taiwan and Japan partially offset by the fall in the Vietnamese bond markets.

### US insurance operations

The short-term fluctuations in investment returns for US insurance operations for 2007, 2008 and 2009 comprise the following items:

	2007	2008	2009
	£m	£m	£m
Short-term fluctuations related to debt securities:			
Charges in the year*			
Defaults . . . . .	—	(78)	—
Losses on sales of impaired and deteriorating bonds . . . . .	(51)	(130)	(6)
Bond write downs . . . . .	(35)	(419)	(630)
Recoveries/reversals . . . . .	8	3	5
Less: risk margin charge included in operating profit based on longer-term investment returns . . . . .	(78)	(624)	(631)
	<u>48</u>	<u>54</u>	<u>76</u>
	<u>(30)</u>	<u>(570)</u>	<u>(555)</u>
Interest related gains (losses):			
Arising in the year . . . . .	31	(25)	125
Less: amortisation gains and losses arising in current and prior years to operating profit based on longer-term investment returns . . . . .	<u>(37)</u>	<u>(28)</u>	<u>(59)</u>
	<u>(6)</u>	<u>(53)</u>	<u>66</u>
Related change to amortisation of deferred acquisition costs . . . . .	9	88	75
Total short-term fluctuations related to debt securities . . . . .	<u>(27)</u>	<u>(535)</u>	<u>(414)</u>
Derivatives (other than equity related): market value movements (net of related change to amortisation of deferred acquisition costs)** . . . . .	(19)	(369)	385
Equity type investments: actual less longer-term return (net of related change to amortisation of deferred acquisition costs) . . . . .	42	(69)	(59)
Other items (net of related change to amortisation of deferred acquisition costs)*** . . . . .	<u>(14)</u>	<u>(85)</u>	<u>115</u>
Total . . . . .	<u>(18)</u>	<u>(1,058)</u>	<u>27</u>

\* The charges on the debt securities of Jackson comprise the following:

	2008 Total	Defaults	Bond write-downs	Losses on sale or impaired and deteriorating bonds	Recoveries/reversals	2009 Total
	£m	£m	£m	£m	£m	£m
Residential mortgage-based securities						
Prime . . . . .	25	—	268	—	—	268
Alt-A . . . . .	138	—	192	(10)	—	182
Sub-prime . . . . .	4	—	49	—	—	49
Total residential mortgage-backed securities . . . . .	<u>167</u>	<u>—</u>	<u>509</u>	<u>(10)</u>	<u>—</u>	<u>499</u>
Corporate debt securities . . . . .	441	—	91	16	—	107
Other . . . . .	16	—	30	—	(5)	25
Total . . . . .	<u>624</u>	<u>—</u>	<u>630</u>	<u>6</u>	<u>(5)</u>	<u>631</u>

As disclosed above, total 2007 defaults, losses on sale, write-downs and recoveries were £(78) million compared to £(624) million in 2008. Given the smaller scale of losses in 2007, a breakdown by type of debt security has not been provided.

Other bond write-downs and defaults of £30 million relate to Piedmont Securities in 2009. Piedmont is an investment vehicle investing in certain asset-backed and mortgage-backed securities in the US.

\*\* The charge of £19 million and £369 million and gain of £385 million value movement for 2007, 2008 and 2009 respectively is for freestanding derivatives held to manage the fixed annuity and other general account business. Under IAS 39, unless hedge accounting is applied, value movements on derivatives are recognised in the income statement. Derivative value movements in respect of equity risk within variable annuity business are included within the operating profit based on longer-term investment returns to match broadly with the commercial effects to which the variable annuity derivative programme relates (subject to some limitations to GMDB liabilities

where US GAAP does not fully reflect the economic features being hedged.) Other derivative value movements are separately identified within short-term fluctuations in investment returns.

For the derivatives programme attaching to the fixed annuity and other general account business the Prudential Group has continued its approach of not seeking to apply hedge accounting under IAS 39. This decision reflects the inherent constraints of IAS 39 for hedge accounting investments and life assurance assets and liabilities under 'grandfathered' US GAAP under IFRS 4.

\*\*\* The £115 million gain (2008: charge of £85 million) for other items shown above comprises a gain of £85 million (2008: charge of £70 million) for the difference between the charge for embedded derivatives included in the operating result and the charge to the total result and a gain of £30 million (2008: charge of £15 million) of other items. For embedded derivatives the operating result reflects the application of 10-year average AA corporate bond rate curves and a static historical equity volatility assumption. The total result reflects the application of year-end AA corporate bond rate curves and current equity volatility levels.

In addition, for US insurance operations, included within the statement of comprehensive income, is an increase in net unrealised losses of £244 million and £2,104 million for 2007 and 2008 respectively, and a reduction in net unrealised losses on debt securities classified as available-for-sale of £2,669 million for 2009. These temporary market value movements do not reflect default or impairments. Additional details on the movement in the value of the Jackson portfolio are included in note D3 to the consolidated financial information set out in Part XIV of this prospectus.

#### *UK insurance operations*

The short-term fluctuations charge of £212 million and gain of £108 million for 2008 and 2009, respectively, reflected primarily asset value movements, principally for shareholder-backed annuity business. The charge of £212 million in 2008 also included £42 million for the effect of credit downgrades on the calculation of liabilities for shareholder-backed annuity business in PRIL and PAC non-profit sub-fund.

#### *IGD hedge costs*

During the severe equity market conditions experienced in the first quarter of 2009 coupled with historically high equity volatility the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programmes. The hedge contracts have expired and have not been renewed.

#### *Other operations*

Short-term fluctuations of other operations, in addition to the previously discussed IGD hedge costs arise from:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Unrealised value movements on swaps held centrally to manage the Prudential Group assets and liabilities . . . . .	(18)	(38)	28
Unrealised value movements on Prudential Capital's bond portfolio . . . . .	(24)	(190)	66
Unrealised value movements on investments held by other operations . . . . .	9	(14)	11
Value movements relating to the investment in an India mutual fund . . . . .	<u>32</u>	<u>(71)</u>	<u>—</u>
	<u>(1)</u>	<u>(313)</u>	<u>105</u>

(vii) Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Actuarial gains and losses</b>			
Actual less expected return on scheme assets . . . . .	4	(97)	23
Experience gains and losses on scheme liabilities . . . . .	(4)	19	17
Gains (losses) on changes of assumptions for scheme liabilities . . . . .	(7)	71	(147)
	<u>(7)</u>	<u>(7)</u>	<u>(107)</u>
Less: amount attributable to the PAC with-profits sub-fund . . . . .	<u>6</u>	<u>(2)</u>	<u>47</u>
	<u>(1)</u>	<u>(9)</u>	<u>(60)</u>
<b>Other gains and losses</b>			
Movement in the provision for deficit funding of PSPS . . . . .	—	(13)	(48)
Less: amount attributable to the PAC with-profits sub-fund . . . . .	<u>—</u>	<u>9</u>	<u>34</u>
	<u>—</u>	<u>(4)</u>	<u>(14)</u>
Total . . . . .	<u>(1)</u>	<u>(13)</u>	<u>(74)</u>

The actuarial gains and losses shown in the table above relate to the Scottish Amicable, M&G and until 2009 the small Taiwan defined benefit pension schemes. The amounts did not include actuarial gains and losses for the Prudential Staff Pension Scheme (PSPS) for which the Prudential Group has not recognised its interest in the scheme's underlying surplus.

The losses of £147 million in 2009 on change of assumptions comprise mainly the effect of a decrease in the risk discount rate combined with the effect of an increase in inflation rates.

Other gains and losses relate to the change in the year or the provisions for deficit funding obligation for PSPS. Further details on the Prudential Group's defined benefit pension schemes and the effect of the accounting policy change are shown in note I2, contained in the consolidated financial information set out in Part XIV of this prospectus.

- (viii) Share-based payments.

The charge for share-based payments for Prudential schemes is for the Save As You Earn (“SAYE”) and the Prudential Group performance-related schemes.

- (ix) Restructuring costs are incurred in the UK as part of the EEV covered business (£7 million, £10 million and £16 million for 2007, 2008 and 2009 respectively) and as part of central operations, or the EEV non-covered business (£12 million, £18 million and £7 million for 2007, 2008 and 2009 respectively).

### **IFRS operating profit based on longer-term investment returns**

The Prudential Group operating profit before tax based on longer-term investment returns on the IFRS basis was £1,152 million in 2007, £1,283 million in 2008 and £1,405 million in 2009.

#### ***Insurance operations***

In Asia, IFRS operating profit for long-term business increased by 62% from £257 million in 2008 to £416 million in 2009. 2009 included a £63 million one-off release of reserves in the Malaysian life operations determined after assessing the measurement basis for policyholders’ liabilities, following the implementation of a Risk Based Capital (“RBC”) regime by the Malaysian regulatory authorities. Excluding this item, Asia delivered a strong underlying operating performance resulting in an increase of £96 million to £353 million in 2009 from £257 million for 2008. This increase reflected both underlying growth as the Prudential Group built the in-force book and a reduction in new business strain from a charge of £97 million in 2008 to a charge of £78 million in 2009.

The Prudential Group’s larger markets in Asia of Malaysia, Hong Kong, Singapore and Indonesia continued to show strong increases in operating profit. In Indonesia, the results increased from £55 million in 2008 to £102 million in 2009, reflecting the strong underlying growth of the business and further improvements to the impact of new business on operating profits. In Malaysia, IFRS operating profit of £65 million in 2009, excluding the one-off credit, was up 41% from £46 million in 2008, driven mainly by the growth in the profits from the in-force business. Hong Kong recorded increased operating profit up 45% from £33 million in 2008 to £48 million in 2009, due mainly to increased profits from the in-force non-participating business, both as a result of growth and the non-recurrence of one-off costs in 2008. This has been offset by reduced participating fund profits following lower bonus payments to policyholders in 2009 reducing the corresponding transfer to shareholders from the with-profits fund. Singapore saw an increase in operating profit of £29 million in 2008 (35%) to £112 million in 2009 reflecting growth in the in-force business. Aside from Japan, where on 15 February 2010 the operation suspended writing new business, Taiwan, which is focusing on its bancassurance business following the disposal of its agency business in June 2009, and Thailand, all the Asian life operations generated operating profits on the IFRS basis in 2009.

In the US, the long-term business operating profit increased by 13% from £406 million in 2008 to £459 million in 2009, primarily from the effect of favourable exchange rate movements, increased operating profits from the fixed and fixed indexed annuity business and lower DAC amortisation on variable annuity business as compared to 2008. These increases were offset by the combined negative accounting impact of equity market movements on Jackson’s variable annuity business and related hedging programme. The hedging programme is undertaken on an economic basis and the accounting measurement does not always fully capture the economic effects.

In the UK, the long-term business IFRS operating profit of £606 million in 2009 increased by 11% from £545 million in 2008. This reflected growth from the shareholder-backed annuity business, with operating profits being £194 million higher than in 2008, partially offset by lower contribution from the with-profits business of £281 million in 2009, compared with £395 million in 2008. The lower profit from the with-profit business reflected the impact of rate reductions in the February 2009 bonus declaration made in response to recent volatile investment performance. These lower bonus payments to policyholders have a corresponding negative impact on operating profit as they reduce the consequential transfer to shareholders from the with-profit fund, calculated as one-ninth of the cost of policyholders’ bonus. Profit from UK general insurance commission increased to £51 million in 2009 from £44 million in 2008. As a result, the total IFRS operating profit increased by 12% in 2009 to £657 million from £589 million in 2008.

The Prudential Group’s Asian operations IFRS operating profit for long-term business increased by 84% from £140 million in 2007 to £257 million in 2008. In Indonesia the results increased from £35 million in 2007 to £55 million in 2008 whilst in the established operations (Singapore, Hong Kong and Malaysia) the growth was more muted, growing from £153 million in 2007 to £162 million in 2008. For the Korean operation the result improved from a loss of £13 million in 2007 to a profit of £12 million in 2008. The driver for the growth was the implementation, for IFRS reporting purposes, of a more appropriate basis of deferring and amortising acquisition costs rather than continuing with the local regulatory basis reporting. The Indian operation posted a loss of £6 million in 2008, before development expenses for the agency field force which is shown separately in the

analysis above of IFRS basis operating profit under 'development expenses'. The result also reflects that as the business matures it is appropriate to now defer and amortise acquisition costs, resulting in a benefit of £19 million in 2008. The result for other operations increased from £8 million in 2007 to £34 million in 2008 reflecting mainly reserve releases in the Japanese operation.

The US business's IFRS operating profit of £406 million in 2008 was down by 9% from £444 million in 2007. This was mainly due to accelerated levels of Variable Annuities DAC amortisation as a result of large negative equity market movements. These impacts were partially offset by positive operating derivative income on variable annuity business, reflecting the increase in market value of the net short derivative positions due to falling equity prices.

In the UK business, total IFRS operating profit increased by 12% in 2008 to £589 million from £528 million in 2007. The increase of 4% achieved for the long-term business in 2008 as compared to 2007 reflected profits attributable to the with-profits business of £395 million together with 15% growth from the long-term shareholder backed business. IFRS profits from the shareholder annuity business in 2008 included the impact of strengthening the allowance for credit defaults partly offset by profits emerging from a rebalancing of the asset portfolio. Non-long-term business IFRS profit reflected profit from general insurance commission which increased to £44 million in 2008 from £4 million in 2007, with cash beginning to emerge following the 2002 sale of the business to Churchill.

### ***Asset management business***

M&G's operating profit based on longer term investment returns for 2009 was £238 million, a decrease of 17% from £286 million in 2008. This primarily reflected the relative levels of equity and property markets between 2008 and 2009, with the FTSE All Share Index being on average 15% lower in 2009 than in 2008, as well as higher staff costs and lower performance-related fees. These negative impacts were partly offset by revenue earned on the very strong fund net inflows during 2009 (£13.5 billion in 2009 compared with £3.4 billion in 2008).

M&G's operating profit based on longer term investment returns for 2008 was £286 million, an increase of 13% from £254 million in 2007. Higher profits from the fixed income business and higher performance-related fees were partially offset by the negative impact of market conditions, particularly in the retail business.

The Asian asset management operations reported operating profit based on longer term investment returns of £55 million, up by 6% from £52 million in 2008. This reflects favourable exchange rates and management's focus on profitability during the period. Profit in 2009 was adversely impacted by a one-off loss in India of £6 million.

In Asia, operating profit based on longer-term investment returns for asset management in 2008 was £52 million which represented a 28% decrease against the 2007 operating profit of £72 million driven by decreasing funds under management and performance-related fees as a result of the market position in 2008.

### ***Unallocated corporate***

The change of £135 million in other income and expenditure to negative £395 million in 2009 from the negative £260 million in 2008 primarily reflected lower returns on central funds as a result of falling interest rates, an increase in interest payable on core structural borrowings and the non-recurrence in 2009 of a positive one-off 2008 item of profit on the sale of a seed capital investment in an Indian mutual fund.

Other income and expenditure in 2008 at negative £260 million was flat compared to 2007 (negative £260 million).

### **Charge for short-term fluctuations in investment returns**

In calculating the IFRS operating profit, longer-term investment return assumptions are used rather than actual investment returns achieved. The actual movements in asset values beyond the longer-term assumptions appear in the profit and loss account as short-term fluctuations in investment returns, with the exception of Jackson, where unrealised gains or losses on debt securities feature directly as movements in shareholder reserves.

In 2009, short-term fluctuations of £36 million comprised £166 million relating to insurance operations offset by £130 million in respect of other operations and represented a significant increase over the negative short-term fluctuations of £1,721 million recognised in 2008.

Short-term fluctuations in investment returns for insurance operations of positive £166 million in 2009 comprised £31 million for Asia, £27 million for US operations and £108 million in the UK.

The positive short-term fluctuations of £31 million for Asian insurance operations in 2009 primarily reflected strong market performance in Taiwan and Japan partially offset by the impact of unrealised losses on the debt securities portfolio in Vietnam.

The positive short-term fluctuations of £27 million for US insurance operations in 2009 comprised positive £385 million for market value movements on the free-standing derivatives used to manage the fixed annuity and other general account business, negative £414 million in respect of debt securities, and positive £56 million of other items. The negative £414 million for debt securities reflected the levels of realised gains and losses (including write-downs) in excess of the allowance for longer-term defaults and amortisation of interest-related gains included in the operating result adjusted for associated deferred acquisition costs.

The positive short-term fluctuations of £108 million for UK insurance operations in 2009 reflected principally value movements on the assets backing the capital of the shareholder-backed annuity business.

For other operations, the principal component of short-term fluctuations in investment returns in 2009 was a one-off £235 million cost arising from the hedge temporarily put in place during the first quarter, to protect the Prudential Group IGD capital surplus in the light of exceptional market conditions. During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to its regular operational hedging programmes. The residual short-term fluctuations in investment returns for other operations of positive £105 million included £66 million for unrealised appreciation on Prudential Capital's debt securities portfolio and £28 million on swaps held centrally to manage Prudential Group assets and liabilities.

The £1,721 million charge for short-term fluctuations in investment returns in 2008 mainly comprised £138 million, £1,058 million and £212 million relating to its Asian, US and UK insurance operations respectively.

The Asian insurance operations' negative short-term fluctuations of £138 million in 2008 primarily reflected movements in Vietnam and Japan of £81 million and £34 million respectively.

The result in Vietnam mainly reflected the two-thirds fall in the Vietnam equity market. In Japan there were a number of contributory factors, the largest of these being losses of £14 million reflecting the 42% fall in the country's stock market and unrealised losses of £13 million on leveraged super senior notes.

The Prudential Group's US results included a £1,058 million charge in 2008 (2007: £18 million charge) for short-term fluctuations in investment returns. This comprised £535 million in respect of debt securities, £439 million in respect of freestanding derivatives and embedded derivative liabilities, £69 million for equity-type securities and a net £15 million for other items.

The £535 million charge for debt securities in 2008 reflected the levels of defaults, losses on sale, and write downs in excess of the allowance for longer-term defaults included in the operating result. The main constituent of the £439 million charge in 2008 was £369 million for freestanding derivatives held to manage the fixed annuity and other general account business. There was also a charge of £70 million in 2008 in respect of Guaranteed Minimum Withdrawal Benefit and other embedded derivative liabilities for the difference between the effect of applying year-end AA corporate bond rate and equity volatility curves in the total result rather than longer-term levels, as applied in determining the operating result.

The UK insurance operations' short-term fluctuations charge of £212 million in 2008 reflected asset value movements, principally for the shareholder-backed annuity business, of negative £170 million and £42 million for the effect of credit downgrades on the measurement of annuity liabilities.

Other short-term fluctuations charge of £313 million in 2008 included £190 million for unrealised value movements in Prudential Capital and £71 million on the sale of an investment in an Indian Mutual Fund.

### **Sale of Taiwan agency business**

On 20 February 2009, the Prudential Group announced its agreement to transfer the assets and liabilities of the agency distribution business in Taiwan, including the capital consuming in-force book, to China Life Insurance Limited (Taiwan). The transaction completed on 19 June 2009 following regulatory approval being given on that day. The transfer has resulted in a one-off negative pre-tax impact of £621 million. After allowing for tax, and other adjustments, the effect on shareholders' equity was negative £607 million. The overall size of loss reflects the carrying value of the IFRS equity of the business as applied in the calculation of the loss on sale and the application of 'grandfathered' US GAAP under IFRS 4 for insurance assets and liabilities. US GAAP does not and is not designed to include the costs of holding economic capital to support the legacy interest rate guaranteed products, as recognised under the Prudential Group's supplementary reporting basis under EEV principles. The loss on sale reflects this element of the economic value. Separately, it is to be noted that under IFRS there is no recognition of the enhanced IGD capital surplus position arising on completion.

### Profit (loss) from continuing operations before tax attributable to shareholders

The total profit from continuing operations before tax attributable to shareholders and minority interests on an IFRS basis was £746 million in 2009, compared with a loss of £450 million in 2008. This increase principally reflects increases in operating profit and favourable short term fluctuations experienced in investment returns.

The total loss from continuing operations before tax attributable to shareholders and minority interests on an IFRS basis was £450 million in 2008, compared with a profit of £1,063 million for 2007. This reduction primarily reflects adverse short-term fluctuations experienced in investment returns.

### Presentation of results before tax and effective rate of tax

The total tax charge for the Prudential Group reflects tax that in addition to relating to shareholders' profits is also attributable to policyholders and unallocated surplus of with-profits funds and unit-linked policies. This is explained in more detail in note F5 to the consolidated financial information set out in Part XIV of this prospectus. However, pre-tax profits are determined after transfers to or from unallocated surplus of with-profits funds. These transfers are in turn determined after taking account of tax borne by with-profits funds. Consequently reported profit before the total tax charge is not representative of pre-tax profits attributable to shareholders. In order to provide a measure of pre-tax profits attributable to shareholders the Prudential Group has chosen to adopt an income statement presentation of the tax charge and pre-tax results that delineates between policyholder and shareholder components.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Tax credit (charge) . . . . .	(349)	1,683	(873)
Less: tax credit attributable to policyholders' returns . . . . .	<u>(5)</u>	<u>(1,624)</u>	<u>818</u>
Tax credit (charge) attributable to shareholders' returns . . . . .	<u>(354)</u>	<u>59</u>	<u>(55)</u>

The effective rate of tax attributable to shareholders' profits on operating profits, based on longer-term investment returns, was 23% in 2009 (2008: 23%). The effective rate of tax attributable to shareholders' profits at the total IFRS profit level for continuing operations was 7% in 2009 (2008: 13%) due to the ability to utilise losses carried forward for which the Prudential Group was previously unable to recognise a deferred tax asset in Jackson, partially offset by the absence of tax relief on the loss on the disposal of the Taiwan agency business.

The effective rate of tax attributable to shareholders' profits on operating profits, based on longer-term investment returns, was 23% in 2008 (2007: 31%). The effective rate of tax attributable to shareholders' profits at the total IFRS profit level for continuing operations was 13% in 2008 (2007: 33%). The effective rate of tax on operating profits was lower in 2008 than 2007, reflecting a combination of the settlement of issues with HM Revenue and Customs at amounts below those previously provided and a reduction in amounts previously provided on outstanding issues with HM Revenue and Customs. The effective rate of tax at total IFRS profits level in 2008 was lower than expected, substantially due to a restriction on the ability to recognise deferred tax assets on all losses in Asia and the US.

### IFRS earnings per share

	<u>2007</u>	<u>2008</u>	<u>2009</u>
EPS-based operating profit based on longer-term investment returns from continuing operations after tax and minority interest . . . . .	32.5p	39.9p	43.3p
Basic EPS based on total profit (loss) after minority interest. . . . .	38.7p	(16.0)p	27.0p

**Analysis of life insurance pre-tax IFRS operating profit based on longer-term investment returns by driver**

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Investment spread . . . . .	804	747	1,001
Asset management fees . . . . .	365	403	458
Net expense margin . . . . .	(443)	(385)	(388)
DAC amortisation (Jackson only) . . . . .	(286)	(450)	(223)
Net insurance margin . . . . .	273	308	472
With-profits business . . . . .	420	425	310
Non-recurrent release of reserves for Malaysian life operation . . . . .	—	—	63
Other . . . . .	<u>(40)</u>	<u>134</u>	<u>(218)</u>
<b>Total long-term business operating profit based on longer-term investment returns . . . . .</b>	<b><u>1,093</u></b>	<b><u>1,182</u></b>	<b><u>1,475</u></b>

The analysis above classifies the Prudential Group's pre-tax operating profits from long-term insurance operations in 2007, 2008 and 2009 into the underlying drivers of those profits, using the following categories:

- (i) Investment spread — this represents the difference between net investment income (or premium income in the case of the UK annuities new business) and amounts credited to policyholder accounts.
- (ii) Asset management fees — this represents profits driven by investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.
- (iii) Net expense margin — this represents expenses charged to the profit and loss account (excluding those borne by the with-profits fund and those products where earnings are purely protection driven) including amounts relating to movements in deferred acquisition costs, net of any fees or premium loadings related to expenses. Jackson DAC amortisation (net of hedging effects), which is intended to be part of the expense margin, has been separately highlighted in the table below.
- (iv) Insurance margin — this represents profits derived from the insurance risks of mortality, morbidity and persistency, including fees earned on variable annuity guarantees.
- (v) With-profits business — this represents the shareholders' transfer from the with-profits fund in the period.
- (vi) Other represents a mixture of other income and expenses that are not directly allocated to the underlying drivers, including non-recurring items.

An analysis of life insurance pre-tax operating profit based on longer-term investment returns for 2007, 2008 and 2009 by driver and segment has also been provided:

	<u>2007</u>			
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Total</u>
	(£m)			
Investment spread . . . . .	52	533	219	804
Asset management fees . . . . .	39	266	60	365
Net expense margin . . . . .	(119)	(186)	(138)	(443)
DAC amortisation (Jackson only) . . . . .	—	(286)	—	(286)
Net insurance margin . . . . .	142	122	9	273
With-profits business . . . . .	26	—	394	420
Other <sup>(i)</sup> . . . . .	<u>(15)</u>	<u>(5)</u>	<u>(20)</u>	<u>(40)</u>
<b>Total . . . . .</b>	<b><u>125</u></b>	<b><u>444</u></b>	<b><u>524</u></b>	<b><u>1,093</u></b>

	<b>2008</b>			
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Total</u>
	( <b>£m</b> )			
Investment spread . . . . .	54	550	143	747
Asset management fees . . . . .	54	292	57	403
Net expense margin . . . . .	(79)	(192)	(114)	(385)
DAC amortisation (Jackson only) . . . . .	—	(450)	—	(450)
Net insurance margin . . . . .	198	122	(12)	308
With-profits business . . . . .	30	—	395	425
Other <sup>(i)</sup> . . . . .	<u>(26)</u>	<u>84</u>	<u>76</u>	<u>134</u>
Total . . . . .	<u>231</u>	<u>406</u>	<u>545</u>	<u>1,182</u>

	<b>2009</b>			
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Total</u>
	( <b>£m</b> )			
Investment spread . . . . .	56	622	323	1,001
Asset management fees . . . . .	80	324	54	458
Net expense margin . . . . .	(65)	(227)	(96)	(388)
DAC amortisation (Jackson only) . . . . .	—	(223)	—	(223)
Net insurance margin . . . . .	253	178	41	472
With-profits business . . . . .	29	—	281	310
Non-recurrent release of reserves for Malaysian Life operations . . . . .	63	—	—	63
Other <sup>(i)</sup> . . . . .	<u>(6)</u>	<u>(215)</u>	<u>3</u>	<u>(218)</u>
Total . . . . .	<u>410</u>	<u>459</u>	<u>606</u>	<u>1,475</u>

Notes:

(i) Asia “other” includes development expenses of £6 million (2008: £26 million, 2007: £15 million). US “other” comprises principally of hedging costs/profits before the allowance for Variable Annuity guarantee fees included within net insurance margin, together with other one-off items. UK “other” in 2008 represents the benefits of a number of one-off items.

### Reconciliation of IFRS operating profit based on longer-term investment returns to IFRS total profit

The following tables reconcile the Prudential Group’s operating profit based on longer-term investment returns to the Prudential Group’s total profit (loss) after tax for 2007, 2008 and 2009:

#### Year ended 31 December 2007

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Group Total</u>
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Operating profit based on longer-term investment returns . . . . .	528	444	125	254	8	72	1,431	(279)	1,152
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	(47)	(18)	15	4	1	—	(45)	(6)	(51)
Shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	5	—	—	5	(6)	(1)
Results for the sold Taiwan agency business . . . . .	<u>—</u>	<u>—</u>	<u>(37)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(37)</u>	<u>—</u>	<u>(37)</u>
Profit/(loss) before tax attributable to shareholders from continuing operations . .	<u>481</u>	<u>426</u>	<u>103</u>	<u>263</u>	<u>9</u>	<u>72</u>	<u>1,354</u>	<u>(291)</u>	<u>1,063</u>
Tax attributable to shareholders . . . . .									<u>(354)</u>
Profit/(loss) from continuing operations after tax . . . . .									709
Discontinued operations . . . . .									<u>241</u>
Profit for the year . . . . .									<u>950</u>

*Year ended 31 December 2008*

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Group Total</u>
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Operating profit based on longer-term investment returns . . . . .	589	406	231	286	7	52	1,571	(288)	1,283
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	(212)	(1,058)	(138)	(195)	—	—	(1,603)	(118)	(1,721)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	(2)	(10)	—	—	(12)	(1)	(13)
Results for the sold Taiwan agency business . . . . .	—	—	1	—	—	—	1	—	1
(Loss) profit before tax attributable to shareholders from continuing operations . . . . .	<u>377</u>	<u>(652)</u>	<u>92</u>	<u>81</u>	<u>7</u>	<u>52</u>	<u>(43)</u>	<u>(407)</u>	<u>(450)</u>
Tax attributable to shareholders . . . . .									<u>59</u>
Loss for the year . . . . .									<u>(391)</u>

*Year ended 31 December 2009*

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Total</u>
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Operating profit based on longer-term investment returns . . . . .	657	459	410	238	4	55	1,823	(418)	1,405
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	108	27	31	70	—	—	236	(200)	36
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(46)	—	—	(14)	—	—	(60)	(14)	(74)
Loss on sale and results for Taiwan agency business <sup>(i)</sup> . . . . .	—	—	(621)	—	—	—	(621)	—	(621)
Profit (loss) from continuing operations before tax attributable to shareholders . . . . .	<u>719</u>	<u>486</u>	<u>(180)</u>	<u>294</u>	<u>4</u>	<u>55</u>	<u>1,378</u>	<u>(632)</u>	<u>746</u>
Tax attributable to shareholders . . . . .									<u>(55)</u>
Profit (loss) from continuing operations after tax . . . . .									691
Discontinued operations . . . . .									<u>(14)</u>
Profit for the year . . . . .									<u>677</u>

(i) This comprises loss on sale of Taiwan agency business of £559 million and trading results before tax of £62 million as explained in note I1 of the consolidated financial information set out on Part XIV of the prospectus.

**Profit (loss) from continuing operations after tax**

The total profit after tax for 2009 was £691 million compared with a loss after tax of £391 million in 2008. This increase principally reflects increases in operating profit and favourable short-term fluctuations experienced in investment returns as illustrated by the tables above.

The total loss after tax for 2008 was £391 million compared with a profit after tax of £950 million in 2007. This reduction principally reflects adverse short-term fluctuations experienced in investment returns.

## Explanation of movements in profits before shareholder tax by nature of revenue and charges

The following table shows the Prudential Group's consolidated total revenue and consolidated total charges for the periods presented:

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Gross earned premiums <sup>(a)</sup> . . . . .	18,359	18,993	20,299
Outward reinsurance premiums . . . . .	(171)	(204)	(323)
Earned premiums, net of reinsurance . . . . .	18,188	18,789	19,976
Investment return <sup>(b)</sup> . . . . .	12,225	(30,202)	26,889
Other income . . . . .	2,457	1,146	1,234
Total revenue, net of reinsurance . . . . .	<u>32,870</u>	<u>(10,267)</u>	<u>48,099</u>
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance <sup>(c)</sup> . . . . .	(26,785)	10,824	(41,195)
Acquisition costs and other operating expenditure <sup>(d)</sup> . . . . .	(4,859)	(2,459)	(4,572)
Finance costs: interest on core structural borrowings of shareholder-financed operations . . . . .	(168)	(172)	(209)
Loss on sale of Taiwan agency business . . . . .	—	—	(559)
Total charges, net of reinsurance . . . . .	<u>(31,812)</u>	<u>8,193</u>	<u>(46,535)</u>
Profit(loss) before tax ( <i>being tax attributable to shareholders' and policyholders' returns</i> ) <sup>*</sup> . . . . .	1,058	(2,074)	1,564
Tax (charge) credit attributable to policyholders' returns . . . . .	5	1,624	(818)
Profit(loss) before tax attributable to shareholders . . . . .	1,063	(450)	746
Tax (charge) credit attributable to shareholders' returns . . . . .	(354)	59	(55)
Profit(loss) from continuing operations after tax . . . . .	709	(391)	691
Discontinued operations (net of tax) <sup>(e)</sup> . . . . .	241	—	(14)
Profit(loss) for the year . . . . .	<u>950</u>	<u>(391)</u>	<u>677</u>

\* This measure is the formal profit (loss) before tax measure under IFRS but is not the result attributable to shareholders.

### (a) Gross earned premiums

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Asian Operations . . . . .	5,022	5,333	5,345
US Operations . . . . .	5,860	6,032	9,197
UK Operations . . . . .	7,477	7,628	5,757
Total . . . . .	<u>18,359</u>	<u>18,993</u>	<u>20,299</u>

Gross earned premiums for insurance operations totalled £20,299 million in 2009, up 7% from £18,993 million in 2008. The increase of £1,306 million in 2009 was primarily driven by growth of £3,165 million in the US operations that was partially offset by a decrease of £1,871 million in the UK operations.

Gross earned premiums for insurance operations totalled £18,993 million in 2008 compared to £18,359 million in 2007. The increase in gross earned premiums in 2008 against 2007 was driven by growth across all regions during the year.

#### Asia

Gross earned premiums were flat in 2009, increasing by £12 million from £5,333 million in 2008 to £5,345 million. This reflects in part the fall in new business premiums across the Asian life insurance industry, particularly for single premium and investment-linked products, seen in the first half of 2009, being offset by strong sales in the fourth quarter of 2009 as consumer confidence returned to the retail financial services sector.

Gross earned premiums increased by 6% to £5,333 million in 2008 compared to £5,022 million in 2007, aided by exchange rate movements during the year.

The Prudential Group has focused on the sales of capital efficient unit-linked products in Asia, and is particularly strong in the regular premium savings sector. In recent years, the Prudential Group has increased its focus on higher-margin protection products, both as riders to savings policies and on a standalone basis.

#### *United States*

Gross earned premiums increased by 52% from £6,032 million in 2008 to £9,197 million in 2009. This increase reflected both the beneficial effects of exchange rate movements compared to 2008, as well as the highest level of variable annuity sales in the company's history, driven by the stabilisation of US equity markets that began in the second quarter of 2009. Jackson also experienced an increase in sales of fixed index annuities as a result of increased customer demand for products with a guaranteed rate of return. These increases were slightly offset by the restriction made by the company on the sales of institutional guaranteed investment contracts.

Gross earned premiums increased by 3% from £5,860 million in 2007 to £6,032 million in 2008. This increase was mainly as a result of exchange rate movements during the year, with a decrease in underlying variable annuity sales reflecting continued volatility in US equity markets in 2008 and intense price competition partially offset by increases in fixed annuity sales reflecting changing customer demands.

#### *United Kingdom*

Gross earned premiums for the UK operations decreased by 25% from £7,628 million in 2008 to £5,757 million in 2009. Sales of with-profits bonds increased by 35% on 2008 in 2009 but this was more than offset by lower sales of retail products due to persisting challenging market conditions and also reflecting the Prudential Group's focus on value over volume. Additionally, 2008 included a large bulk annuity transaction which was not repeated in 2009, due to the unavailability of transactions which met Prudential's return criteria.

Gross earned premiums for Prudential UK increased by 2% in the year from £7,477 million in 2007 to £7,628 million in 2008, primarily driven by strong growth in with-profits bonds supplemented by growth in offshore products and PruHealth, amongst other items.

#### **(b) Investment return**

	<b>Year ended 31 December</b>		
	<b>2007</b>	<b>2008</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Asian Operations . . . . .	1,818	(4,156)	4,431
US Operations . . . . .	2,140	(5,409)	5,138
UK Operations . . . . .	8,396	(20,435)	17,786
Unallocated corporate and intra-group elimination . . . . .	(129)	(202)	(466)
<b>Total . . . . .</b>	<b><u>12,225</u></b>	<b><u>(30,202)</u></b>	<b><u>26,889</u></b>

Investment return principally comprises interest income, dividends, investment appreciation/depreciation (realised and unrealised gains and losses) on investments designated as fair value through profit and loss and realised gains and losses, including impairment losses, on Jackson's debt securities designated as available-for-sale. Movements in unrealised appreciation/depreciation of Jackson's debt securities designated as available for-sale are not reflected in investment return but are recorded instead in other comprehensive income.

### Allocation of investment return between policyholders and shareholders

Investment return is attributable to policyholders and shareholders. A key feature of the accounting policies under IFRS is that the investment return included in the income statement relates to all investment assets of the Prudential Group, irrespective of whether the return is attributable to shareholders, or to policyholders or the unallocated surplus of with-profits funds, the latter two of which have no net impact on shareholders' profit. The table below provides a breakdown of the investment return for each regional operation attributable to each type of business:

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
<b>Asian operations</b>			
Policyholder returns			
Assets backing unit-linked liabilities . . . . .	753	(2,552)	2,539
With-profits business . . . . .	866	(1,611)	1,519
	1,619	(4,163)	4,058
Shareholder returns . . . . .	199	7	373
Total . . . . .	1,818	(4,156)	4,431
<b>US operations</b>			
Policyholder returns			
Assets held to back (separate account) unit-linked liabilities . . . . .	620	(5,925)	3,760
Shareholder returns			
Realised gains and losses (including impairment losses on available-for-sale bonds) . . . . .	(47)	(651)	(529)
Value movements on derivative hedging programme for general account business . . . . .	19	(311)	340
Interest/dividend income and value movements on other financial instruments for which fair value movements are booked in the income statement . . . . .	1,548	1,478	1,567
	1,520	516	1,378
Total . . . . .	2,140	(5,409)	5,138
<b>UK operations</b>			
Policyholder returns			
Scottish Amicable Insurance Fund (SAIF) . . . . .	849	(2,095)	1,438
Assets held to back unit-linked liabilities . . . . .	515	(2,971)	2,947
With-profits fund (excluding SAIF) . . . . .	5,881	(14,595)	10,461
	7,245	(19,661)	14,846
Shareholder returns			
Prudential Retirement Income Limited (PRIL) . . . . .	216	(684)	1,827
Other business . . . . .	935	(90)	1,113
	1,151	(774)	2,940
Total . . . . .	8,396	(20,435)	17,786
<b>Unallocated corporate</b>			
Shareholder returns . . . . .	(129)	(202)	(466)
<b>Group total</b>			
Policyholder returns . . . . .	9,484	(29,749)	22,664
Shareholder returns . . . . .	2,741	(453)	4,225
Total . . . . .	12,225	(30,202)	26,889

#### Policyholder returns

The returns, as shown in the table above, are delineated between those returns allocated to policyholders and those allocated to shareholders. In making this distinction, returns allocated to policyholders are those from investments in which shareholders have no direct economic interest, namely:

- unit-linked business in the UK and Asia and SAIF in the UK, for which the investment return is wholly attributable to policyholders,
- separate account business of US operations, the investment return of which is also wholly attributable to policyholders, and
- with-profits business (excluding SAIF) in the UK and Asia (in which the shareholders' economic interest, and the basis of recognising IFRS basis profits, is restricted to a share of the actuarially determined surplus for

distribution (in the UK, 10%). Except for this surplus, the investment return of the with-profit funds is attributable to policyholders (through the asset-share liabilities) or the unallocated surplus, which is accounted for as a liability under IFRS 4.

The assets of these three types of business represented 72% of the total investments of the Prudential Group as at 31 December 2009. The investment return related to the types of business above does not affect shareholders' profits directly. However, there is an indirect impact, for example, investment-related fees or the effect of investment return on the shareholders' share of the cost of bonuses of with-profits funds.

Investment returns for unit-linked and similar products have a reciprocal impact on benefits and claims, with a decrease in market returns on the attached pool of assets affecting policyholder benefits on these products. Similarly, for with-profits funds there is a close correlation between increases or decreases in investment returns and the level of combined charge for policyholder benefits and movement on unallocated surplus that arises from such returns.

#### *Shareholder returns*

For shareholder-backed non-participating business of the UK (comprising PRIL and other non-linked non-participating business) and of the Asian operations, the investment return is not directly attributable to policyholders and therefore does not impact shareholders' profit directly. However, it should be noted that for UK shareholder-backed annuity business, principally PRIL, where the durations of asset and liability cash flows are normally closely matched, the discount rate applied to measure liabilities to policyholders (under grandfathered UK GAAP under IFRS 4) reflects movements in asset yields (after allowances for the future defaults) of the backing portfolios. Therefore, the net impact on the shareholders' profits of the investment return of the assets backing the liabilities of UK shareholder-backed annuity business is after taking into account the consequential effect on the movement in policyholder liabilities.

Changes in shareholder investment returns for US operations reflect primarily movements in investment income, movements in the value of the derivative instruments held to manage the general account assets and liability portfolio, and realised gains and losses. However, separately reflecting Jackson's types of business, an allocation is made to policyholders through the application of crediting rates. The shareholder investment return for US operations also includes the fair value movement of the derivatives and the movement on the related liabilities of the variable annuity guarantees under Jackson's dynamic hedging programme.

The majority of the investments held to back the US non-participating business are debt securities for which the available-for-sale designation is applied for IFRS basis reporting. Under this designation the return included in the income statement reflects the aggregate of investment income and realised gains and losses (including impairment losses). However, movements in unrealised appreciation are booked directly to equity. The return on these assets is attributable to shareholders.

#### *Reasons for year-on-year changes in investment returns*

With two exceptions, all Prudential investments are carried at fair value in the balance sheet with fair value movements, which are volatile from year to year, recorded in the income statement. The exceptions are for:

- (i) debt securities of the US operations, which are accounted for on an IAS 39 available-for-sale basis, in respect of which realised gains and losses (including impairment losses) are recorded in the income statement, while movements in unrealised appreciation (depreciation) are booked as other comprehensive income. As a result, the changes in fair value of these debt securities are not reflected in the Prudential Group's investment return in the income statement. The unrealised gains and losses in the income statement of US operations primarily arise on the assets of the US separate account business; and
- (ii) loans and receivables, which are carried at amortised cost.

Subject to the effect of these two exceptions, the year-on-year changes in investment return primarily reflect the generality of overall market movements for equities, debt securities and, in the UK, for investment property. In addition, for Asian and US separate account business, foreign exchange rates affect the sterling value of the translated income. Consistent with the treatment applied for other items of income and expenditure, investment returns for overseas operations are translated at average exchange rates.

## Asia

The table below provides an analysis of investment return attributable to Asian operations for the periods presented:

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Interest/dividend income (including foreign exchange gains and losses) . . . . .	462	302	625
Investment appreciation (depreciation) . . . . .	<u>1,356</u>	<u>(4,458)</u>	<u>3,806</u>
Total . . . . .	<u>1,818</u>	<u>(4,156)</u>	<u>4,431</u>

In the Prudential Group's Asian operations, debt securities accounted for 38%, 51% and 43% of the total investment portfolio as at 31 December 2007, 2008 and 2009, respectively, with equities comprising 54%, 37% and 48%, respectively. The remaining 8%, 12% and 9% of the total investment portfolio, respectively, primarily comprised loans and deposits with credit institutions. In Asia, investment return increased by £8,587 million in 2009 to £4,431 million. This increase was due to an increase of £323 million in interest and dividend income (including foreign exchange gains and losses) and an £8,264 million increase in investment appreciation, including realised and unrealised gains and losses. The increase of £8,264 million in investment appreciation primarily reflected the effect of the strong performance of Asian equity markets in 2009, in comparison to the significant downturns experienced in 2008.

In 2008, investment return decreased by £5,974 million from a £1,818 million credit in 2007 to a £4,156 million charge in 2008. This decrease was due to a £160 million decrease in interest/dividend income (including foreign exchange gains and losses) and a decrease of £5,814 million in investment appreciation compared to 2007. The decrease of £5,814 million in investment appreciation was primarily the result of volatility in the Asian financial markets in 2008, reflecting a combined effect of the significant downturn in the Asian equity markets partially offset by the effects of bond yield declines.

## United States

The table below provides an analysis of investment return attributable to US operations for the periods presented:

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Realised losses (including impairment losses on available-for-sale bonds) . . . . .	(47)	(651)	(529)
Investment return of investments backing US separate account liabilities . . . . .	620	(5,925)	3,760
Other investment return . . . . .	<u>1,567</u>	<u>1,167</u>	<u>1,907</u>
Total . . . . .	<u>2,140</u>	<u>(5,409)</u>	<u>5,138</u>

In the Prudential Group's US operations, investment return increased from a charge of £5,409 million in 2008 to a credit of £5,138 million in 2009. The significant £10,547 million favourable change was due to a £122 million decrease in realised losses on available-for-sale debt securities, an increase of £9,685 million in investment return of investments backing the US variable annuity separate account liabilities and an increase of £740 million in other investment returns. Realised losses in 2009 of £529 million included mainly losses incurred in the debt securities portfolio due to write-downs and losses on the sale of bonds. The primary driver of the increase in the US investment return was the increase in returns on investments backing the US variable annuity separate account liabilities as a result of significantly more favourable movements in US equity markets in 2009. The increase of £740 million in other investment return was mainly accounted for by the movement in the fair value of derivatives held to manage the general account business, which was a positive £340 million in 2009 compared to a negative of £311 million in 2008.

Investment return decreased by £7,549 million from a £2,140 million credit in 2007 to a £5,409 million charge in 2008. This decrease was due to a £604 million increase in realised losses on debt securities classified as available-for-sale, a decrease in the investment return of the investments backing the US variable annuity separate account liabilities of £6,545 million and a decrease of £400 million in other investment returns. Realised losses in 2008 were £651 million compared to £47 million in 2007 and were related to losses incurred in the debt securities portfolio due to defaults, losses on the sale of bonds and write-downs. The primary driver of the decrease in the US investment return was the reduction in returns on investments backing the US variable annuity separate account liabilities as a result of adverse movements in US equity markets. The investment return of the investment assets backing US separate account liabilities decreased by £6,545 million from a £620 million credit in 2007 to a

£5,925 million charge in 2008. The decrease of £400 million in other investment return was mainly accounted for by a £311 million decrease in the fair value of derivatives held to manage the general account business.

#### *United Kingdom*

The table below provides an analysis of investment return attributable to UK operations for the periods presented:

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Interest/dividend income . . . . .	6,763	7,117	6,628
Foreign exchange gains and losses <sup>(i)</sup> . . . . .	(101)	(2,964)	921
Investment appreciation (depreciation) <sup>(ii)</sup> . . . . .	<u>1,734</u>	<u>(24,588)</u>	<u>10,237</u>
<b>Total . . . . .</b>	<b><u>8,396</u></b>	<b><u>(20,435)</u></b>	<b><u>17,786</u></b>

(i) Foreign exchange gains and losses on retranslation of non-sterling based assets, including foreign currency forwards, principally of the UK with-profits fund.

(ii) Investment appreciation (depreciation) comprises realised and unrealised gains and losses on the investments.

In the Prudential Group's UK operations, equities accounted for 42%, 32% and 28% of the total investment portfolio as at 31 December 2007, 2008 and 2009, respectively. Debt securities comprised 40%, 48% and 51%, respectively, with investment properties accounting for 10%, 10% and 8% of the total investment portfolio in each respective year. The remaining 8%, 10% and 13% of the total investment portfolio as at 31 December 2007, 2008 and 2009, respectively, related to loans, deposits with credit institutions, investment in partnerships in investment pools and derivative assets. Within debt securities of £69 billion as at 31 December 2009, 84% was comprised of corporate debt securities.

In the UK, the investment return improved significantly by £38,221 million in 2009, from a £20,435 million charge in 2008 to a £17,786 million credit in 2009. This significant favourable change comprises a decrease of £489 million in interest and dividend income, which was more than offset by an increase of £3,885 million in foreign exchange gains and a decrease in investment depreciation of £34,825 million. The reduction in interest and dividend income of £489 million in 2009 primarily reflected the combined effects of lower interest rates and portfolio changes from equities to other asset classes. The foreign exchange gains of £921 million in 2009 related mainly to gains from foreign currency forwards of the UK with-profits fund as sterling appreciated above the contract levels in 2009. The investment appreciation of £10,237 million in 2009 primarily reflected the recovery in the UK financial markets compared to 2008, especially in the latter half of 2009, and mainly reflected movement on equities and debt securities.

Investment return in the UK decreased £28,831 million from an £8,396 million credit in 2007 to a £20,435 million charge in 2008. This reduction was due to an increase of £354 million interest/dividend income being more than offset by a decrease of £2,863 million in foreign exchange gains and losses and an increase in investment depreciation of £26,322 million. The foreign exchange losses of £2,964 million in 2008 mainly related to losses from foreign currency forward contracts of the UK with-profits fund as sterling depreciated in 2008. These contracts were purchased to limit the effects of volatility in foreign exchange rates on investments denominated in currencies other than sterling. The investment depreciation of £24,588 million primarily reflected adverse conditions in the UK financial markets in 2008, with negative returns from holdings in equities, debt securities and investment properties.

#### *Unallocated corporate and intra-group elimination*

Investment return for unallocated corporate changed by a negative £264 million to a negative £466 million in 2009 compared to a negative £202 million in 2008. This change related mainly to a one-off £235 million IGD hedge cost incurred in 2009 as explained previously.

Investment return for unallocated corporate changed by a negative £73 million from a negative £129 million in 2007 to a negative £202 million in 2008.

(c) *Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance*

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Asian Operations . . . . .	(5,722)	(192)	(7,710)
US Operations . . . . .	(7,096)	(947)	(13,285)
UK Operations . . . . .	<u>(13,967)</u>	<u>11,963</u>	<u>(20,200)</u>
Total . . . . .	<u>(26,785)</u>	<u>10,824</u>	<u>(41,195)</u>

Benefits and claims represent payments, including final bonuses, to policyholders in respect of maturities, surrenders and deaths plus the change in technical provisions (which primarily represents the movement in amounts owed to policyholders). Benefits and claims are amounts attributable to policyholders. The movement in unallocated surplus of with-profits funds represents the transfer to (from) the unallocated surplus each year through a charge (credit) to the income statement of the annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders.

The underlying reasons for the year-on-year changes in benefits and claims and movement in unallocated surplus in each of the Prudential Group's regional operations are changes in the incidence of claims incurred, increases or decreases in policyholders' liabilities, and movements in unallocated surplus of with-profits funds.

Total benefits and claims and movement in unallocated surplus with-profits funds increased by £52,019 million in 2009 to a charge of £41,195 million compared to a credit of £10,824 million in 2008. Total benefits and claims and movement in unallocated surplus of with-profits funds decreased by £37,609 million in 2008 to a credit of £10,824 million compared to a charge of £26,785 million in 2007. The amounts of this year-on-year change attributable to each of the underlying reasons as stated above are shown below:

Prudential Group

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Claims incurred . . . . .	(14,727)	(16,210)	(15,781)
(Increase)/decrease in policyholder liabilities . . . . .	(11,517)	21,219	(23,855)
Movement in unallocated surplus of with-profits funds . . . . .	<u>(541)</u>	<u>5,815</u>	<u>(1,559)</u>
Benefits and claims and movement in unallocated surplus . . . . .	<u>(26,785)</u>	<u>10,824</u>	<u>(41,195)</u>

The principal driver for variations in amounts allocated to policyholders is changes to investment return reflected in the balance sheet measurement of liabilities for the Prudential Group's with-profits, SAIF and unit-linked policies (including US separate account business). In addition, for those liabilities under IFRS, in particular, liabilities relating to the UK annuity business (principally PRIL), where the measurement reflects the yields on assets backing the liabilities, the year to year changes in investment yields also contribute significantly to variations in the measurement of policyholder liabilities. The principal driver for variations in the change in unallocated surplus of with-profits funds is the value movements on the investment assets of the with-profits funds to the extent not reflected in policyholder liabilities.

The principal variations are for the increases or decreases in policyholder liabilities and movements in unallocated surplus of with-profits funds for each regional operation are discussed below.

*Asia*

In 2009, benefits and claims and movements in unallocated surplus of with-profits funds totalled £7,710 million, representing an increase of £7,518 million compared to the charge of £192 million in 2009.

In 2008, benefits and claims and movements in unallocated surplus of with-profits funds totalled £192 million, a 97% decrease from £5,722 million in 2007.

The amounts of the year-on-year change attributable to each of the underlying reasons are shown below.

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Claims incurred . . . . .	(1,429)	(1,552)	(1,814)
(Increase)/decrease in policyholder liabilities . . . . .	(4,004)	314	(6,230)
Movement in unallocated surplus of with-profits funds . . . . .	<u>(289)</u>	<u>1,046</u>	<u>334</u>
Benefits and claims and movement in unallocated surplus . . . . .	<u>(5,722)</u>	<u>(192)</u>	<u>(7,710)</u>

The growth in the policyholder liabilities in Asia over the three-year period partially reflected the increase due to the strong growth in new business in the region. The variations in the increases or decreases in policyholder liabilities in individual years were, however, primarily due to movement in investment returns. This was as a result of asset value movements that are reflected in the unit value of the unit-linked policies, which represent a significant proportion of the Asian operations' business. In addition, the policyholder liabilities of the Asian operations' with-profits policies also fluctuated with the investment performance of the funds.

Accordingly, due to significant improvement in market returns in 2009 compared to 2008, there was a related increase in the charge for benefits and claims in the year. Conversely, in 2008, due to the significant decrease in market returns compared to 2007, there was a related decrease in the charge for benefits and claims in the period.

#### *United States*

Except for institutional products and certain term annuities which are classified as investment products under IAS 39 for the purposes of IFRS reporting, deposits into the US operations' products are recorded as premiums, withdrawals and surrenders and are included in benefits and claims, and the resulting net movement is recorded under other reserve movements within benefits and claims. Benefits and claims also include interest credited to policyholders in respect of deposit products less fees charged on these policies.

In 2009, the accounting charge for benefits and claims increased by £12,338 million to £13,285 million compared to £947 million in 2008. In 2008, the accounting charge for benefits and claims decreased by 87% to £947 million compared to £7,096 million in 2007. The amounts of the year-on-year change attributable to each of the underlying reasons are shown below:

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Claims incurred . . . . .	(3,032)	(3,666)	(4,092)
(Increase)/decrease in policyholder liabilities . . . . .	<u>(4,064)</u>	<u>2,719</u>	<u>(9,193)</u>
Benefits and claims and movement in unallocated surplus . . . . .	<u>(7,096)</u>	<u>(947)</u>	<u>(13,285)</u>

The movements year-on-year in the claims incurred for the US operations as shown in the table above also included the effects of translating the US dollar results into pounds sterling at the average exchange rates for the relevant years.

The variations in the charge/credit in the increases or decreases in policyholder liabilities from year to year in the United States were primarily attributable to movements in the investment return on the assets backing the variable annuity separate account liabilities, and the growth of the variable annuity business.

#### *United Kingdom*

Overall, benefits and claims and the movement in unallocated surplus recorded in the income statement was a £20,200 million charge in 2009 compared to a £11,963 million credit in 2008 and a £13,967 million charge in 2007.

The year-on-year changes attributable to each of the underlying reasons are shown below, together with a further analysis of the amounts included in respect of the movements in policyholder liabilities by type of business:

	<u>Year ended 31 December</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Claims incurred . . . . .	(10,266)	(10,992)	(9,875)
Decrease/(increase) in policyholder liabilities			
SAIF . . . . .	504	3,578	37
PRIL . . . . .	(1,075)	909	(1,746)
Unit-linked and other non-participating business . . . . .	(571)	195	(3,031)
With-profits (excluding SAIF) . . . . .	(2,307)	13,504	(3,692)
	(3,449)	18,186	(8,432)
Movement in unallocated surplus of with-profits funds . . . . .	<u>(252)</u>	<u>4,769</u>	<u>(1,893)</u>
Benefits and claims and movement in unallocated surplus . . . . .	<u>(13,967)</u>	<u>11,963</u>	<u>(20,200)</u>

Claims incurred in the UK operations decreased from £10,992 million in 2008 to £9,875 million in 2009. The reduction in claims incurred primarily reflects the combined effect of lower maturities and surrenders for with-profits funds. The reduction in maturing claims reflects a lower base level of policies.

As has been explained above, the principal driver for variations in amounts allocated to the policyholders is changes to investment returns.

In aggregate, as a result of the significant improvement in market returns in 2009 there has been a corresponding impact on benefits and claims and movements in unallocated surplus of with-profits funds in the year, moving from a net credit in 2008 to a net charge in 2009. Conversely, the comparison of the net credit in 2008 and the net charge in 2007 for benefits and claims and movement in unallocated surplus reflected the impact of negative market returns in 2008.

SAIF is a ring-fenced fund with no new business written. The decrease in policyholder liabilities in SAIF reflects the underlying decreasing policyholder liabilities as the liabilities run off. The variations from year to year are, however, affected by the market valuation movement of the investments held by SAIF, which are wholly attributable to policyholders.

For PRIL, the increases and decreases in policyholder liabilities reflect the effect of altered investment yield reflected in the discount rate applied in the measurement of the liabilities, together with other factors such as changes in premium income for new business and altered assumptions.

For unit-linked business, the variations in the increases and decreases in the policyholder liabilities relating to the unit-linked business were primarily due to the movement in the market value of the unit-linked assets as reflected in the unit value of the unit-linked policies.

The part of the Prudential Group where variations in amounts attributed to policyholder liabilities and unallocated surplus are most significant is the UK with-profits business (excluding SAIF). As explained in note D2 to the consolidated financial information set out in Part XIV of this prospectus, the liabilities for UK with-profits policyholders are determined on an asset-share basis that incorporates the accumulation of investment returns and all other items of income and outgo that are relevant to each policy type. Accordingly, the movement in policyholder liabilities in the income statement will fluctuate with the investment return of the fund. Separately, the excess of assets over liabilities of the fund represents the unallocated surplus. This surplus will also fluctuate on a similar basis to the market value movement on the investment assets of the fund with the movement reflected in the income statement. In addition, other items of income and expenditure affect the level of movement in policyholder liabilities (to the extent reflected in assets shares) and unallocated surplus.

The correlation between total net income (loss) before benefits and claims and movement in unallocated surplus, on the one hand, and the (charge) credit for benefits and claims and movement in unallocated surplus, on the other, for the UK component of the PAC with-profits fund (excluding SAIF) is illustrated numerically by the table below for each of the years presented. In summary, the correlation principally arises due to the following factors:

- (a) Investment return is included in full in the income statement and is attributable either to contracts or unallocated surplus.
- (b) Investment return, to the extent attributable to contracts, directly affects asset-share liabilities, which are reflected in the income statement through changes in policyholder liabilities.

(c) *Investment return, to the extent attributable to unallocated surplus, forms the majority part of the movement in such surplus in the income statement.*

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Earned premiums, net of reinsurance <sup>(i)</sup> . . . . .	4,181	2,927	3,063
Investment return . . . . .	5,881	(14,595)	10,461
Other income . . . . .	1,417	(36)	(2)
Acquisition costs and other operating expenditure <sup>(ii)</sup> . . . . .	(2,105)	(408)	(842)
Tax (charge) credit . . . . .	(24)	1,191	(640)
<b>Total net income before benefit and claims and movement in unallocated surplus, net of reinsurance . . . . .</b>	<b>9,350</b>	<b>(10,921)</b>	<b>12,040</b>
<b>Charges of:</b>			
Claims incurred . . . . .	(6,512)	(7,068)	(6,253)
(Increase)/decrease in policyholder liabilities <sup>(i)</sup> . . . . .	(2,307)	13,504	(3,692)
Movement in unallocated surplus of with-profits funds . . . . .	(252)	4,769	(1,893)
<b>Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance . . . . .</b>	<b>(9,071)</b>	<b>11,205</b>	<b>(11,838)</b>
<b>Shareholders' profit after tax . . . . .</b>	<b>279</b>	<b>284</b>	<b>202</b>

(i) For the purposes of presentation in the Prudential Group's consolidated financial information, references to the UK with-profits fund also include, for convenience, the amounts attaching to Prudential's UK Defined Charge Participating Sub-fund which includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 31 December 2007. The earned premiums and increase in policyholder liabilities for 2007 as shown in the table above included £1.7 billion relating to this transfer. Profits to shareholders emerge on a 'charges less expenses' basis and policyholders are entitled to 100% of the investment earnings.

(ii) In November 2007, Prudential sold its subsidiary PPM Capital, and the Prudential Group ceased to consolidate venture fund investments managed by the sold entity from that date, resulting in a reduction in the associated operating expenditure. The acquisition costs and other operating expenditure for 2007 as shown above included the operating expenditure of the consolidated venture funds investments of £1,408 million up to the date when the investments ceased to be consolidated.

Separately, the cost of current year bonuses which is attributable to policyholders is booked within the movement in policyholder liabilities. One-ninth of the declared cost of policyholders' bonus is attributable to shareholders and represents the shareholders' profit. Both of these amounts, by comparison with the investment return, movement in other constituent elements of the change in policyholder liabilities and the change in unallocated surplus, are relatively stable from period to period.

In 2009, the income statement of the UK component of the PAC with-profits funds was charged with a transfer of £1.9 billion from the unallocated surplus. This transfer, together with a corresponding transfer in the unallocated surplus of the Asia with-profits funds and the effect of exchange rate movements, resulted in an increase in the Prudential Group's unallocated surplus from £8.4 billion in 2008 to £10.0 billion in 2009. This movement reflected the net effect of changes in the value of assets, liabilities (incorporating policyholder bonuses and other elements of asset shares attributable to policyholders), and the shareholders' share of the cost of bonuses for 2009.

The surplus for distribution in future years will reflect the aggregate of policyholder bonuses and the cost of bonuses attributable to shareholders, which is currently set at 10%. The policyholder bonuses comprise the aggregate of regular and final bonuses. When determining policy payouts, including final bonuses, the Prudential Group considers asset shares of specimen policies.

The Prudential Group does not take into account the surplus assets of the long-term fund, or the investment return, in calculating asset shares. Asset-shares are used in the determination of final bonuses, together with treating customers fairly, the need to smooth claim values and payments from year to year and competitive considerations.

In the unlikely circumstance that the depletion of excess assets within the long-term fund was such that the Prudential Group's ability to treat its customers fairly was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

The factors that the PAC Board considers in setting bonus rates are described in more detail in the section headed "With-profits products" in paragraph 4.4 of Part VII (*Information about the Prudential Group*) of this prospectus and in paragraph 5.1 of this Part XII and are summarised in note D2 to the consolidated financial information set out in Part XIV of this prospectus.

(d) *Acquisition costs and other operating expenditure*

	Year ended 31 December		
	2007	2008	2009
	£m	£m	£m
Asian Operations . . . . .	(1,077)	(1,032)	(1,698)
US Operations . . . . .	(730)	(613)	(879)
UK Operations . . . . .	(3,001)	(710)	(2,013)
Unallocated corporate . . . . .	(51)	(104)	18
Total . . . . .	<u>(4,859)</u>	<u>(2,459)</u>	<u>(4,572)</u>

Total acquisition costs and other operating expenditure of £4,572 million in 2009 was 86% higher than the £2,459 million incurred in 2008. Total acquisition costs and other operating expenditure of £2,459 million in 2008 was 49% lower than the £4,859 million incurred in 2007.

*Asia*

Total acquisition costs and other operating expenditure for Asia in 2009 were £1,698 million, an increase of £666 million, or 65% over 2008. This increase was primarily due to an increase of £606 million in the charge for the investment gains attributable to external unit-holders relating to investment funds managed on behalf of third parties which are consolidated but have no recourse to the Prudential Group. The increase in the charge reflects the increase in the overall returns in 2009 in these consolidated investment funds. Additionally, the increase in 2009 compared to 2008 included the effects of movements in the exchange rates applied to translate the results into the pounds sterling value.

In 2008, total acquisition costs and other operating expenses for Asia were £1,032 million, a decrease of £45 million compared to £1,077 million in 2007. This decrease mainly reflected a decrease in operating costs of £181 million to £380 million in 2008 partially offset by higher acquisition costs.

*United States*

Total acquisition costs and other operating expenditure for the US increased by £266 million from £613 million in 2008 to £879 million in 2009. The increase in 2009 compared to 2008 included the effects of movements in the exchange rates applied to translate the US dollar results into the pounds sterling value.

In 2008, acquisition costs and other operating expenditure of £613 million in 2008 were 16% lower than expenses in 2007 of £730 million, due mainly to a decrease in DAC amortisation.

*United Kingdom*

Total UK acquisition costs and other operating expenditure for the UK in 2009 were £2,013 million, compared to £710 million in 2008. The significant increase was primarily due to an increase over 2008 of £972 million in the charge for the investment gains attributable to external unit-holders relating to investment funds managed on behalf of third parties which are consolidated but have no recourse to the Prudential Group. This increase was partially offset by decreases in acquisition costs incurred and other operating costs.

Total acquisition costs and other operating expenditure for the UK in 2008 were £710 million, compared to £3,001 million in 2007. The decrease of £2,291 million in 2008 mainly related to a decrease in other operating expenditure.

The principal movement in other operating expenditure in 2008 compared to 2007 related to the non-consolidation in 2008 of entities held by way of venture fund investments following the disposal of PPM Capital in the second half of 2007, which meant that the Prudential Group was no longer deemed to control these operations. Included within other operating expenses for 2007 was £1,289 million in respect of consolidated venture fund investments. Corresponding revenue for the investments of £1,418 million was included within other income for 2007. The decrease in 2008 was also due to the decrease over 2007 of £1,085 million in the charge for the investment results attributable to external unit-holders relating to consolidated investment funds managed on behalf of third parties. The decrease in the charge reflected the decrease in overall returns in 2008 in these consolidated investment funds.

(e) *Discontinued operations*

The Prudential Group's discontinued operations related in 2007 to the UK banking business following the sale of Egg Banking Plc ("Egg") on 1 May 2007. The profit from discontinued operations of £241 million in 2007 arose as a result of a £290 million profit on the sale of Egg, which was partially offset by a £49 million trading loss incurred by Egg prior to its disposal. There was no impact on the results for 2008. The 2009 charge of £14 million, which is

net of tax, reflected completion adjustments for a previously disposed business. Additional information is set out in note I9 to the Prudential Group's consolidated financial information set out in Part XIV of this prospectus.

## 7. IFRS Shareholders' funds

The following table sets forth a summary of the movement in the Prudential Group's IFRS Shareholders' funds for 2007, 2008 and 2009:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Operating profit based on longer-term investment returns . . . . .	1,152	1,283	1,405
Items excluded from operating profit . . . . .	<u>(89)</u>	<u>(1,733)</u>	<u>(659)</u>
<b>Total profit/(loss) before tax</b> . . . . .	1,063	(450)	746
Tax, discontinued operations and minority interest . . . . .	<u>(116)</u>	<u>54</u>	<u>(70)</u>
<b>Profit/(loss) for the period</b> . . . . .	947	(396)	676
Exchange movements, net of related tax . . . . .	13	510	(195)
Unrealised gains and losses on Jackson securities classified as available-for-sale . . .	(105)	(831)	1,043
Dividends . . . . .	(426)	(453)	(481)
New share capital subscribed . . . . .	182	170	141
Other . . . . .	<u>27</u>	<u>(4)</u>	<u>29</u>
<b>Net increase/(decrease) in shareholders' funds</b> . . . . .	638	(1,004)	1,213
Shareholders' funds at beginning of period . . . . .	<u>5,424</u>	<u>6,062</u>	<u>5,058</u>
<b>Shareholders' funds at the end of period</b> . . . . .	<u><u>6,062</u></u>	<u><u>5,058</u></u>	<u><u>6,271</u></u>

Statutory IFRS basis shareholders' funds as at 31 December 2009 were £6.3 billion. This compares to the £5.1 billion as at 31 December 2008, an increase of £1.2 billion.

The movement reflected the profit for the year after tax of £0.7 billion, exchange translation losses, principally on Jackson, of £0.2 billion and dividend payments of £0.5 billion, the positive effect of a reduction in the level of net unrealised losses on Jackson's debt securities of £1.0 billion and other items of £0.2 billion.

In 2009 the net unrealised gains/losses within the statement of financial position value for debt securities classified as available-for-sale moved from a net unrealised loss of £2,897 million to a net unrealised gain of £4 million. After allowing for DAC and tax effects this reduction in the level of unrealised gains/losses has led to a £1.0 billion increase in shareholders' funds during the year. The reduction in unrealised gains/losses reflects the benefits of some normalisation in credit markets with spreads tightening.

Statutory IFRS basis shareholders' funds as at 31 December 2008 were £5.1 billion, compared with £6.1 billion as at 31 December 2007. This result represented a decrease of £1.0 billion, reflecting operating profit of £1.3 billion and a foreign exchange credit of £0.5 billion net of tax, offset by unfavourable movement in short-term fluctuations in investment returns and other items excluded from operating profit of negative £1.7 billion, a net unrealised value change on Jackson debt securities of negative £0.8 billion net of tax and the balance of dividend payments of £0.5 billion partially offset by proceeds of new share capital subscribed of £0.2 billion.

The net unrealised value change on Jackson debt securities of £0.8 billion in 2008 is explained by net unrealised losses of negative £2,104 million (being the gross unrealised losses of £2,482 million less unrealised gains of £378 million); reflecting temporary market movements due to the effects of widening global credit spreads offset partially by the effect of reduced risk-free interest rates and a steepening yield curve. These unrealised losses were further offset by associated DAC of £831 million and tax of £442 million.

## 8. Liquidity and capital resources

Prudential Capital operates a central treasury function for the Prudential Group, which has overall responsibility for managing the Prudential Group's capital funding programme as well as its central cash and liquidity positions. The Prudential Group arranges the financing of each of its subsidiaries primarily by raising external finance either at the parent company level (including through finance subsidiaries whose obligations the parent company guarantees) or at the operating company level.

### Cash flow

The Prudential Group's consolidated cash flow includes the movement in cash included within both policyholders' and shareholders' funds, such as cash in the with-profits fund. Prudential therefore believes that it is more relevant to

consider individual components of the movement in holding company cash flow which relate solely to the shareholders.

### *Holding company cash flow*

The Prudential Group continues to manage cash flows across the group with a view to achieving a balance between ensuring sufficient net remittances from the businesses to cover the progressive dividend (after corporate costs) and maximising value for shareholders through the reinvestment of the free surplus generated at business unit level in the particularly profitable opportunities available to the Prudential Group given its established position in key life insurance markets. On this basis, the holding company cash flow statement at an operating level should generally balance to close to zero before exceptional cash flows.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Net cash remitted by business units:</b>			
UK Life fund paid to Group . . . . .	261	279	284
Shareholder-backed business:			
Other UK paid to Group . . . . .	3	46	189
Group invested in UK . . . . .	(145)	(126)	(39)
Total shareholder-backed business . . . . .	(142)	(80)	150
<b>UK net . . . . .</b>	<b>119</b>	<b>199</b>	<b>434</b>
US paid to Group . . . . .	122	144	39
Group invested in US . . . . .	—	—	—
<b>US net . . . . .</b>	<b>122</b>	<b>144</b>	<b>39</b>
Asia paid to Group			
Long-term business . . . . .	148	163	181
Other operations . . . . .	38	234	46
	186	397	227
Group invested in Asia			
Long-term business . . . . .	(92)	(310)	(101)
Other operations . . . . .	(57)	(82)	(86)
	(149)	(392)	(187)
<b>Asia net . . . . .</b>	<b>37</b>	<b>5</b>	<b>40</b>
<b>M&amp;G paid to Group . . . . .</b>	<b>99</b>	<b>106</b>	<b>93</b>
<b>PruCap paid to Group . . . . .</b>	<b>40</b>	<b>61</b>	<b>82</b>
<b>Net remittances to Group from business units . . . . .</b>	<b>417</b>	<b>515</b>	<b>688</b>
Net interest paid . . . . .	(96)	(128)	(214)
Tax received . . . . .	40	130	71
Corporate activities . . . . .	(200)	(177)	(163)
<b>Total central outflows . . . . .</b>	<b>(256)</b>	<b>(175)</b>	<b>(306)</b>
<b>Operating holding company<sup>(i)</sup> cash flow before dividend . . . . .</b>	<b>161</b>	<b>340</b>	<b>382</b>
Dividend paid net of scrip and share options . . . . .	(243)	(286)	(344)
<b>Operating holding company<sup>(i)</sup> cash flow after dividend . . . . .</b>	<b>(82)</b>	<b>54</b>	<b>38</b>
Exceptional items:			
Cash flow arising from sale of Taiwan agency business . . . . .	—	—	(125)
IGD hedge costs <sup>(ii)</sup> . . . . .	—	—	(235)
Egg sale net proceeds . . . . .	527	—	—
Other cash movements			
Issue of hybrid debt, net of costs . . . . .	—	—	822
Repayment of maturing debt . . . . .	(150)	—	(249)
Receipts (payments) arising from foreign exchange movements on US\$ hedging instruments . . . . .	38	(352)	60
<b>Total holding company cash flow . . . . .</b>	<b>333</b>	<b>(298)</b>	<b>311</b>
Cash and short-term investments at 1 January 2009 . . . . .	1,119	1,456	1,165
Foreign exchange movements . . . . .	4	7	10
<b>Cash and short-term investments as at 31 December . . . . .</b>	<b>1,456</b>	<b>1,165</b>	<b>1,486</b>

(i) Including central finance subsidiaries.

(ii) Costs in respect of IGD hedge taken out in Q1 2009 to mitigate against further adverse movement in market indices from the lows experienced at that time.

Operating holding company cash flow for 2009 before dividend was £382 million, £42 million higher than for 2008. After dividend, the operating holding company cash flow was £38 million, £16 million lower than 2008 reflecting the higher dividend paid in 2009 and a higher scrip take-up in 2008.

The holding company received £688 million net remittances from business units in 2009, (including £506 million which relates to long-term business operations) up from £515 million in 2008, with increased contributions from the UK and Asia businesses partly offset by lower remittances from the US operations. The UK shareholder-backed business was cash flow positive in 2009, one year ahead of Prudential's previously announced target.

Prudential has flexibility available in its management of the holding company cash flow from and to the different business units. In 2009, it utilised this flexibility to bring forward the cash emergence of the in-force value through the proactive use of financing techniques.

Capital invested in business units in 2009 was £226 million compared to £518 million for 2008. Injections into Asia and the UK were both down from 2008 levels, when higher injections into Asia were made to meet solvency requirements following market falls, and reflecting Prudential's disciplined approach to capital preservation in the UK.

Net interest paid in 2009 increased from £128 million to £214 million. £38 million of the increase was in respect of the two debt issues in 2009 and, in addition, interest received on central shareholders' funds fell by £48 million due to falling interest rates.

Tax received in 2009 was £71 million, down £59 million from 2008, due to lower UK taxable profits available for offset. Payments for corporate activities at £163 million were £14 million lower, mainly due to the non-recurrence of 2008 costs relating to the investigation of the potential reattribution of the inherited estate.

After corporate costs, there was a net cash inflow before dividend of £382 million in 2009 compared to £340 million for 2008. The dividend paid net of scrip was £344 million in 2009 compared to £286 million in 2008. The take-up of scrip dividends in 2009 continued to be significant at £137 million (2008: £157 million).

As a consequence, overall, Prudential reported a positive underlying cash inflow before exceptional items of £38 million in 2009. There were also two exceptional payments. Prudential paid £125 million in connection with the sale of the Taiwan agency business to China Life Insurance Company Ltd of Taiwan, which comprised £45 million to purchase a 9.99% stake in that company and £80 million for transaction-related expenditure including restructuring costs.

In the first quarter of 2009, Prudential incurred one-off exceptional costs in relation to an IGD hedge taken out in 2009 to mitigate against further adverse movement in market indices from the lows experienced at that time, with the transaction being executed by Jackson where the specialist skills reside for the particular types of instruments utilised and £235 million of capital has been injected into Jackson.

When taken in aggregate with the subordinated and Tier 1 debt raising net of repayments undertaken during 2009, the overall holding company cash balances as at 31 December 2009 increased by £0.3 billion to £1.5 billion (2008: £1.2 billion).

### **Movements Subsequent to 31 December 2009**

Prudential cash and short term investments as included in the holding company cash flow statement as at 28 February 2010 were £1,260 million (31 December 2009: £1,486 million). The reduction since the year end comprises operating cash flow and payments in relation to the acquisition of UOB Life Assurance Limited totalling £240 million offset by £14 million of foreign exchange movements.

Core structural borrowings as at 28 February 2010 were £3,496 million (31 December 2009: £3,394 million), the movement arising principally from exchange rate movements. Overall net core structural borrowings as at 28 February 2010 were £2,236 million (31 December 2009: £1,908 million), reflecting the movements in cash and debt as described above.

In addition to core structural borrowings, the Prudential Group had operational borrowings attributable to shareholder-financed operations of £3,168 million at 28 February 2010 (31 December 2009: £2,751 million). The increase mainly reflects £250 million medium term notes issued in January 2010.

Between 28 February 2010 and 14 May 2010 (the latest practicable date prior to publication of this prospectus), no new core structural borrowings have been issued. Net core structural borrowings, being core structural borrowings net of holding company cash and short term investments in the period have increased by approximately £0.5 billion. As at 14 May 2010 operational borrowings attributable to shareholder financed operations had not changed materially from those as at 28 February 2010. In addition to the borrowings noted above, Prudential has access to

committed credit facilities and committed lending liquidity facilities as described in detail in the paragraph entitled “Shareholder borrowings and financial flexibility” in section 9 of Part XII of this Prospectus. As at 14 May 2010 there has been no change in the terms of these facilities since 31 December 2009. No drawdown on these facilities has taken place since 31 December 2009. Additional borrowings will be incurred to finance part of the costs of the Acquisition as described in section 3 of Part V of this prospectus. The annual post-tax financing costs of these borrowings is estimated to be approximately £300 million (assuming this financing comprises (i) the issue of US\$3 billion of MCNs and US\$2 billion of Tier 1 Notes to AIA Aurora; and (ii) US\$5.5 billion (gross) of external debt financing which is intended to be raised under the Bond Offerings, comprising of US\$5.5 billion (gross) of upper and lower Tier 2 notes, the cost of which is estimated at market rates prevailing at the date of this prospectus). Only a portion of the principal amount of the MCNs will be classified in the balance sheet as a liability with the residual being treated as a component of equity (see note 7 to the pro forma net asset statement in section A of Part XVI (*Unaudited Pro Forma Financial Information*)). Due to this accounting treatment, the £75 million coupon relating to the MCNs would not be included in the IFRS income statement as an expense and it is not included in the £300 million above. The MCN liability referred to above includes the present value of the future coupon payments and the unwind of the discount for the first year is an interest expense estimated at £4 million.

### ***Group liquidity requirements***

#### ***Dividend payments***

The total cost of dividends settled by Prudential were £481 million, £453 million and £426 million for the years ended 31 December 2009, 2008 and 2007, respectively, gross of scrip. The dividend paid net of scrip and share options was £344 million, £297 million and £255 million for the years ended 31 December 2009, 2008 and 2007 respectively.

The Board recommended a final dividend for 2009 of 13.56 pence per share, bringing the 2009 full-year dividend to 19.85 pence per share, an increase of 5%. The 2009 full-year dividend is scheduled to be paid on 27 May 2010.

#### ***Debt service costs***

Debt service costs charged to profit in respect of core borrowings paid by the Prudential Group in 2009 were £209 million compared with £172 million in 2008 and £168 million for 2007. Of total consolidated borrowings of £7,429 million as at 31 December 2009, the parent company had core borrowings of £3,236 million outstanding, all of which are due to mature in more than five years.

### ***Group liquidity sources***

The parent company held cash and short-term investments of £1,486 million, £1,165 million and £1,456 million as at 31 December 2009, 2008 and 2007, respectively. The sources of cash in 2009 included dividends, loans and interest received from operating subsidiaries, Prudential received £914 million in cash remittances from business units in 2009, compared to £1,033 million received in 2008 and £711 million received in 2007. These remittances primarily comprise dividends from business units and the shareholders’ statutory transfer from the PAC long-term with-profits fund (UK Life Fund) relating to earlier bonus declarations. Offset against these cash remittances were £226 million, £518 million and £294 million of capital invested in 2009, 2008 and 2007 respectively. Overall net remittances from business units had increased from £515 million in 2008 to £688 million in 2009.

### ***Shareholders’ statutory transfer***

In 2009, PAC declared a total surplus of £2,149 million from PAC’s primary with-profits sub-fund, of which £1,935 million was added to with-profits policies and £214 million was distributed to shareholders. In 2008, PAC declared a total surplus of £3,029 million from PAC’s primary with-profits sub-fund, of which £2,730 million was added to with-profits policies and £298 million was distributed to shareholders. In 2007, PAC declared total surplus of £2,901 million from PAC’s primary with-profits sub-fund, of which £2,612 million was added to with-profits policies and £289 million was distributed to shareholders.

### ***Dividends, loans and interest received from subsidiaries***

Under UK company law, dividends can only be paid if a company has distributable reserves sufficient to cover the dividend. In PAC, the Prudential Group’s largest operating subsidiary, distributable reserves are created mainly by the statutory long-term business profit transfer to shareholders that occurs upon the declaration of bonuses to policyholders of with profit products. See “Shareholders’ statutory transfer” above. The Prudential Group’s insurance and fund management subsidiaries’ ability to pay dividends and loans to the parent company is restricted by various laws and regulations. Jackson is subject to state laws that limit the dividends payable to its parent company. Dividends in excess of these limitations generally require approval of the state insurance commissioner.

The table below shows the dividends, loans and other amounts received by Prudential from the principal operating subsidiaries for FY 2007, 2008 and 2009:

	<b>Dividends, loans and interest received in:</b>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<b>£m</b>		
Asian Operations . . . . .	186	397	227
US Operations . . . . .	122	144	39
UK Insurance Operations (mainly PAC) . . . . .	264	325	473
M&G (including Prudential Capital) . . . . .	<u>139</u>	<u>167</u>	<u>175</u>
Total . . . . .	<u>711</u>	<u>1,033</u>	<u>914</u>

Each of the Prudential Group's main operations generates sufficient profits to pay dividends to the parent. The amount of dividends paid by the operations is determined after considering the development, growth and investment requirements of the operating businesses. The Prudential Group does not believe that the legal and regulatory restrictions constitute a material limitation on the ability of businesses to meet their obligations or pay dividends to Prudential.

#### ***Acquisition and sale of businesses by shareholder-financed operations***

On 1 March 2010, Prudential announced the proposed combination of the Prudential Group and the AIA Group as described in Part I and Part V of this prospectus.

On 6 January 2010, the Prudential Group announced the acquisition of UOB Life Assurance in Singapore for total cash consideration of SGD428 million (£192 million), subject to a post-completion adjustment to reflect the net asset value as at the completion date.

In June 2009, the Prudential Group completed the sale of its Taiwan agency business.

On 9 November 2007, the Prudential Group announced that it had completed the sale of PPM Capital, its direct private equity business.

On 29 January 2007, the Prudential Group announced that it had entered into a binding agreement to sell its holding in Egg to Citi. The sale completed on 1 May 2007 for a cash consideration (net of expenses) of £527 million.

#### ***Operating businesses***

##### *UK life insurance*

The liquidity sources for the Prudential Group's UK life insurance businesses comprise premiums, deposits and charges on policies, investment income, proceeds from the sale and maturity of investments, external borrowings and capital contributions from the parent company. The liquidity requirements comprise benefits and claims, operating expenses, interest on debt, purchases of investments and dividends to the parent company.

The liquidity requirements of the Prudential Group's UK life insurance businesses are regularly monitored to match anticipated cash inflows with cash requirements. Cash needs are forecast and projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying these projections are reviewed periodically. Adjustments are made periodically to the investment policies with respect to, among other things, the maturity and risk characteristics of the investment assets to reflect changes in the business' cash needs and also to reflect the changing competitive and economic environment.

The liquidity of the Prudential Group's UK insurance operations is affected by the payment of guaranteed benefits and terminal bonuses on maturing and surrendering policies by the UK insurance operations. In addition, the non-cash bonus declaration to policyholders results in a cash transfer to shareholders' funds. A large proportion of Prudential's liabilities contains discretionary surrender values or surrender charges. In addition, pension annuity policies cannot be surrendered by the policyholder.

As at 31 December 2009, 2008 and 2007, PAC's long-term fund assets in excess of its minimum capital requirements were £13,288 million, £5,819 million and £26,866 million, respectively. The "with-profits insurance capital component" of the enhanced capital requirement, as at 31 December 2009, 2008 and 2007 amounted to £5,570 million, £1,062 million and £16,369 million respectively.

## *M&G*

The principal liquidity source for M&G is fee income for managing retail, institutional and the internal investment funds of the Prudential Group's UK operations. The principal liquidity requirements are for operating expenses and to facilitate the investment activities of Prudential Capital as referred to in note E2 of the consolidated financial information set out in Part XIV of this prospectus. Amounts are distributed to the parent company after considering capital requirements. Capital requirements are driven by the regulatory stipulations based on fixed operating expenses and other operating considerations. As at 31 December 2009, M&G met the relevant regulatory requirements.

## *US life insurance*

The liquidity sources for Jackson are its cash, short-term investments and publicly traded bonds, premium income deposits received on certain annuity and institutional products, investment income, reverse repurchase agreements, utilisation of a short-term borrowing facility with the Federal Home Loan Bank of Indianapolis and capital contributions from the parent company.

Liquidity requirements are principally for purchases of new investments and businesses, repayment of principal and interest on intercompany debt, payments of interest on surplus notes, funding of insurance product liabilities including payments for policy benefits, surrenders, maturities and new policy loans, and funding of expenses including payment of commissions operating expenses and taxes. As at 31 December 2009, Jackson's outstanding notes and bank debt included:

- US\$33 million of collateralised loans maturing in the period between 2011 and 2016,
- US\$6 million of non-investment grade debt issued by variable interest entities maturing in the period between 2013 and 2016, and
- US\$250 million of surplus notes maturing in 2027.

Significant increases in interest rates and disintermediation can create sudden increases in surrender and withdrawal requests by policyholders and contract holders. Other factors that are not directly related to interest rates can also give rise to disintermediation risk, including but not limited to changes in ratings from rating agencies, general policyholder concerns relating to the life insurance industry (e.g. the unexpected default of a large, unrelated life insurer) and competition from other products, including non-insurance products such as mutual funds, certificates of deposit and newly developed investment products. Most of the life insurance, annuity and institutional products Jackson offers permit the policyholder or contract holder to withdraw or borrow funds or surrender cash values, although some include policy restrictions such as surrender charges and market value adjustments to discourage early withdrawal of policy and contract funds. As at 31 December 2009, approximately US\$10.5 billion of policy and contract funds had no surrender charge or market value adjustment restrictions.

Jackson uses a variety of asset-liability management techniques to provide for the orderly provision of cash flow from investments and other sources as policies and contracts mature in accordance with their normal terms. Jackson's principal sources of liquidity to meet unexpected cash outflows associated with sudden and severe increases in surrenders and withdrawals are its portfolio of liquid assets and its net operating cash flows. As at 31 December 2009, the portfolio of cash, short-term investments and publicly traded bonds and equities amounted to US\$28.7 billion. Operating net cash inflows for Jackson in 2009 were US\$2.6 billion.

As at 31 December 2009, the statutory capital and surplus of Jackson was US\$4.0 billion, which was in excess of the requirements set out under Michigan insurance law. As described in Part XIV of this prospectus, Jackson is also subject to risk-based capital guidelines that provide a method to measure the adjusted capital that a life insurance company should have for regulatory purposes, taking into account the risk characteristics of Jackson's investments and products. As at 31 December 2009, Jackson's total risk based capital ratio under the National Association of Insurance Commissioners' definition exceeded model act standards.

## *Asia life insurance*

The liquidity sources for the Prudential Group's Asia life insurance businesses comprise premiums, deposits and charges on policies, investment income, proceeds from the sale and maturity of investments, external borrowings and capital contributions from the parent company. The liquidity requirements comprise benefits and claims, operating expenses, interest on debt, purchases of investments and dividends to the parent company.

The liquidity requirements of the Prudential Group's Asia life insurance businesses are regularly monitored to match anticipated cash inflows with cash requirements. Cash needs are forecast and projected sources and uses of

funds, as well as the asset, liability, investment and cash flow assumptions underlying these projections are reviewed periodically. Adjustments are made periodically to the investment policies with respect to, among other things, the maturity and risk characteristics of the investment assets to reflect changes in the business cash needs and also to reflect the changing competitive and economic environment.

## 9. Summary balance sheet

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Investments . . . . .	204,050	193,434	208,722
Holding company cash and short-term investments . . . . .	1,456	1,165	1,486
Other . . . . .	<u>13,876</u>	<u>20,943</u>	<u>17,546</u>
Total assets . . . . .	219,382	215,542	227,754
Less: Liabilities			
Policyholder liabilities . . . . .	176,358	173,977	186,398
Unallocated surplus of with-profits funds . . . . .	<u>13,959</u>	<u>8,414</u>	<u>10,019</u>
	190,317	182,391	196,417
Core structural borrowings of shareholders' financed operations (IFRS book value basis) . . . . .	2,492	2,958	3,394
Other liabilities including minority interest . . . . .	<u>20,511</u>	<u>25,135</u>	<u>21,672</u>
Total liabilities and minority interest . . . . .	<u>213,320</u>	<u>210,484</u>	<u>221,483</u>
<b>IFRS basis net assets net of minority interest . . . . .</b>	<u>6,062</u>	<u>5,058</u>	<u>6,271</u>
Share capital and premium . . . . .	1,951	1,965	1,970
IFRS basis shareholders' reserves . . . . .	<u>4,111</u>	<u>3,093</u>	<u>4,301</u>
IFRS basis shareholders' equity . . . . .	<u><u>6,062</u></u>	<u><u>5,058</u></u>	<u><u>6,271</u></u>

The following sections focus on key areas of interest in the balance sheet:

### Shareholders' net borrowings and debt ratings

Shareholders borrowings for FY 2007, FY 2008 and FY 2009:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Perpetual subordinated capital securities (Innovative Tier 1) . . . . .	763	1,059	1,422
Subordinated notes (Lower Tier 2) . . . . .	<u>807</u>	<u>928</u>	<u>1,269</u>
	1,570	1,987	2,691
Senior debt:			
2009 . . . . .	248	249	—
2023 . . . . .	300	300	300
2029 . . . . .	<u>249</u>	<u>249</u>	<u>249</u>
Holding company total . . . . .	2,367	2,785	3,240
Jackson surplus notes (Lower Tier 2) . . . . .	<u>125</u>	<u>173</u>	<u>154</u>
Total . . . . .	2,492	2,958	3,394
Less: Holding company cash and short-term investments . . . . .	<u>(1,456)</u>	<u>(1,165)</u>	<u>(1,486)</u>
Net core structural borrowings of shareholder-financed operations . . . . .	<u><u>1,036</u></u>	<u><u>1,793</u></u>	<u><u>1,908</u></u>

### Shareholders' borrowings and financial flexibility

The Prudential Group's core structural borrowings as at 31 December 2009 totalled £3.4 billion on an IFRS basis, compared with £3.0 billion as at the end of 2008 and £2.5 billion at the end of 2007. In May 2009, senior debt of £0.3 billion was repaid on maturity and new hybrid debt of £0.4 billion was issued. In July 2009 a further £0.5 billion of new hybrid debt was issued. In addition, there were exchange translation gains of £0.2 billion on foreign currency denominated borrowings during 2009.

After adjusting for holding company cash and short-term investments of £1.5 billion, net core structural borrowings as at 31 December 2009 were £1.9 billion compared with £1.8 billion as at the end of 2008 and £1 billion as at the end of 2007. The movement of £0.1 billion in 2009 includes the gains of £0.2 billion mentioned above and the previously discussed positive cash flow of £38 million offset by the exceptional payments of £360 million.

Core structural borrowings as at 31 December 2009 included £2,933 million at fixed rates of interest, after taking into consideration the effects of interest rate swaps in place for these borrowings at that time, with maturity dates ranging from 2021 to perpetuity. The total US dollar denominated core structural borrowings as at 31 December 2009 were US\$2,550 million, of which US\$1,550 million were formally designated as net investment hedges, to hedge partially the currency exposure of the net investments in the US operations.

In addition to the core structural borrowings set out above, the Prudential Group also has in place an unlimited global commercial paper programme. As at 31 December 2009, the Prudential Group had issued commercial paper under this programme totalling £409 million, US\$1,976 million, and EUR 449 million. The central treasury function also manages its £5,000 million medium-term note (“MTN”) programme covering both core and non-core borrowings, under which the outstanding subordinated debt as at 31 December 2009 was £835 million, US\$750 million and EUR520 million, while the senior debt outstanding was £200 million and US\$12 million. In addition, Prudential has access to £1,600 million of committed revolving credit facilities, provided by 15 major international banks, and renewable between September 2011 and March 2012; and an annually renewable £500 million committed securities lending liquidity facility. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding as at 31 December 2009. The commercial paper programme, the MTN programme, the committed revolving credit facilities and the committed securities lending liquidity facility are all available for general corporate purposes and to support the liquidity needs of Prudential and are intended to maintain a strong and flexible funding capacity.

The Joint Lead Arrangers have entered into a subordinated debt financing facility to Prudential of up to £1 billion. This facility would only be available to be drawn during the period of twelve months following the completion of the Acquisition, on the occurrence of certain stresses on Prudential’s IGD capital. Prudential is entitled to extend the availability of this facility for a further twelve months at its option. If drawn, the facility will provide Prudential with capital resources to enhance its IGD capital at the relevant time. The facility will provide for Lower Tier 2 loans with a term of six years. The amount drawn will replenish the IGD capital to the amount referred to under “FSA Supervision Arrangements for the Enlarged Group” in Part X in this prospectus. There will be limited conditions to drawing the facility. If drawn, the Joint Lead Arrangers will have the right to exchange the drawings under the facility for Lower Tier 2 notes and/or Upper Tier 2 notes. Drawings under the facility will be used to prepay any amounts outstanding under the Bridge Facility. The commitments under the facility will be mandatorily cancelled and, subject to FSA approval, any drawings under the facility will be mandatorily prepaid by an amount equal to the capital benefit arising from (a) any disposals by the Enlarged Group and (b) any capital release from any member of the Enlarged Group, in each case which is counted towards Prudential’s IGD capital ratios. The commitments under the facility will also be mandatorily cancelled by an amount equal to the proceeds of any other issuance of regulatory capital by Prudential (except where such issuance is used to refinance or replace any existing regulatory capital instruments). Whilst the facility is in place, Prudential will be subject to restrictions on making acquisitions and on paying dividends which are not consistent with the group dividend policy as described in Part VI of this prospectus.

The Prudential Group’s core debt is managed within a target level consistent with its current debt ratings. As at 31 December 2009, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders’ funds plus debt) was 11.1%, compared with 10.7% as at 31 December 2008.

Prudential has strong debt ratings from Standard & Poor’s, Moody’s and Fitch. Prudential’s long-term senior debt is rated (as at 31 March 2010) A+ (negative watch), A2 (negative outlook) and A+ (negative watch) from Standard & Poor’s, Moody’s and Fitch, while short-term ratings are A-1, P-1 and F1+ (negative watch), respectively.

## Policyholder liabilities

	<u>Asia</u> £m	<u>US</u> £m	<u>UK</u> £m	<u>Total</u> £m
<b>Shareholder-backed business</b>				
At 1 January 2007 . . . . .	7,389	31,746	32,288	<b>71,423</b>
Premiums . . . . .	3,098	6,352	4,394	<b>13,844</b>
Surrenders . . . . .	(886)	(3,476)	(1,649)	<b>(6,011)</b>
Maturities/Deaths . . . . .	<u>(212)</u>	<u>(490)</u>	<u>(1,800)</u>	<u><b>(2,502)</b></u>
<b>Net cash flows</b> . . . . .	2,000	2,386	945	<b>5,331</b>
Investment-related items and other movements . . . . .	1,017	1,225	1,324	<b>3,566</b>
Assumption changes . . . . .	—	—	(34)	<b>(34)</b>
Foreign exchange translation differences . . . . .	<u>226</u>	<u>(509)</u>	<u>(5)</u>	<u><b>(288)</b></u>
As at 31 December 2007 . . . . .	10,632	34,848	34,518	<b>79,998</b>
<b>With-profits funds</b>				
— Policyholder liabilities . . . . .				<b>96,360</b>
— Unallocated surplus . . . . .				<b>13,959</b>
<b>Total as at 31 December 2007</b> . . . . .				<u><b>110,319</b></u>
<b>Total policyholder liabilities including unallocated surplus as at 31 December 2007</b> . . . . .				<u><b>190,317</b></u>
	<u>Asia</u> £m	<u>US</u> £m	<u>UK</u> £m	<u>Total</u> £m
<b>Shareholder-backed business</b>				
As at 1 January 2008 . . . . .	10,632	34,848	34,518	<b>79,998</b>
Premiums . . . . .	3,124	6,728	6,215	<b>16,067</b>
Surrenders . . . . .	(837)	(3,852)	(1,945)	<b>(6,634)</b>
Maturities/Deaths . . . . .	<u>(173)</u>	<u>(564)</u>	<u>(2,015)</u>	<u><b>(2,752)</b></u>
<b>Net cash flows</b> . . . . .	2,114	2,312	2,255	<b>6,681</b>
Investment-related items and other movements . . . . .	(2,973)	(4,552)	(3,369)	<b>(10,894)</b>
Assumption changes . . . . .	—	—	447	<b>447</b>
Foreign exchange translation differences . . . . .	<u>3,202</u>	<u>12,753</u>	<u>2</u>	<u><b>15,957</b></u>
As at 31 December 2008 . . . . .	12,975	45,361	33,853	<b>92,189</b>
<b>With-profits funds</b>				
— Policyholder liabilities . . . . .				<b>81,788</b>
— Unallocated surplus . . . . .				<b>8,414</b>
<b>Total as at 31 December 2008</b> . . . . .				<u><b>90,202</b></u>
<b>Total policyholder liabilities including unallocated surplus as at 31 December 2008</b> . . . . .				<u><b>182,391</b></u>

	<u>Asia</u> £m	<u>US</u> £m	<u>UK</u> £m	<u>Total</u> £m
<b>Shareholder-backed business</b>				
As at 1 January 2009	12,975	45,361	33,853	<b>92,189</b>
Premiums	2,984	9,177	3,596	<b>15,757</b>
Surrenders	(840)	(3,255)	(1,577)	<b>(5,672)</b>
Maturities/Deaths	(89)	(733)	(2,092)	<b>(2,914)</b>
<b>Net cash flows</b>	<b>2,055</b>	<b>5,189</b>	<b>(73)</b>	<b>7,171</b>
Investment-related items and other movements	2,811	2,986	5,023	<b>10,820</b>
Disposal of Taiwan agency business	(3,508)	—	—	<b>(3,508)</b>
Assumption changes	(67)	—	(46)	<b>(113)</b>
Foreign exchange translation differences	(1,216)	(5,225)	(57)	<b>(6,498)</b>
As at 31 December 2009	13,050	48,311	38,700	<b>100,061</b>
<b>With-profits funds</b>				
— Policyholder liabilities				<b>86,337</b>
— Unallocated surplus				<b>10,019</b>
<b>Total as at 31 December 2009</b>				<b>96,356</b>
<b>Total policyholder liabilities including unallocated surplus as at 31 December 2009</b>				<b>196,417</b>

Policyholder liabilities related to shareholder-backed business grew by £7.9 billion from £92.2 billion as at 31 December 2008 to £100.1 billion as at 31 December 2009.

The increase reflects positive net cash flows (premiums less surrenders and maturities/deaths) of £7.2 billion in 2009, predominantly driven by strong inflows in the US (£5.2 billion) and Asia (£2.1 billion), as well as positive investment-related items of £10.8 billion, primarily reflecting the growth in global equity and bond markets during the year.

These increases were offset by foreign exchange movements of negative £6.5 billion, the disposal of the Taiwan agency business in June 2009 (reduction of £3.5 billion) and a reduction in liabilities of £0.1 billion following assumptions changes primarily in Malaysia, namely £63 million relating to a consequential change in reserves following the adoption of a Risk-based Capital regime by the local regulator, and in the UK.

During 2009, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Prudential Group's with-profits funds on a statutory basis, increased from £8.4 billion as at 31 December 2008 to £10.0 billion as at 31 December 2009.

## Investments

	<u>2007</u>	<u>2008</u>	<u>2009</u>			
	<u>Total Group</u>	<u>Total Group</u>	<u>Participating Funds</u>	<u>Linked and variable annuities</u>	<u>Shareholder-backed</u>	<u>Total Group</u>
	£m	£m	£m	£m	£m	£m
Debt securities	83,984	95,224	47,327	8,848	45,576	<b>101,751</b>
Equity	86,157	62,122	29,962	38,620	772	<b>69,354</b>
Property investments	13,688	11,992	8,759	662	1,484	<b>10,905</b>
Commercial mortgage loans	3,422	5,473	145	—	4,489	<b>4,634</b>
Other loans	4,502	5,018	1,742	27	2,351	<b>4,120</b>
Deposits	7,889	7,294	9,638	746	2,436	<b>12,820</b>
Other investments	4,408	6,311	3,448	110	1,580	<b>5,138</b>
<b>Total</b>	<b>204,050</b>	<b>193,434</b>	<b>101,021</b>	<b>49,013</b>	<b>58,688</b>	<b>208,722</b>

Total investments held by the Prudential Group as at 31 December 2009 were £208.7 billion, of which £101.0 billion were held by participating funds, £49.0 billion by unit-linked funds and £58.7 billion by shareholder-backed operations. Shareholders are not directly exposed to value movements on assets backing participating or unit-linked operations, with sensitivity mainly related to shareholder-backed operations.

Of the £58.7 billion investments related to shareholder-backed operations, £3.9 billion was held by Asia long-term business, £28.9 billion by Jackson and £22.8 billion by the UK long-term business respectively.

The investments held by the shareholder-backed operations are predominantly debt securities, totalling £2.5 billion, £22.8 billion and £19.0 billion for Asia, the US and the UK long-term business respectively, of which 79%, 93% and 95% are rated, either externally or internally, as investment grade. Included within debt securities of shareholder-backed operations are Tier 1 and Tier 2 bank holdings of £3.6 billion, of which Tier 1 holdings of UK bank securities

is £153 million, with exposure being wholly within the UK long-term business. Within Tier 2, the Prudential Group's exposure to UK banks is £0.9 billion, with exposure being £0.7 billion, £0.1 billion, and £0.1 billion for the UK long-term business, the US and other operations respectively.

In addition, £3.0 billion was held by asset management and other operations, of which £2.8 billion was managed by Prudential Capital, and a further £0.2 billion in central operations.

## 10. Capitalisation and indebtedness

The following table shows the capitalisation of Prudential Group as at 31 December 2009 and the indebtedness of the Prudential Group (excluding amounts in respect of the Prudential Group's life funds) as at 28 February 2010. With the exception of capitalisation balances which are extracted without material adjustment from the historical financial information set out in Part XIV and reported on by KPMG Audit Plc, the balances in this section 10 are extracted without material adjustment from unaudited information contained in underlying financial accounting systems and other management documents.

	<u>£m</u>
<b>Capitalisation as at 31 December 2009:</b>	
Share capital (2,532,227,471 ordinary shares of 5p each fully paid) . . . . .	127
Share premium . . . . .	<u>1,843</u>
Total share capital and share premium . . . . .	<u>1,970</u>
<b>Indebtedness as at 28 February 2010:</b>	
Core structural borrowings of shareholder-financed operations (see (a) below) . . . . .	3,496
Operational borrowings attributable to shareholder-financed operations (see (b) below) . . . . .	<u>3,168</u>
Total indebtedness (see (c) below) . . . . .	<u>6,664</u>

There has been no material change in the issued share capital of Prudential since 31 December 2009.

### (a) Core structural borrowings of shareholder-financed operations as at 28 February 2010

	<u>£m</u>
<b>Parent company (Prudential)</b>	
Subordinated debt:	
<b>Innovative Tier 1:</b>	
US\$1,000m 6.5% Perpetual Subordinated Capital Securities . . . . .	657
US\$250m 6.75% Perpetual Subordinated Capital Securities <sup>(i)</sup> . . . . .	164
US\$300m 6.5% Perpetual Subordinated Capital Securities <sup>(i)(ii)</sup> . . . . .	206
US\$750m 11.75% Perpetual Subordinated Capital Securities . . . . .	<u>483</u>
	1,510
<b>Lower Tier 2:</b>	
€500m 5.75% Subordinated Notes 2021 <sup>(iii)</sup> . . . . .	447
€20m Medium-Term Subordinated Notes 2023 <sup>(iv)</sup> . . . . .	18
£435m 6.125% Subordinated Notes 2031 . . . . .	428
£400m 11.375% Subordinated Notes 2039 . . . . .	<u>380</u>
	1,273
Senior debt:	
£300m 6.875% Bonds 2023 . . . . .	300
£250m 5.875% Bonds 2029 . . . . .	<u>249</u>
	<u>549</u>
Total parent company (Prudential) . . . . .	3,332
<b>Jackson</b>	
<b>Lower Tier 2:</b>	
US\$250m 8.15% Surplus Notes 2027 <sup>(v)</sup> . . . . .	<u>164</u>
<b>Total</b> . . . . .	<u>3,496</u>

#### Notes

(i) The US\$250 million 6.75% borrowings and the US\$300 million 6.5% borrowings can be converted, in whole or in part, at Prudential's option and subject to certain conditions, on any interest payment date falling on or after 23 March 2010 and 23 March 2011 respectively, into one or more series of Prudential preference shares.

- (ii) Interest on the US\$300 million 6.5% borrowings was swapped into floating rate payments but, in 2008, was swapped back into fixed rate payments of 6.5% until September 2010.
- (iii) The €500 million 5.75% borrowings have been swapped into borrowings of £333 million with interest payable at six month £Libor plus 0.962%.
- (iv) The €20 million borrowings were issued at 20-year Euro Constant Maturity Swap (capped at 6.5%). These have been swapped into borrowings of £14 million with interest payable at three month £Libor plus 1.2%.
- (v) The Jackson borrowings are unsecured and subordinated to all present and future indebtedness, policy claims and other creditor claims of Jackson.

**(b) Operational borrowings attributable to shareholder-financed operations as at 28 February 2010**

	<u>£m</u>
Borrowings in respect of short-term fixed income securities programmes:	
Commercial paper . . . . .	2,235
Medium-Term Notes 2010 . . . . .	8
Medium-Term Notes 2013 . . . . .	<u>249</u>
	<u>2,492</u>
Non-recourse borrowings of US operations <sup>(i)</sup> :	
Investment subsidiaries of Jackson . . . . .	22
Piedmont and CDO funds <sup>(ii)</sup> . . . . .	<u>155</u>
	<u>177</u>
Other borrowings:	
Bank loans and overdrafts <sup>(iii)</sup> . . . . .	133
Obligations under finance leases . . . . .	3
Other borrowings <sup>(iv)</sup> . . . . .	<u>363</u>
	<u>499</u>
<b>Total <sup>(v)</sup> . . . . .</b>	<b><u>3,168</u></b>

**Notes**

- (i) 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.
- (ii) Piedmont is an investment trust investing in certain asset-backed and mortgage-backed securities in the US. These borrowings pertain to debt instruments issued to external parties.
- (iii) Bank loans and overdrafts include a short-term loan of £130 million in respect of Asian operations.
- (iv) Other borrowings represents amounts whose repayment to the lender is contingent on future surpluses emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on the contracts, there is no recourse to other assets of the Prudential Group and the liability is not payable to the degree of shortfall.
- (v) In addition to the operational borrowings shown in the table above, Prudential has issued £200 million Floating Rate Notes 2010, which were wholly subscribed to by a Prudential Group subsidiary. These borrowings are eliminated on consolidation and so have been excluded from the table above.

As at 28 February 2010, a total £543 million of borrowings are secured which includes borrowings with no recourse to assets beyond the investment fund to which they relate or future surpluses on contracts specified in the arrangement. There were no significant guarantees of third party indebtedness at that date.

**(c) Guarantees, contingent liabilities and contingent indebtedness**

The Directors have confirmed, that there has been no material adverse change in outstanding guarantees and contingent liabilities as discussed in note H14 to the financial information in Part XIV of this prospectus, since 31 December 2009.

Prudential has access to committed credit facilities and committed lending liquidity facilities as described in detail in the paragraph entitled “Shareholder borrowings and financial flexibility” in section 9 of this Part XII. There has been no change in the terms of these facilities as at 28 February 2010.

**(d) Mortgages and charges**

As at 28 February 2010, no member of the Prudential Group has any outstanding mortgages or charges on its property, plant and equipment that would have a material impact on the financial position of the Prudential Group.

(e) **Obligations under sale and repurchase agreements**

Obligations under sale and repurchase agreements attributable to shareholder-financed operations as at 28 February 2010 amounted to £676 million.

**11. Investments**

**General**

The overall financial strength of the Prudential Group and the results, both current and future, of the insurance business are in part dependent upon the quality and performance of the various investment portfolios in the UK, the US and Asia.

**The Prudential Group's total investments**

The following table shows the Prudential Group's insurance and non-insurance investments as at 31 December 2009. In addition, as at 31 December 2009 the Prudential Group had £80.9 billion of external mutual funds under management. Assets held to cover linked liabilities relate to unit-linked and variable annuity products.

<b>As at 31 December 2009</b>									
	<u>UK Insurance</u>	<u>US Insurance</u>	<u>Asia Insurance</u>	<u>Total Insurance</u>	<u>Asset Mgmt</u>	<u>Other</u>	<u>Total</u>	<u>Less: assets to cover linked liabilities and external unit holders<sup>(i)</sup></u>	<u>Group excluding assets to cover linked liabilities and external unit holders</u>
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Investment properties . . .	10,861	33	11	10,905	—	—	10,905	(884)	10,021
Investments accounted for using the equity method . . . . .	4	—	2	6	—	—	6	—	6
Financial investments:									
Loans . . . . .	1,815	4,319	1,207	7,341	1,413	—	8,754	(27)	8,727
Equity securities . . . . .	37,051	20,984	11,182	69,217	137	—	69,354	(35,517)	33,837
Debt securities . . . . .	67,772	22,831	9,984	100,587	1,164	—	101,751	(13,364)	88,387
Other investments . . . . .	3,630	955	258	4,843	113	176	5,132	(116)	5,016
Deposits . . . . .	<u>11,557</u>	<u>454</u>	<u>746</u>	<u>12,757</u>	<u>63</u>	<u>—</u>	<u>12,820</u>	<u>(929)</u>	<u>11,891</u>
Total financial investments . . . . .	<u>121,825</u>	<u>49,543</u>	<u>23,377</u>	<u>194,745</u>	<u>2,890</u>	<u>176</u>	<u>197,811</u>	<u>(49,953)</u>	<u>147,858</u>
Total investments . . . . .	<u><b>132,690</b></u>	<u><b>49,576</b></u>	<u><b>23,390</b></u>	<u><b>205,656</b></u>	<u><b>2,890</b></u>	<u><b>176</b></u>	<u><b>208,722</b></u>	<u><b>(50,837)</b></u>	<u><b>157,885</b></u>

(i) Assets to cover external unit holders relate to assets attributable to unit holders of consolidated unit trusts and similar funds for which an equivalent liability is held in the balance sheet. The Prudential Group's interest in these unit trusts and similar funds are included in equity securities within the column "Group excluding assets to cover linked liabilities and external unit holders." This differs from the Prudential Group accounts where the funds are consolidated in full with the underlying investments held by the funds being shown in the Prudential Group balance sheet.

## Prudential's investment yields

The following table shows the income from the investments of the Prudential Group operations by asset category for the periods indicated. This table does not include investment income from assets held to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds. Yields have been calculated using the average of opening and closing balances for the appropriate asset.

	Year Ended 31 December					
	Yield	2007	Yield	2008	Yield	2009
		Amount		Amount		Amount
		£m		£m		£m
<b>Investment properties</b>						
Net investment income . . . . .	4.9%	611	5.6%	676	6.6%	700
Net realised investment (losses) gains . . . . .	1.2%	147	(0.4)%	(51)	(0.6)%	(63)
Net unrealised investment (losses) gains . . . . .	(5.8)%	(723)	(28.2)%	(3,372)	(0.7)%	(76)
Ending assets . . . . .		12,658		11,282		10,021
<b>Investments accounted for using the equity method</b>						
Net investment income . . . . .	0%	0	0%	0	0%	0
Net realised investment gains . . . . .	0%	0	0%	0	0%	0
Net unrealised investment gains . . . . .	0%	0	0%	0	0%	0
Ending assets . . . . .		12		10		6
<b>Loans</b>						
Net investment income . . . . .	6.4%	425	6.0%	549	4.8%	461
Net realised investment (losses) gains . . . . .	0.7%	47	2.3%	210	(1.1)%	(105)
Net unrealised investment gains . . . . .	0%	0	0%	0	0%	0
Ending assets . . . . .		7,887		10,378		8,727
<b>Equity securities</b>						
Net investment income . . . . .	4.5%	2,388	3.8%	1,731	3.9%	1,373
Net realised investment gains . . . . .	8.7%	4,633	4.5%	2,014	5.5%	1,905
Net unrealised investment gains (losses) . . . . .	(3.0)%	(1,589)	(39.7)%	(17,897)	14.8%	5,165
Ending assets . . . . .		54,452		35,821		33,837
<b>Debt securities</b>						
Net investment income . . . . .	5.9%	4,335	1.3%	1,071	6.9%	5,939
Net realised investment losses . . . . .	(0)%	(18)	(0.7)%	(573)	(0.7)%	(572)
Net unrealised investment gains (losses) . . . . .	(1.5)%	(1,129)	(2.9)%	(2,348)	3.9%	3,380
Ending assets . . . . .		75,114		84,929		88,387
<b>Other investments</b>						
Net investment income . . . . .	2.5%	119	3.0%	155	0.6%	32
Net realised investment (losses) gains . . . . .	6.4%	306	(33.6)%	(1,745)	(9.7)%	(541)
Net unrealised investment (losses) gains . . . . .	14.4%	687	(34.8)%	(1,805)	(0.4)%	(23)
Ending assets . . . . .		4,275		6,097		5,016
<b>Deposits</b>						
Net investment income . . . . .	5.5%	365	8.4%	534	0.7%	64
Net realised investment gains . . . . .	0%	0	0%	0	0%	0
Net unrealised investment gains . . . . .	0%	0	0%	0	0%	0
Ending assets . . . . .		6,353		6,391		11,891
<b>Total</b>						
Net investment income . . . . .	5.2%	8,243	3.0%	4,716	5.5%	8,569
Net realised investment gains (losses) . . . . .	3.3%	5,115	(0.1)%	(145)	0.4%	624
Net unrealised investment gains (losses) . . . . .	(1.8)%	(2,754)	(16.1)%	(25,422)	5.4%	8,446
Ending assets . . . . .		160,751		154,908		157,885

## The Prudential Group's insurance investment strategy and objectives

The Prudential Group's insurance investments support a range of businesses operating in many geographic areas. Each of the operations formulates a strategy based on the nature of its underlying liabilities, its level of capital and its local regulatory requirements.

## Internal funds under management

The Prudential Group manages 86% of its group funds principally through its fund management businesses, M&G in the United Kingdom, PPM America in the United States and Prudential Asset Management in Asia. The remaining 14% of the Prudential Group's funds mainly relate to assets held to back unit-linked, unit trust and variable annuity liabilities.

In each of the operations, local management analyses the liabilities and determines asset allocation, benchmarks and permitted deviations from these benchmarks appropriate for its operation. These benchmarks and permitted deviations are agreed with internal fund managers, who are responsible for implementing the specific investment strategy through their local fund management operations.

## Investments relating to UK insurance business

### Strategy

In the UK, the Prudential Group tailors its investment strategy for long-term business, other than unit-linked business, to match the type of product a portfolio supports. The primary distinction is between with-profits portfolios and non-participating portfolios, which include the majority of annuity portfolios. Generally, the objective is to maximise returns while maintaining investment quality and asset security and adhering to the appropriate government regulations.

With-profits contracts are long-term contracts with minimal guaranteed amounts. Accordingly, the with-profits fund investment strategy emphasises a well-diversified equity portfolio (containing some international equities), real estate (predominantly in the UK), UK and international fixed income securities and cash.

For the Prudential Group's UK pension annuities business and other non-participating business the objective is to maximise profits while ensuring stability by closely matching the cash flows of assets and liabilities. To achieve this matching, the strategy is to invest in fixed income securities of appropriate maturity dates.

For the Prudential Group's unit-linked business, the primary objective is to maximise investment returns subject to following an investment policy consistent with the representations the Prudential Group has made to its unit-linked product policyholders.

### Investments

The following table summarises the total investments of the UK insurance business as at 31 December 2009.

	As at 31 December 2009					
	SAIF £m	PAC £m	Other £m	Total £m	Less: assets to cover linked liabilities and external unit holders £m	Total excluding assets to cover linked liabilities and external unit holders £m
Investment properties . . . . .	710	8,049	2,102	10,861	(884)	9,977
Investment accounted for using the equity method . . . . .	—	—	4	4	—	4
Financial investments:						
Loans . . . . .	138	968	709	1,815	—	1,815
Equity securities . . . . .	2,994	23,277	10,780	37,051	(11,248)	25,803
Debt securities . . . . .	4,797	37,542	25,433	67,772	(6,861)	60,911
Other investments . . . . .	340	3,035	255	3,630	(72)	3,558
Deposits . . . . .	869	8,755	1,933	11,557	(550)	11,007
Total financial investments . . . . .	9,138	73,577	39,110	121,825	(18,731)	103,094
Total investments . . . . .	<u>9,848</u>	<u>81,626</u>	<u>41,216</u>	<u>132,690</u>	<u>(19,615)</u>	<u>113,075</u>

Please refer to the notes in the Prudential Group total investments table above.

The following table shows additional analysis of the investments relating to the Prudential Group UK insurance business, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, as at 31 December 2009. The “Other” column includes investments relating to solvency capital of unit-linked funds and investments relating to non-life long-term business.

	As at 31 December 2009					
	<u>With-Profits</u>	<u>PRIL</u>	<u>SAIF</u>	<u>Other</u>	<u>Total</u>	<u>Total%</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	
Investment properties . . . . .	7,975	968	710	324	9,977	8.8
Investments accounted for using the equity method . . . . .	—	—	—	4	4	—
Financial investments:						
Loans:						
Mortgage loans . . . . .	145	37	—	666	848	
Policy loans . . . . .	15	—	9	—	24	
Other loans . . . . .	808	6	129	—	943	
Total loans and receivables . . . . .	968	43	138	666	1,815	1.6
Equity securities:						
UK:						
Listed . . . . .	14,121	3	1,805	77	16,006	
Unlisted . . . . .	323	—	45	—	368	
Total UK . . . . .	14,444	3	1,850	77	16,374	14.5
International:						
United States . . . . .	1,482	—	195	—	1,677	
Europe (excluding the UK) . . . . .	2,807	—	392	—	3,199	
Japan . . . . .	680	—	99	—	779	
Pacific (excluding Japan) . . . . .	1,741	—	253	5	1,999	
Other . . . . .	1,569	—	206	—	1,775	
Total international . . . . .	8,279	—	1,145	5	9,429	8.3
Total equity securities . . . . .	22,723	3	2,995	82	25,803	22.8
Debt securities:						
UK government . . . . .	2,364	1,424	205	415	4,408	
US government . . . . .	529	—	1	4	534	
Other . . . . .	34,174	15,210	4,591	1,994	55,969	
Total debt securities . . . . .	37,067	16,634	4,797	2,413	60,911	53.9
Other investments:						
Participation in investment pools . . . . .	1,590	—	223	0	1,813	
Other financial investments . . . . .	850	—	—	—	850	
Derivative assets . . . . .	590	174	117	14	895	
Total other investments . . . . .	3,030	174	340	14	3,558	3.2
Deposits . . . . .	8,755	586	868	798	11,007	9.7
Total investments . . . . .	<b>80,518</b>	<b>18,408</b>	<b>9,848</b>	<b>4,301</b>	<b>113,075</b>	<b>100.0</b>

#### Equity Securities

The Prudential Group’s UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, had £25,803 million invested in equities as at 31 December 2009. Most of these equities support PAC’s with-profits fund and the SAIF fund, both of which are managed using the same general investment strategy.

The following table shows the geographic spread of this equity portfolio by market value in accordance with the policies described in note A4 to the consolidated financial information set out in Part XIV of this prospectus.

	As at 31 December 2008		As at 31 December 2009	
	Market Value	%	Market Value	%
			£m	
United Kingdom . . . . .	18,681	63.5	16,374	63.5
United States . . . . .	2,066	7.0	1,677	6.5
Europe (excluding United Kingdom) . . . . .	3,822	13.0	3,199	12.4
Japan . . . . .	1,278	4.3	779	3.0
Pacific (excluding Japan) . . . . .	1,968	6.7	1,999	7.7
Other . . . . .	<u>1,620</u>	<u>5.5</u>	<u>1,775</u>	<u>6.9</u>
Total . . . . .	<u><b>29,435</b></u>	<u><b>100.0</b></u>	<u><b>25,803</b></u>	<u><b>100.0</b></u>

The UK equity holdings are well diversified and broadly mirror the FTSE All-Share share index. The Prudential Group held equities in 463 UK companies as at 31 December 2009. The ten largest holdings in UK equities as at 31 December 2009 amounted to £6,731 million, accounting for 41.1% of the total UK equity holdings of £16,374 million supporting the UK insurance operations. The following table shows the market value of the ten largest holdings in UK equities as at 31 December 2009.

	As at 31 December 2009	
	Market Value	%
	£m	
BP . . . . .	1,109	6.8
HSBC Holdings . . . . .	1,007	6.1
Vodafone Group . . . . .	807	4.9
GlaxoSmithKline . . . . .	749	4.6
Royal Dutch Shell . . . . .	681	4.2
British American Tobacco . . . . .	544	3.3
Rio Tinto . . . . .	705	4.3
Tesco . . . . .	376	2.3
AstraZeneca . . . . .	396	2.4
BHP Billiton . . . . .	<u>357</u>	<u>2.2</u>
Total . . . . .	<u><b>6,731</b></u>	<u><b>41.1</b></u>

A wide variety of industry sectors are represented in the Prudential Group's equity portfolio. As at 31 December 2009, within the £16,374 million in UK equities supporting the UK insurance operations, the Prudential Group had £10,341 million, or 63.2% of the holdings, invested in ten industries. The following table shows the primary industry concentrations based on market value of the portfolio of UK equities relating to the UK insurance business as at December 31 2009.

	As at 31 December 2009	
	Market Value	%
	£m	
Oil and Gas Producers . . . . .	2,324	14.2
Mining . . . . .	1,546	9.4
Banks . . . . .	1,527	9.3
Pharmaceuticals and Biotech . . . . .	1,225	7.5
Tobacco . . . . .	853	5.2
Mobile Telecommunications . . . . .	808	4.9
Travel & Leisure . . . . .	628	3.8
Aerospace and defence . . . . .	507	3.2
Gas, Water & Multi Utilities . . . . .	482	2.9
Support Services . . . . .	<u>441</u>	<u>2.8</u>
Total . . . . .	<u><b>10,341</b></u>	<u><b>63.2</b></u>

### Debt Securities

As at 31 December 2009, of the debt securities held by the UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, 91.9% were issued by corporations and overseas governments other than the US, 7.2% were issued or guaranteed by the UK government and 0.9% were issued or guaranteed by the US government. These guarantees relate only to payment and, accordingly, do not provide protection against fluctuations in market price that may occur during the term of the fixed income securities.

The following table shows the market value of the debt securities portfolio by maturity as at 31 December 2009, in accordance with the policies described in note A4 to the consolidated financial information set out in Part XIV of this prospectus.

The following table contains balances derived from unaudited information contained in underlying financial accounting systems and other management documents.

	<u>As at 31 December 2009</u>	
	<u>Market Value</u>	<u>%</u>
	<u>£m</u>	
Securities maturing:		
Within one year . . . . .	1,263	2.1
Over one year and up to five years . . . . .	8,986	14.8
Over five years and up to ten years . . . . .	14,253	23.4
Over ten years and up to fifteen years . . . . .	8,926	14.7
Over fifteen years . . . . .	<u>27,483</u>	<u>45.0</u>
Total debt securities . . . . .	<u><b>60,911</b></u>	<u><b>100.0</b></u>

The following table shows debt securities by rating:

	<u>As at 31 December 2009</u>	
	<u>Market Value</u>	<u>%</u>
	<u>£m</u>	
S&P — AAA . . . . .	13,628	22.4
S&P — AA+ to AA- . . . . .	5,651	9.3
S&P — A+ to A- . . . . .	17,785	29.2
S&P — BBB+ to BBB- . . . . .	11,189	18.4
S&P — Other . . . . .	<u>2,165</u>	<u>3.5</u>
	<u>50,418</u>	<u>82.8</u>
Moody's — Aaa . . . . .	459	0.8
Moody's — Aa1 to Aa3 . . . . .	275	0.4
Moody's — A1 to A3 . . . . .	800	1.3
Moody's — Baa1 to Baa3 . . . . .	815	1.3
Moody's — Other . . . . .	<u>339</u>	<u>0.6</u>
	<u>2,688</u>	<u>4.4</u>
Fitch . . . . .	1,022	1.7
Other . . . . .	<u>6,783</u>	<u>11.1</u>
Total debt securities . . . . .	<u><b>60,911</b></u>	<u><b>100.0</b></u>

## Real Estate

As at 31 December 2009, the Prudential Group's UK insurance operations, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, had £9,977 million of investments in real estate. The following table shows the real estate portfolio by type of investment. The real estate investments are shown at market value in accordance with the policies described in note A4 to the consolidated financial information set out in Part XIV to this prospectus.

	As at 31 December 2009	
	Market Value	%
	£m	
Office buildings . . . . .	4,427	44.4
Shopping centres/commercial . . . . .	3,540	35.5
Retail warehouses/industrial . . . . .	1,472	14.8
Development . . . . .	20	0.2
Other . . . . .	518	5.1
<b>Total . . . . .</b>	<b>9,977</b>	<b>100.0</b>

Approximately 41.4% of the UK held real estate investment is located in London and Southeast England (Buckinghamshire, Berkshire, East and West Sussex, Hampshire, Isle of Wight, Kent, Oxfordshire and Surrey) with 39.2% located throughout the rest of the UK and the remaining 19.4% located overseas.

## Investments relating to US insurance business

### Strategy

The investment strategy of the US insurance operations, for business other than the variable annuity business, is to maintain a diversified and largely investment grade debt securities portfolio that maintains a desired investment spread between the yield on the portfolio assets and the rate credited on policyholder liabilities. Interest rate scenario testing is continually used to monitor the effect of changes in interest yields on cash flows, the present value of future profits and interest rate spreads.

The investment portfolio of the US insurance operations consists primarily of debt securities, although the portfolio also contains investments in mortgage loans, policy loans, common and preferred stocks, derivative instruments, cash and short-term investments and miscellaneous other investments.

### Investments

The following table shows total investments relating to the US insurance operations as at 31 December 2009.

	As at 31 December 2009		
	Variable annuity separate account assets	Fixed annuity, GIC and other business	Total
	£m	£m	£m
Investment properties . . . . .	—	33	33
Financial investments:			
Loans . . . . .	—	4,319	4,319
Equity securities . . . . .	20,639	345	20,984
Debt securities . . . . .	—	22,831	22,831
Other investments . . . . .	—	955	955
Deposits . . . . .	—	454	454
<b>Total financial investments . . . . .</b>	<b>20,639</b>	<b>28,904</b>	<b>49,543</b>
<b>Total investments . . . . .</b>	<b>20,639</b>	<b>28,937</b>	<b>49,576</b>

The following table further analyses the insurance investments of the US insurance operations, excluding the separate account investments supporting the variable annuity business, as at 31 December 2009.

	As at 31 December 2009	
	£m	%
<b>Non-institutional</b>		
Investment properties . . . . .	33	0.1
Loans . . . . .	3,916	13.5
Equity securities . . . . .	270	0.9
Corporate securities . . . . .	14,881	51.5
Residential mortgage-backed securities . . . . .	3,072	10.6
Commercial mortgage-backed securities . . . . .	1,805	6.2
Other debt securities . . . . .	862	3.0
Total debt securities . . . . .	20,620	71.3
Other investments . . . . .	955	3.3
Deposits . . . . .	454	1.6
Total non-institutional . . . . .	<b>26,248</b>	<b>90.7</b>
<b>Institutional</b>		
Investment properties . . . . .	—	—
Loans . . . . .	403	1.4
Equity securities . . . . .	75	0.3
Corporate securities . . . . .	1,574	5.5
Residential mortgage-backed securities . . . . .	244	0.8
Commercial mortgage-backed securities . . . . .	299	1.0
Other debt securities . . . . .	94	0.3
Total debt securities . . . . .	2,211	7.6
Other investments . . . . .	—	—
Deposits . . . . .	—	—
Total institutional . . . . .	<b>2,689</b>	<b>9.3</b>
<b>Total</b>		
Investment properties . . . . .	33	0.1
Loans . . . . .	4,319	14.9
Equity securities . . . . .	345	1.2
Corporate securities . . . . .	16,455	56.9
Residential mortgage-backed securities . . . . .	3,316	11.5
Commercial mortgage-backed securities . . . . .	2,104	7.2
Other debt securities . . . . .	956	3.3
Total debt securities . . . . .	22,831	78.9
Other investments . . . . .	955	3.3
Deposits . . . . .	454	1.6
Total . . . . .	<b>28,937</b>	<b>100.0</b>

Under IFRS, debt securities are shown at fair value and loans are at amortised cost. Equity securities and investment properties are shown at fair value. The fair value of unlisted securities is estimated by Jackson using independent pricing services or analytically determined values.

## Debt Securities

### Corporate securities

As at 31 December 2009, the US insurance operations had £16,455 million of corporate securities representing 56.9% of US insurance operations total investments (excluding separate account investments). Of the £16,455 million, £13,338 million consisted of debt securities that are publicly traded or trade under Rule 144A under the US Securities Act (“Rule 144A”) and £3,117 million consisted of investments in non-Rule 144A privately placed fixed income securities.

For statutory reporting in the United States, debt securities are classified into six quality categories specified by the Securities Valuation Office of the National Association of Insurance Commissioners (“NAIC”). The categories range from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated Classes 1-5. Securities in or near default are designated as Class 6. Securities designated as Class 3, 4, 5 and 6 are non-investment grade securities. Generally, securities rated AAA to A by nationally recognised statistical ratings organisations are Class 1, BBB are Class 2, BB are Class 3 and B and below are Classes 4 through 6. If a designation is not currently available from the NAIC, Jackson’s investment adviser, PPM America, has provided the designation for the purposes of the disclosure contained herein.

The following table shows the credit quality of the portfolio of publicly traded and Rule 144A fixed income securities as at 31 December 2009.

	As at 31 December 2009	
	Book Value £m	%
NAIC class designation		
1 . . . . .	5,067	38.0
2 . . . . .	7,508	56.3
3 . . . . .	598	4.5
4 . . . . .	122	0.9
5 . . . . .	40	0.3
6 . . . . .	3	—
Total . . . . .	<u>13,338</u>	<u>100.0</u>

The following table shows the credit quality of the non-Rule 144A private placement portfolio as at 31 December, 2009.

	As at 31 December 2009	
	Book Value £m	%
NAIC class designation		
1 . . . . .	1,084	34.8
2 . . . . .	1,792	57.5
3 . . . . .	162	5.2
4 . . . . .	54	1.7
5 . . . . .	20	0.6
6 . . . . .	5	0.2
Total . . . . .	<u>3,117</u>	<u>100.0</u>

### Residential mortgage-backed securities

As at 31 December, 2009, the US insurance operations had £3,316 million of residential mortgage-backed securities, representing 11.5% of US insurance operations total investments (excluding separate account investments). As at 31 December, 2009, 73.9% of this total were rated AAA (Standard and Poor’s ratings have been used where available and for securities where Standard and Poor’s ratings are not immediately available, those produced by Moody’s, and then Fitch have been used as an alternative).

The primary investment risk associated with residential mortgage-backed securities is that a change in the interest rate environment or other economic conditions could cause payment of the underlying obligations to be made slower or quicker than was anticipated at the time of their purchase. If interest rates decline, then this risk is called “pre-payment risk” and the underlying obligations will generally be repaid quicker when the yields on reinvestment alternatives are lower. Alternatively, if interest rates rise, the risk is called “extension risk” and the underlying

obligations will generally be repaid slower when reinvestment alternatives offer higher returns. Residential mortgage-backed securities offer additional yield to compensate for these risks. The US Operations can manage pre-payment risk, in part, by reducing crediting rates on its products.

#### *Commercial mortgage-backed securities*

As at 31 December 2009, the US insurance operations had £2,104 million of commercial mortgage-backed securities, representing 7.2% of US insurance operations total investments (excluding separate account investments). 46.0% of this total were rated AAA (Standard and Poor's ratings have been used where available and for securities where Standard and Poor's ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative). Due to the structures of the underlying commercial mortgages, these securities do not present the same pre-payment or extension risk as residential mortgage-backed securities.

#### *Other Debt Securities*

As at 31 December, 2009, the US insurance operations had £956 million of other debt securities, representing 3.3% of US insurance operations total investments excluding separate account investments.

#### *Loans*

As at 31 December 2009, loans totalled £4,319 million, representing 14.9% of US insurance operations total investments (excluding separate account investments). Of the total, £3,774 million related to commercial mortgage loans, £530 million to policy loans and £15 million to other loans.

#### *Commercial mortgage loans*

As at 31 December 2009, commercial mortgage loans represented 13% of US insurance operations total investments (excluding separate account investments). This total included 595 first mortgage loans with an average loan balance of approximately £6.3 million, collateralised by properties located in the United States.

Jackson has addressed the risk of these investments by building a portfolio that is diverse both in geographic distribution and property type, emphasising five main institutional property types: multi-family residential, retail, suburban office, industrial and hotel.

As at 31 December, 2009, approximately 31.8% of the portfolio was industrial, 17.8% multi-family residential, 20.5% suburban office, 19.5% retail, 9.5% hotel and 0.9% other. Approximately 14% of the portfolio is collateralised by properties in California, 10.3% by properties in Texas and 7.9% by properties in Illinois. No other state represents more than 6.0%.

Commercial mortgages generally involve more credit risk than residential mortgages due to several factors, including larger loan size, general and local economic conditions, local real estate conditions and the credit quality of the underlying tenants for the properties. Jackson's investment policy and strict underwriting standards are designed to reduce these risks while maintaining attractive yields. In contrast to residential mortgage loans, commercial mortgage loans have minimal or no pre-payment and extension risk.

#### *Policy loans*

Policy loans represented 1.8% of US insurance operations total investments (excluding separate account investments) as at 31 December 2009. Policy loans are fully secured by individual life insurance policies or annuity policies and are contractual arrangements made under the policy.

#### *Equity securities*

Equity securities supporting US insurance operations, excluding separate account investments, totalled £345 million as at 31 December 2009.

#### *Other*

Other financial investments of £955 million, representing 3.3% of US insurance operations total investments (excluding separate account investments) as at 31 December 2009, were made up of £436 million of limited partnership interests and derivative assets of £519 million.

The largest investment in the limited partnerships category is a £68 million interest in the PPM America Private Equity Fund. The remainder of this category consists of diversified investments in 159 other partnerships managed by independent money managers that generally invest in various equity and fixed income loans and securities.

### Investments relating to Asian insurance business

The Prudential Group's Asian insurance operations' investments, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, largely support the business of the Prudential Group's Singapore, Hong Kong, Malaysia, and Japan operations.

The following table shows Prudential Corporation Asia's investments as at 31 December 2009. In this table, investments are valued in accordance with the policies described in note A4 to the consolidated financial information set out in Part XIV of this prospectus.

As at 31 December 2009							
	With- profits business	Unit- linked assets	Other	Total	Less: assets to cover linked liabilities and external unit holders	Total excluding assets to cover linked liabilities and external unit holders	%
	£m	£m	£m	£m	£m	£m	
Investment properties . . . . .			11	11	—	11	0.1
Investments accounted for using the equity method . . . . .	—	—	2	2	—	2	—
Financial investments:							
Loans . . . . .	781	27	399	1,207	(27)	1,180	9.2
Equity securities . . . . .	3,691	7,224	267	11,182	(3,630)	7,552	59.0
Debt securities . . . . .	4,988	2,462	2,534	9,984	(6,503)	3,481	27.2
Other investments . . . . .	73	44	141	258	(44)	214	1.7
Deposits . . . . .	14	196	536	746	(379)	367	2.8
Total financial investments . . . . .	<u>9,547</u>	<u>9,953</u>	<u>3,877</u>	<u>23,377</u>	<u>(10,583)</u>	<u>12,794</u>	<u>99.9</u>
Total investments . . . . .	<u><b>9,547</b></u>	<u><b>9,953</b></u>	<u><b>3,890</b></u>	<u><b>23,390</b></u>	<u><b>(10,583)</b></u>	<u><b>12,807</b></u>	<u><b>100</b></u>

Please refer to notes in the Total Prudential Group Investments table.

The Prudential Group manages interest rate risk in Asia by matching liabilities with fixed interest assets of the same duration to the extent possible. Asian fixed interest markets however generally have a relatively short bond issue term, which makes complete matching challenging. A large proportion of the Hong Kong liabilities are denominated in US dollars and the Prudential Group holds US fixed interest securities to back these liabilities.

### Debt securities

The following table shows rating categorisation of the debt security investments of Prudential Corporation Asia's long-term insurance fund, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, as at 31 December, 2009.

As at 31 December 2009		
	Market Value	%
	£m	
S&P — AAA . . . . .	904	26.0
S&P — AA+ to AA- . . . . .	632	18.2
S&P — A+ to A- . . . . .	303	8.7
S&P — BBB+ to BBB- . . . . .	115	3.3
S&P — Other . . . . .	596	17.1
	<u>2,550</u>	<u>73.3</u>

	<u>As at 31 December 2009</u>	
	<u>Market Value</u>	<u>%</u>
	<u>£m</u>	
Moody's — Aaa . . . . .	51	1.5
Moody's — Aa1 to Aa3 . . . . .	303	8.7
Moody's — A1 to A3 . . . . .	16	0.5
Moody's — Baa1 to Baa3 . . . . .	8	0.2
Moody's — Other . . . . .	15	0.4
	<u>393</u>	<u>11.3</u>
Fitch . . . . .	—	—
Other . . . . .	538	15.4
Total debt securities . . . . .	<u><u>3,481</u></u>	<u><u>100.0</u></u>

#### *Equity securities*

The following table shows a geographic analysis of equity security investments of Prudential Corporation Asia's long-term insurance fund, excluding assets to cover linked liabilities and those attributable to external unit holders of consolidated unit trusts and similar funds, as at 31 December 2009.

	<u>As at 31 December 2009</u>	
	<u>Market Value</u>	<u>%</u>
	<u>£m</u>	
Hong Kong . . . . .	4,123	54.6
Singapore . . . . .	3,224	42.7
Taiwan . . . . .	47	0.6
Vietnam . . . . .	26	0.3
Malaysia . . . . .	126	1.7
Other . . . . .	6	0.1
Total . . . . .	<u><u>7,552</u></u>	<u><u>100.0</u></u>

## **Quantitative and Qualitative Disclosures about Market Risk**

### ***Overview***

As a provider of financial services, including insurance, Prudential's business is the managed acceptance of risk. The control procedures and systems established within the Prudential Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. They can only provide reasonable and not absolute assurance against material misstatement or loss, and focus on aligning the levels of risk-taking with the achievement of business objectives.

The Prudential Group's internal control processes are detailed in the Group Governance Framework. This is supported by the Prudential Group's risk framework as discussed in detail in Section 15.1 of this Part XII, which provides an overview of the group-wide philosophy and approach to risk management. Where appropriate, more detailed policies and procedures have been developed at the group and/or business unit levels. These include group-wide mandatory policies on certain operational risks, including: health, safety, fraud, money laundering, bribery, business continuity, information security and operational security. Additional guidelines are provided for some aspects of actuarial and finance activity.

The Prudential Group's risk reporting framework forms an important part of its business planning process. Business units carry out a review of risks as part of the annual preparation of their three-year business plan. This involves an assessment of the impact and likelihood of key risks and of the effectiveness of controls in place to manage them, and is reviewed regularly throughout the year. In addition, business unit dialogue meetings involving group and business unit executive management are held regularly to review opportunities and risks to business objectives. Any mitigation strategies involving large transactions, such as a material derivative transaction, are subject to scrutiny at group level before implementation.

### ***Major risks***

A summary of the principal risks relating to the Prudential Group's and Enlarged Group's business is found in Part II (*Risk Factors*) of this prospectus.

### *Market and financial risks*

A detailed analysis of market and financial risks is provided in notes C(d), D1(e), D2(e), D3(e) and D4(e) to the consolidated financial information set out in Part XIV of this prospectus.

### ***Currency of Investments***

The Prudential Group's investments are generally held in the same currency as its liabilities and, accordingly, pound sterling liabilities will generally be supported by pound sterling assets and US dollar liabilities will generally be supported by US dollar assets. However, where the Prudential Group believes it is appropriate, it holds some non-domestic equities in the equity portfolios in the belief that this diversifies the overall portfolio risk.

As at 31 December 2009, the Group held 19% (2008: 20%) of its financial assets in currencies, mainly US dollar and Euro, other than the functional currency of the relevant business unit.

The financial assets, of which 74% (2008: 77%) are held by the PAC with-profits fund, allow the PAC with-profits fund to obtain exposure to foreign equity markets.

The exchange risks inherent in these exposures are mitigated through the use of derivatives, mainly forward currency contracts.

### ***Currency of Core Borrowings***

The Prudential Group is subject to certain interest rate risk and foreign exchange risk on its core borrowings. As at 31 December 2009 there was £1,357 million debt, £1,576 million, or approximately US\$2,550 million, of US dollar debt and £461 million, or approximately €520 million of Euro debt. £2,933 million of the core debt was at fixed rates of interest and £461 million has been swapped into floating rates of interest.

Foreign currency borrowings that have been used to provide a hedge against group equity investments in overseas subsidiaries are translated at year end exchange rates and gains and losses are taken directly to shareholders' equity. Other foreign currency monetary items are translated at year end exchange rates with changes recognised in the income statement. Foreign currency transactions are translated at the spot rate prevailing at the time.

### ***Sensitivity Analysis***

The Prudential Group is sensitive to interest rate movements, movements in the values of equities and real estate and foreign exchange fluctuations.

Sensitivity analysis with regard to the Prudential Group's investments in debt securities, equities and real estate, to insurance contracts and to foreign exchange fluctuations, is provided in notes D2(i), D3(i), D4(i) and E4 to the consolidated financial information set out in Part XIV of this prospectus.

Additional sensitivity analysis of the Prudential Group's long-term debt and interests in derivatives contracts has been provided below.

### Interest Rate Risk — Long-term Debt

The table below quantifies the estimated increase in fair value of long-term borrowings as at 31 December 2009, resulting from a 100 basis point reduction in interest rates at those dates. The carrying value of short-term borrowings, which approximates their fair value, would not be materially increased by a 100 basis point reduction in interest rates. Prudential believes this to be a reasonably possible near-term market change for interest rates.

	31 December 2009		
	Carrying Value £m	Fair Value £m	Estimated Increase in Fair Value £m
Long-term borrowings			
Central companies			
Bonds, €500 million aggregate principal amount, 5.75% due 2021 . .	443	435	8
Bonds, £300 million aggregate principal amount, 6.875% due 2023. .	300	308	27
Bonds, £250 million aggregate principal amount, 5.875% due 2029. .	249	235	25
Bonds, £435 million aggregate principal amount, 6.125%, due 2031 . . . . .	428	395	41
Bonds, £400 million aggregate principal amount, 11.375%, due 2039 . . . . .	380	524	44
Capital securities, US\$1,000 million aggregate principal amount, 6.5% perpetual . . . . .	619	502	49
Capital securities, US\$250 million aggregate principal amount, 6.75% perpetual . . . . .	155	149	1
Capital securities, US\$300 million aggregate principal amount, 6.5% perpetual . . . . .	192	167	1
Capital securities, US\$750 million aggregate principal amount, 11.75% perpetual . . . . .	456	533	24
Medium Term Subordinated Notes, €20 million, 2023. . . . .	<u>18</u>	<u>18</u>	<u>0</u>
Total central companies . . . . .	<u>3,240</u>	<u>3,266</u>	<u>220</u>
Insurance operations			
Guaranteed bonds, £100 million, principal amount, 8.5% undated subordinated . . . . .	100	97	11
Surplus notes, US\$250 million principal amount, 8.15% due 2027 . .	<u>154</u>	<u>158</u>	<u>15</u>
Total long-term business . . . . .	<u>254</u>	<u>255</u>	<u>26</u>
Total . . . . .	<u><u>3,494</u></u>	<u><u>3,521</u></u>	<u><u>246</u></u>

There is no impact on profit as at 31 December 2009 as a result of these reductions in interest rates because the liabilities are recognised in the financial information at carrying value, which is equal to their amortised cost.

### Derivative Contracts

As at 31 December 2009 the net market value exposure of derivatives was a gain of £279 million of which the largest exposures were held by the UK and US insurance operations. Excluding derivative contracts within assets held to cover linked liabilities and those attributable to unit holders of consolidated unit trusts and similar funds, as at 31 December 2009 the net market value exposure of derivatives of the UK and US insurance operations was a gain of £341 million. The tables below show the sensitivity of the UK and US insurance operations derivatives, measured in terms of fair value, to equity and real estate market increases and decreases of 10% and to interest rate increases and decreases of 100 basis points. Prudential believes these increases and decreases to be reasonably possible near-term market changes. These exposures will change as a result of ongoing portfolio and risk management activities.

	As at 31 December 2009		
	10% Equity & Real Estate Increase/(decrease) in Fair Value	Fair Value	10% Equity & Real Estate Decrease Increase/(decrease) in Fair Value
	£m	£m	£m
United Kingdom — insurance operations			
With-profits fund (including PAL) . . . . .	(44)	157	45
Shareholder-backed annuities . . . . .	—	46	—
SAIF . . . . .	11	80	(11)
United States — insurance operations . . . . .	(263)	58	332
Total . . . . .	<u>(296)</u>	<u>341</u>	<u>366</u>

	As at 31 December 2009		
	100 bp Interest Rate Increase/(decrease) in Fair Value	Fair Value	100 bp Interest Rate Decrease Increase/(decrease) in Fair Value
	£m	£m	£m
United Kingdom — insurance operations			
With-profits fund (including PAL) . . . . .	(245)	157	284
Shareholder-backed annuities . . . . .	(91)	46	115
SAIF . . . . .	(21)	80	43
United States — insurance operations . . . . .	159	58	(148)
Total . . . . .	<u>(198)</u>	<u>341</u>	<u>294</u>

### Limitations

The above sensitivities do not consider that assets and liabilities are actively managed and may vary at the time any actual market movement occurs. There are strategies in place to minimise the exposure to market fluctuations. For example, as market indices fluctuate, the Prudential Group would take certain actions including selling investments, changing investment portfolio allocation, and adjusting bonuses credited to policyholders. In addition, these analyses do not consider the effect of market changes on new business generated in the future.

Other limitations on the sensitivities include: the use of hypothetical market movements to demonstrate potential risk that only represent the Prudential Group's view of reasonably possible near-term market changes and that cannot be predicted with any certainty; the assumption that interest rates in all countries move identically; the assumption that all global currencies move in tandem with the US dollar against pounds sterling; and the lack of consideration of the inter-relation of interest rates, equity markets and foreign currency exchange rates.

## 12. Trend information — current trading and prospects

The Prudential Group's outlook for its Asian business is positive. Although some challenges remain in the Asian economies, there are encouraging signs that the recovery is well underway. The Prudential Group has market-leading positions in several countries in Asia and this, combined with the GDP growth rates, high savings rates and low penetration of life insurance products make Asia the primary focus for growth and investment. The Prudential Group remains cautious with respect to the major Western economies, because of a number of imbalances threatening their return to higher growth, including high levels of consumer and government debt. In the US the Prudential Group, through Jackson, continues to write high-margin, capital-efficient variable annuities and in the UK the Prudential Group continues to focus on its strong positioning, brand and products in order to continue to generate cash and capital for the Prudential Group.

The Prudential Group continues to deliver growth in its target markets. The Prudential Group's new business APE sales in the first quarter of 2010 of £807<sup>(61)</sup> million have increased by 26% compared to the first quarter of 2009. This growth is driven by sales in our Asian and US businesses where the Prudential Group has seen growth of 30% and 39% respectively. The net investment flows of our investment management businesses in the first quarter of 2010 were £1.2 billion (First Quarter 2009: £2.7 billion).

(61) Extracted from Prudential Plc First Quarter 2010 Interim Management Statement dated 17 May 2010 and 2009 comparative APE sales exclude the Japanese insurance operations, which were closed to new business from 15 February 2010.

As set out in Part XIX of this prospectus the total Rights Issue and Transaction Related Expenses (excluding any amounts associated with the hedging of the consideration amount) are estimated at approximately £850 million. In relation to the Acquisition, the new IFRS standard on business combinations (IFRS 3 revised) will require expenses relating solely to the Acquisition, as opposed to capital raising, to be expensed. All incremental costs which arise as a result of the issue of the Rights Issue shares, such as underwriting fees, will be offset against share premium. Costs associated with debt financing will be offset against the debt proceeds raised and amortised to the profit and loss over the life of the debt instrument.

In addition to the Acquisition costs, integration costs are expected to be of the order of US\$380 million before tax (excluding any amounts associated with revenue synergies), of which US\$100 million is expected to be incurred in 2010 (approximately £65 million). As set out in Part VI of this prospectus, it is anticipated that the combination will generate annualised run-rate cost synergies of approximately US\$370 million before tax during 2013.

### **13. Derivative financial instruments and commitments**

The Prudential Group enters into a variety of exchange traded and over-the-counter derivative financial instruments, including futures, options, forward currency contracts and swaps, such as interest rate swaps, cross-currency swaps, swaptions and credit default swaps.

All over-the-counter derivative transactions are conducted under standardised International Swaps and Derivatives Association Inc (“ISDA”) master agreements and the Prudential Group has collateral agreements between the individual group entities and relevant counterparties in place under each of these market master agreements.

These derivatives are used for efficient portfolio management to obtain cost effective and efficient exposure to various markets in accordance with the Prudential Group’s investment strategies and to manage exposure to interest rate, currency, credit and other business risks.

The Prudential Group uses various interest rate derivative financial instruments such as interest rate swaps to reduce exposure to interest rate volatility.

The UK insurance operations use various currency derivatives in order to limit volatility due to foreign currency exchange rate fluctuations arising on securities denominated in currencies other than sterling. In addition, total return swaps and interest rate swaps are held for efficient portfolio management.

As part of the efficient portfolio management of the PAC with-profits fund, the fund may, from time to time, invest in cash-settled forward contracts over Prudential Shares, which are accounted for consistently with other derivatives. This is in order to avoid a mismatch of the with-profits investments portfolio with the investment benchmarks set for its equity-based investment funds. The contracts will form part of the long-term investments of the with-profits fund. These contracts are subject to a number of limitations for legal and regulatory reasons.

Some of the Prudential Group’s products, especially those sold in the United States, have certain guarantee features linked to equity indexes. A mismatch between product liabilities and the performance of the underlying assets backing them, exposes the Prudential Group to equity index risk. In order to mitigate this risk, the relevant business units purchase swaptions, equity options and futures to match asset performance with liabilities under equity-indexed products.

The US operations and some of the UK operations hold large amounts of interest-rate sensitive investments that contain credit risks on which a certain level of defaults is expected. These entities have purchased swaptions in order to manage the default risk on certain underlying assets and hence reduce the amount of regulatory capital held to support the assets.

The types of derivatives used by Jackson and their purposes are as follows:

- interest rate swaps generally involve the exchange of fixed and floating payments over the period for which Jackson holds the instrument without an exchange of the underlying principal amount. These agreements are used for hedging purposes;
- put-swaption contracts provide the purchaser with the right, but not the obligation, to require the writer to pay the present value of a long-duration interest rate swap at future exercise dates. Jackson purchases and writes put-swaptions with maturities up to ten years. On a net basis, put-swaptions hedge against significant upward movements in interest rates;
- equity index futures contracts and equity index call and put options are used to hedge Jackson’s obligations associated with its issuance of fixed indexed immediate and deferred annuities and certain variable annuity guarantees. These annuities and guarantees contain embedded options which are fair valued for financial reporting purposes;

- total return swaps in which Jackson receives equity returns or returns based on reference pools of assets in exchange for short-term floating rate payments based on notional amounts, are held for both hedging and investment purposes;
- cross-currency swaps, which embody spot and forward currency swaps and additionally, in some cases, interest rate swaps and equity index swaps, are entered into for the purpose of hedging Jackson's foreign currency denominated funding agreements supporting trust instrument obligations;
- spread cap options which are used as a macro-economic hedge against declining interest rates. Jackson receives quarterly settlements based on the spread between the two-year and the 10-year constant maturity swap rates in excess of a specified spread; and
- credit default swaps, which represent agreements under which Jackson has purchased default protection on certain underlying corporate bonds held in its portfolio. These contracts allow Jackson to sell the protected bonds at par value to the counterparty in the event of their default in exchange for periodic payments made by Jackson for the life of the agreement.

#### 14. Contractual obligations

Contractual obligations with specified payment dates as at 31 December 2009 were as follows:

	<u>Total</u>	<u>Less than</u>	<u>1-3 years</u>	<u>3-5 years</u>	<u>More than</u>
	<u>£m</u>	<u>1 year</u>	<u>£m</u>	<u>£m</u>	<u>5 years</u>
		<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Policyholder liabilities <sup>(i)</sup> . . . . .	367,620	17,799	35,716	35,374	278,731
Long-term debt <sup>(ii)</sup> . . . . .	7,429	2,216	1,143	180	3,890
Capital lease obligations . . . . .	166	8	20	18	120
Operating lease obligations . . . . .	345	63	94	84	104
Purchase obligations <sup>(iii)</sup> . . . . .	428	428	—	—	—
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	3,482	3,482	—	—	—
Other long-term liabilities <sup>(iv)</sup> . . . . .	4,452	4,008	141	34	269
<b>Total</b> . . . . .	<u>383,922</u>	<u>28,004</u>	<u>37,114</u>	<u>35,690</u>	<u>283,114</u>
<b>Reconciliation to consolidated statement of financial position:</b>	<b>£m</b>	<b>£m</b>			
Total contractual obligations per above . . . . .		383,922			
Difference between policyholder liabilities per above (based on undiscounted cash flows) and total policyholder liabilities and unallocated surplus of with-profits funds per balance sheet: Total policyholder liabilities and unallocated surplus of with-profits funds per balance sheet . . . . .	196,417				
Policyholder liabilities (undiscounted) per above . . . . .	<u>(367,620)</u>	(171,203)			
Other short-term/non-contractual obligations:					
Current tax liabilities . . . . .	1,215				
Deferred tax liabilities . . . . .	3,872				
Accruals and deferred income . . . . .	594				
Other creditors (excluding capital and operating lease obligations and purchase obligations) . . . . .	1,612				
Derivative liabilities . . . . .	1,501				
Other liabilities . . . . .	<u>877</u>	9,671			
Other items . . . . .		<u>(939)</u>			
Total liabilities per consolidated statement of financial position . . . . .		<u>221,451</u>			

(i) Amounts shown in respect of policyholder liabilities represent estimated undiscounted cash flows for the Prudential Group's life assurance contracts. In determining the projected payments, account has been taken of the contract features, in particular that the amount and timing of policyholder benefit payments reflect either surrender, death, or contract maturity. In addition, the undiscounted amounts shown include the

expected payments based on assumed future investment returns on assets backing policyholder liabilities. The projected cash flows exclude the unallocated surplus of with-profits funds. As at 31 December 2009, on the IFRS basis of reporting, the unallocated surplus was £10,019 million. The unallocated surplus represents the excess of assets over liabilities, including policyholder “asset share” liabilities, which reflect the amount payable under the realistic Peak 2 reporting regime of the FSA. Although accounted for as a liability, as permitted by IFRS 4, there is currently no expected payment date for the unallocated surplus.

- (ii) This represents the contractual maturity of amounts included in the consolidated statement of financial position (i.e. excludes future interest payments.)
- (iii) Comprising unfunded commitments for investments in limited partnerships of £339 million and unfunded commitments related to mortgage loans of £89 million.
- (iv) Amounts due in less than one year include amounts attributable to unit holders of consolidated unit trusts and similar funds of £3,809 million.

## **15. Risk and capital management**

### **15.1 Risk management**

The Prudential Group’s risk governance framework requires that all of the Prudential Group’s business and functions establish processes for identifying, evaluating and managing the key risks faced by the Prudential Group. The framework is based on the concept of “three lines of defence”: risk management, risk oversight and independent assurance.

*Risk management:* The primary responsibility for strategy, performance management and risk control lies with the Board, the Group Chief Executive and the chief executives of each business unit.

*Risk oversight:* Risk exposures are monitored and reviewed by group-level risk committees, chaired by the Group Chief Risk Officer or the Chief Financial Officer:

- *Group Executive Risk Committee:* Meets monthly to oversee the Prudential Group’s risk exposures (market, credit, liquidity, insurance and operational risks) and monitor capital.
- *Balance Sheet and Capital Management Committee:* Meets monthly to monitor the Prudential Group’s liquidity and oversee the activities of the Prudential Capital business unit.
- *Group Operational Risk Committee:* Reports to the Group Executive Risk Committee and meets quarterly to oversee the Group’s non-financial risk (operational, business environment and strategic risks) exposures.
- The committees’ oversight is supported by the Group Chief Risk Officer, with functional oversight provided by:
  - Group Security: Develop and deliver appropriate security measures to protect the Prudential Group’s staff, physical assets and intellectual property.
  - Group Compliance: Verify compliance with regulatory standards and inform the Prudential Group’s senior management and the Board on key regulatory issues affecting the Prudential Group.
  - Group Risk: Establish and embed a capital management and risk oversight framework and culture consistent with the Prudential Group’s risk appetite that protects and enhances the Group’s embedded and franchise value.

*Independent assurance:* The Group Audit Committee, supported by group-wide Internal Audit, provides independent assurance and oversight of the effectiveness of the Prudential Group’s system of internal control and risk management.

#### *Principles and objectives*

Risk is defined as the uncertainty that the Prudential Group faces in successfully implementing its strategies and objectives. This includes all internal or external events, acts or omissions that have the potential to threaten the success and survival of the Prudential Group.

The control procedures and systems established within the Prudential Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. They can only provide reasonable and not absolute assurance against material misstatement or loss, and focus on aligning the levels of risk-taking with the achievement of business objectives. Material risks will only be retained where this is consistent with the Prudential Group’s risk appetite framework, i.e.:

- The retention of the risk contributes to value creation;
- The Prudential Group is able to withstand the impact of an adverse outcome; and

- The Prudential Group has the necessary capabilities, expertise, processes and controls to manage the risk.

The Prudential Group has the following five objectives for risk and capital management:

- **Framework:** Design, implement and maintain a capital management and risk oversight framework consistent with the Group’s risk appetite and Risk-Adjusted Profitability (“RAP”) model.
- **Monitoring:** Establish a “no surprises” risk management culture by identifying the risk landscape, assessing and monitoring risk exposures and understanding change drivers.
- **Control:** Implement risk mitigation strategies and remedial actions where exposures are deemed inappropriate and manage the response to extreme events.
- **Communication:** Communicate the Group risk, capital and profitability position to internal and external stakeholders and rating agencies.
- **Culture:** Foster a risk management culture, providing quality assurance and facilitating the sharing of best practice risk measurement and management across the group and industry.

### *Reporting*

The Group Executive Committee and the Board are provided with regular updates on the Prudential Group’s economic capital position, overall position against risk limits and RAP. They also receive the annual financial condition reports prepared by the Prudential Group’s insurance operations.

The Group Audit Committee is provided with minutes of the Group Operational Risk Committee, and regular updates on financial and operational risk exposures.

Group Head Office oversight functions have clear escalation criteria and processes for the timely reporting of risks and incidents by business units. As appropriate, these risks and incidents are escalated to the various group-level risk committees and the Board.

Internal business unit routine reporting requirements vary according to the nature of the business. Each business unit is responsible for ensuring that its risk reporting framework meets both the needs of the business unit (for example reporting to the business unit risk and audit committees) and the minimum standards set by the Prudential Group (for example, to meet group-level reporting requirements).

Business units review their risks as part of the annual preparation of their business plans, and review opportunities and risks against business objectives regularly with Group Head Office. Group Risk reviews, and reports to Group Head Office, on the impact of large transactions or divergences from the business plan.

## **15.2 Risk oversight**

### *Group risk appetite*

The Prudential Group defines and monitors aggregate risk limits for its earnings volatility and its capital requirements based on financial and non-financial stresses:

- Earnings volatility:** the objectives of the limits are to ensure that (a) the volatility of earnings is consistent with stakeholders’ expectations, (b) the Prudential Group has adequate earnings (and cash flows) to service debt, for expected dividends and to withstand unexpected shocks, and (c) earnings (and cash flows) are managed properly across geographies and are consistent with funding strategies. The two measures applied to monitor the volatility of earnings are EEV operating profit and IFRS operating profit, although EEV and IFRS total profits are also considered.
- Capital requirements:** the limits aim to ensure that (a) the Prudential Group meets its internal economic capital requirements, (b) the Prudential Group achieves its desired target rating to meet its business objectives, and (c) supervisory intervention is avoided. The two measures applied are the EU Insurance Groups Directive (“IGD”) capital requirements and internal economic capital requirements. In addition, capital requirements are also monitored on a local statutory basis.

The Prudential Group’s risk appetite framework forms an integral part of its annual business planning cycle. Its Group Risk function monitors the Prudential Group’s risk profile against the agreed limits. Using submissions from business units, Group Risk calculates the Prudential Group’s aggregated position (allowing for diversification effects between business units) relative to the limits implied by the risk appetite statements.

Local limits are agreed with each of the business units to ensure that the aggregate risk exposure remains within the defined group-level risk appetite. Each business unit determines its own individual risk position by calculating the impacts (on earnings and capital measures) of a shock to its market, credit, insurance and operational risk exposures and agrees them with Group Risk and the Group Executive Risk Committee (“GERC”).

The Prudential Group uses a two-tier approach to apply the limits at business unit level. First, it calculates business unit risk limits. These ensure that, provided each business unit keeps within its limits, the group risk position will remain within the group limits. Secondly, the impact on the risk position is considered as part of Group Risk’s scrutiny of large transactions or departures from plans proposed by individual business units.

In the event that any of the business unit plans imply risk limits will be exceeded, this will necessitate a dialogue between GERC and the relevant business unit or units. Exceeding group limits may be avoided if, for example, limits in other business units are not fully utilised, or if the diversification effect at group level of a particular risk with other business units means the group limit is not breached.

Market risk is managed such that as conditions evolve the risk profile is maintained within risk appetite. In addition to business unit operational limits on credit risk, the Prudential Group sets counterparty risk limits at group level. The limits on total group-wide exposures to a single counterparty are specified within different credit rating ‘categories’. Group Risk and the GERC monitor the Prudential Group’s actual exposures against these limits on a monthly basis.

### *Risk exposures*

The Group Risk Framework deploys a common risk language, allowing meaningful comparisons to be made between different business units. Risks are broadly categorised as shown below.

<u>Category</u>	<u>Risk type</u>	<u>Definition</u>
1. Financial risks	(a) Market risk	The risk that arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates.
	(b) Credit risk	The risk of loss if another party fails to meet its obligations, or fails to do so in a timely fashion.
	(c) Insurance risk	The inherent uncertainty as to the occurrence, amount and timing of insurance cash flows. This includes the impact of adverse mortality, morbidity and persistency experience.
	(d) Liquidity risk	The risk that a business, though solvent on a balance sheet basis, either does not have the financial resources to meet its obligations as they fall due or can secure them only at excessive cost.
2. Non-financial risks	(a) Operational risk	The risk of direct or indirect loss resulting from inadequate or failed internal processes, people or systems, or from external events. This includes legal and regulatory compliance risk.
	(b) Business environment risk	Exposure to forces in the external environment that could significantly change the fundamentals that drive the business’s overall objectives and strategy.
	(c) Strategic risk	Ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Prudential Group’s capabilities.

## *Financial risks*

### *(a) Market risk*

#### *(i) Equity risk*

In the UK business, most of the Prudential Group's equity exposure is incurred in the with-profits fund which includes a large inherited estate estimated at £6.4 billion as at 31 December 2009 (2008: £5.4 billion), which can absorb market fluctuations and protect the fund's solvency. The inherited estate itself is partially protected against falls in equity markets through an active hedging policy. In the course of 2009, the Prudential Group has reduced the with-profits fund's exposure to UK equities whilst increasing the proportion of fixed income assets.

In Asia, a high proportion of the Prudential Group's in-force book is made up of unit-linked products with limited shareholder exposure to equities. The Prudential Group has minimal direct shareholder exposure to Asian equity markets outside its unit-linked holdings.

In the US, where Jackson is a leading provider of variable annuities, there are well-understood risks associated with the guarantees embedded in its products. Jackson provides guarantees for minimum death benefits ("GMDB") on all policies in this class, minimum withdrawal benefits ("GMWB") on 47% of the book, and minimum income benefits ("GMIB") on only 8%. To protect the shareholders against the volatility induced by these embedded options, both a comprehensive hedging programme and reinsurance are used. Due to the inability to reinsure economically or hedge the GMIB, Jackson ceased offering this benefit in 2009.

Jackson's variable annuity sales activities focus on meeting the needs of conservative and risk averse customers who are seeking accumulation pre-retirement and/or reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers select conservative investment options and, importantly, have historically bought fewer guarantee products compared to the industry as a whole. Jackson is able to meet the needs of these customers because its unique and market leading operational platform allows it to tailor more than 1,400 product combinations.

It is the Prudential Group's philosophy not to compete on price. Its individual guarantees tend to be more expensive than the market average, because it seeks to sell at a price capable of funding the cost it incurs to hedge or reinsure its risks.

The Prudential Group uses a macro approach to hedging that covers the entire equity risk in the US business, including all exposure to GMDB and GMWB guarantees. Within this macro approach use is made of the natural offsets that exist between the variable annuity guarantees and the fixed index annuity book, and then a combination of over the counter options and futures is used to hedge the residual risk, allowing for significant market shocks and limiting the amount of capital put at risk. The hedging programme also covers the fees on variable annuity guarantees.

Jackson hedges the economics of its products rather than the accounting result. Accordingly, while its hedges are effective on an economic basis, due to different accounting treatment for the hedges and some of the underlying hedged items, the reported income effect is more volatile. For Jackson's variable annuities guaranteed benefits and related hedges, while there has been some volatility of results in 2008 and 2009, there has been a small cumulative net operating loss of £7 million over the 24-month period, reflecting the overall effectiveness of the hedging programme. With its large fixed annuity and fixed indexed annuity books, Jackson has natural offsets for its variable annuity interest rate related risks. Specific limits are set for each major risk.

#### *(ii) Interest rate risk*

Interest rate risk arises primarily from Prudential's investments in long-term debt and fixed income securities. Interest rate risk also exists in policies that carry investment guarantees on early surrender or at maturity, where claim values can become higher than the value of backing assets as a result of rises or falls in interest rates.

Interest rates primarily affect the Asia, the US and the UK with-profits businesses. Following the sale of the agency-based business in Taiwan, the exposure to interest rate risk in Asia has significantly reduced. The remaining risk in the region relates mostly to guarantees on traditional shareholder-backed life products and asset-liability mismatches, driven by limited availability of long-term assets in some territories. This exposure is monitored and managed carefully on an ongoing basis, for example by setting clear limits on duration risk set in the investment guidelines. The Prudential Group has a range of risk mitigation options available that would help to reduce the exposure to interest rate movements.

In the US, there is interest rate risk across the portfolio. Jackson manages fixed annuity interest rate exposure through a combination of interest rate swaps and interest rate options, to protect capital against rates rising quickly, and through the contractual ability to reset crediting rates annually.

In the UK, the investment policy for the shareholder-backed annuity business is to match the cash flow from investments with the annuity payments. As a result, assets and liabilities are closely matched by duration. The impact of any residual cash flow mismatching can be adversely affected by changes in interest rates, therefore the mismatching position is regularly monitored.

*(iii) Foreign exchange risk*

The Prudential Group principally operates in the UK, the US, and in 13 countries in Asia. The geographical diversity of the businesses means that it is inevitably subject to the risk of exchange rate fluctuations. Prudential's international operations in the US and Asia, which represent a significant proportion of operating profit and shareholders' funds, generally write policies and invest in assets denominated in local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to significant fluctuations in the consolidated financial statements when results are expressed in pounds sterling.

The Prudential Group does not generally seek to hedge foreign currency revenues, as these are substantially retained locally to support the growth of the Prudential Group's business and meet local regulatory and market requirements. However, in cases where a foreign surplus is deemed to be supporting group capital or shareholders' interest, this exposure is hedged if it is deemed economically optimal to do so. Currency borrowings, swaps and other derivatives are used to manage exposures.

*(b) Credit risk*

*Debt portfolio*

The Prudential Group's debt portfolio on an IFRS basis was £101.8 billion as at 31 December 2009. £45.6 billion of these assets backed shareholder business, of which 93% were investment grade, compared to 96% as at 31 December 2008. This change was a result of downgrades, largely occurring in March and April, with the pace of downgrade significantly slowing subsequently. Sovereign debt backing shareholder business represented 11% of the portfolio, or £4.9 billion as at 31 December 2009; 67% of this was AAA and 91% investment grade. Eurozone sovereign exposures backing shareholder business were £3.1 billion as at 31 December 2009; 98% of these were AAA rated. Of the remaining 2%, the highest exposure was in respect of Italy (£55 million) and Spain (£1 million) whilst there was no exposure to Greece, Portugal or Ireland.

Asia's debt portfolio totalled £10.0 billion as at 31 December 2009. Of this, approximately 75% was invested in unit-linked and with-profits funds with minimal shareholders' risk. The remaining 25% was shareholder exposure and was invested predominantly (79% in investment grade bonds). For Asia, the portfolio performed very well, and did not experience any default losses in 2009.

The UK's debt portfolio on an IFRS basis was £67.8 billion as at 31 December 2009, including £42.3 billion within the UK with-profits fund. Shareholders' risk exposure to the with-profits fund is limited as the solvency is protected by the large inherited estate. Outside the with-profits fund there was £6.4 billion in unit linked funds where the shareholders' risk is limited, with the remaining £19.0 billion backing the shareholders' annuity business and other non-linked business (of which 78% is rated AAA to A, 19% BBB and 3% non-investment grade).

On a statutory (Pillar 1) basis, the Prudential Group held prudent credit reserves within the UK shareholder annuity funds of £1.6 billion as at 31 December 2009 to allow for future credit risk. For Prudential Retirement Income Limited ("PRIL") this allowance was set at 71 bps as at 31 December 2009 (2008: 80 bps). This represented 41% of the portfolio spread over swaps compared to 31% as at 30 June 2009 and 25% as at 31 December 2008. A low level of new defaults (£11 million) were reported on the debt portfolio held by the UK shareholder-backed annuity business in 2009.

During the second half of 2009, the Prudential Group materially reduced its holdings in subordinated financial debt backing the annuity business, which improved the overall credit quality of its bond portfolios. This resulted in gross losses of £254 million on shareholder-backed business and £80 million on policyholder backed business. On a Pillar I basis these losses were fully offset by a reduction in long-term default reserves of £180 million shareholder / £31 million policyholder that arose as a result of the improvement in the quality of its remaining bond portfolios and a further £74 million shareholder / £49 million policyholder release of short-term default reserves which were allocated to the assets sold. On an IFRS basis, the gross costs less the reduction in long-term and short-term default reserves resulted in an overall pre-tax operating loss of £51 million shareholder / £32 million policyholder in 2009.

The most significant area of exposure to credit risk for the shareholders is Jackson in the US. As at 31 December 2009 Jackson's fixed income portfolio totalled £22.8 billion, comprised of £16.5 billion of Corporate Debt, £2.1 billion of Commercial Mortgage Backed Securities ("CMBS"), £3.3 billion of Residential Mortgage Backed Securities ("RMBS") and £0.9 billion of other instruments.

The US Corporate Debt portfolio of £16.5 billion was 94% investment grade as at 31 December 2009. Concentration risk was low, with the top 10 holdings accounting for less than 7% of the portfolio. The non-investment grade portfolio was also well diversified with an average holding of £8 million. The largest sector exposures in the investment grade portfolio were Utilities and Energy both at 15%. The portfolio is actively managed and exposures are sold as events dictate.

Within the RMBS portfolio of £3.3 billion, the agency guaranteed portion was 60% as at 31 December 2009. Another 21% of the portfolio was non-agency prime and Alt-A investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. The Prudential Group's exposure to the 2006/2007 vintages totalled £466 million as at 31 December 2009 of which £373 million was invested in the senior part of the capital structure, thereby significantly reducing the risk of defaults and the magnitude of loss if a shortfall were to occur. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS was £93 million. The total RMBS portfolio had an average fair value price of 78 cents in the dollar.

The CMBS £2.1 billion portfolio is performing strongly, with 46% of the portfolio rated AAA and less than 1% rated below investment grade as at 31 December 2009. The entire portfolio had an average credit enhancement level of 30%. This level provides significant protection, since it means the bond has to incur a 30% loss, net of recoveries, before the Prudential Group is at risk.

In Jackson total amounts charged to profits relating to debt securities was £631 million as at 31 December 2009 (2008: £624 million). This was net of recoveries/reversals recognised in the year of £5 million (2008: £3 million).

In 2009, Jackson's total defaults were less than £1 million (2008: £78 million). In addition, as part of its active management of the book, it incurred net losses of £6 million (2008: £130 million) on the sale of impaired bonds.

IFRS write downs excluding defaults for 2009 were £630 million compared to £419 million in 2008. Of this amount £509 million (2008: £167 million) was in respect of RMBS securities.

The impairment process reflects a rigorous review of every single bond and security in its portfolio. The accounting requires the Prudential Group to book full mark to market losses on impaired securities through the income statement. However, it would expect only a proportion of these losses eventually to turn into defaults, and some of the impaired securities to recover in price over time.

In considering potential future losses for Jackson, it is essential to examine the key components of the debt portfolio. As at 31 December 2009, 93% of Jackson's total debt portfolio of £22.8 billion consisted of investment grade securities and 7% were non-investment grade.

The debt portfolio of the Prudential Group's asset management operations of £1.2 billion as at 31 December 2009 principally comprises £1.1 billion related to Prudential Capital operations. Of this amount, debt securities of £1.1 billion were rated AAA to A- by S&P or Aaa by Moody's.

### *Loans*

Of the total Group loans of £8.8 billion as at 31 December 2009, £6.9 billion were held by shareholder-backed operations comprising of £4.5 billion commercial mortgage loans and £2.4 billion of other loans.

Of this total held by shareholder-backed operations, the Asian insurance operations held £0.4 billion of other loans, the majority of which are commercial loans held by the Malaysian operation that are investment graded by two local rating agencies. The US insurance operations held £4.3 billion of loans, comprising £3.8 billion of commercial mortgage loans, all of which are collateralised by properties, and £0.5 billion of policy loans. The US commercial mortgage loan portfolio does not include any single-family residential mortgage loans and therefore is not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The UK insurance operations held £0.8 billion of loans, the majority of which are mortgage loans collateralised by properties.

The balance of the total shareholder loans amounts to £1.4 billion and relates to bridging loan finance managed by Prudential Capital. The bridging loan assets generally have no external credit ratings available, with internal ratings prepared by the Prudential Group's asset management operations as part of the risk management process, with the majority being rated BBB+ to BBB-.

### *Unrealised Credit Losses in the US*

Jackson's net unrealised position moved from a loss of £2,897 million as at 31 December 2008 to a net gain of £4 million as at 31 December 2009 as the markets rebounded from the historically wide spreads at the end of 2008. The gross unrealised loss position moved from £3,178 million as at 31 December 2008 to £966 million as at 31 December 2009. Gross unrealised losses on securities priced at less than 80% of face value totalled £594 million as at 31 December 2009 compared to £1.9 billion as at 31 December 2008.

#### *(c) Insurance risk*

The processes of determining the price of products and reporting the results of long-term business operations require the Prudential Group to make a number of assumptions. In common with other industry players, the profitability of the Prudential Group's businesses depends on a mix of factors including mortality and morbidity trends, persistency, investment performance, unit cost of administration and new business acquisition expenses. Almost all of the Prudential Group's longevity risk arises in the UK, where this is managed as a key risk and where Prudential conducts rigorous research using data from its substantial annuitant portfolio. In other parts of the world, longevity risk is a very minor part of the risk profile. The Prudential Group's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Where appropriate, allowance is also made for the relationship — either assumed or historically observed — between persistency and investment returns, and for the resulting additional risk.

#### *(d) Liquidity risk*

The holding company has significant internal sources of liquidity which are sufficient to meet all of its expected requirements for the foreseeable future without having to make use of external funding. In aggregate Prudential had £2.1 billion of undrawn committed facilities as at 31 March 2010, of which, in February 2009, it renewed £1.4 billion of the undrawn syndicated committed banking facility for a further three years. Prudential also has two £100 million undrawn bilateral committed banking facilities expiring in 2011 and 2012, with the balance being an annually renewable £500 million committed securities lending facility. In addition the Prudential Group has access to liquidity via the debt capital markets, which was demonstrated most recently through the two hybrid instruments, £400 million of Lower Tier 2 debt issued in May 2009 and US\$750 million (approximately £455 million of Innovative Tier 1 debt issued in July 2009, and a £250 million senior three-year MTN issued in January 2010. Liquidity is also assessed at business unit level under base case and stressed assumptions. The liquidity resources available have been assessed to be sufficient under both sets of assumptions.

### *Non-financial risk*

The Prudential Group is exposed to operational, business environment and strategic risk in the course of running its businesses. It processes a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory, including tax, regimes. It also has a significant number of third-party relationships that are important to the distribution and processing of its products, both as market counterparties and as business partners.

The Prudential Group uses the qualitative and quantitative analysis of operational risk exposures material to the Prudential Group to support business decisions, to inform overall levels of capital held and to assess the adequacy of the corporate insurance programme.

## **15.3 Capital management**

### *Regulatory capital (IGD)*

The Prudential Group is subject to the capital adequacy requirements of the EU Insurance Groups Directive (IGD) as implemented by the FSA in the UK. The IGD capital adequacy requirements involve aggregating surplus capital held in the Prudential Group's regulated subsidiaries, from which group borrowings, except those subordinated debt issues that qualify as capital, are deducted. No credit for the benefit of diversification is permitted under this approach.

The Prudential Group's position has been further strengthened during 2009, driven by its prudent but proactive risk management. Its IGD capital surplus is £3.4 billion as at 31 December 2009 (before allowing for the 2009 final dividend) giving a solvency ratio of 283%. This compares to a surplus as at 31 December 2008 (before allowing for

the 2008 final dividend) of £1.5 billion<sup>(62)</sup> and a solvency ratio of 152%. The positive movement of £1.9 billion during 2009 mainly comprises:

- Net capital generation mainly through operating earnings (in-force releases less investment in new business) of £1.1 billion;
- The impact of the sale of the agency distribution business in Taiwan of £0.8 billion;
- Hybrid debt issues in May and July 2009, totalling £0.9 billion;
- Additional recognition of £0.4 billion of surplus in respect of part of the shareholders' interest in the future transfers from the PAC with-profits fund, recognition of £0.2 billion of future profits in the UK and Hong Kong and other intra-group capital efficiencies of £0.3 billion;

Offset by:

- Final 2008 dividends, net of scrip, of £0.2 billion and interim 2009 dividends, net of scrip, of £0.1 billion;
- External financing costs and other central costs of £0.6 billion;
- Credit-related impairments and default losses in the US of £0.4 billion;
- Impacts arising from regulatory changes of £0.2 billion;
- Foreign exchange movements of £0.3 billion.

The Prudential Group has strengthened its IGD capital position in challenging markets. It continues to have further options available to it to manage available and required capital. These could take the form of either increasing available capital (for example, through financial reinsurance or debt issuance) or reducing required capital (for example, through the level and the mix of new business, notably by maintaining pricing discipline and through the use of other risk mitigation strategies such as hedging and reinsurance).

In addition to this strong capital position, the total credit reserve for the UK shareholder annuity funds, which protects the Prudential Group's capital position in excess of the IGD surplus, has been strengthened to £1.6 billion as at 31 December 2009 (from £1.5 billion at 30 September 2009). This reserve is equivalent to 71 bps per annum over the lifetime of the assets.

During the severe equity market conditions experienced in the first quarter of 2009 the Prudential Group entered into exceptional overlay short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programmes. The hedge contracts have expired and not been renewed.

#### *Stress testing*

As at 31 December 2009, the impact of an instantaneous 20% fall in equity markets levels (which is equivalent to the worst historic daily fall in the S&P index), would reduce IGD surplus by £150 million. Were equity markets to fall by more than 20%, Prudential believes that this would not be an instantaneous fall but rather this would be expected to occur over a period during which it would be able to put into place mitigating management actions. For example, Prudential has estimated that the impact (net of mitigating management actions) of an additional 20% fall in equity markets over a four-week period following an instantaneous 20% fall would be an estimated reduction in the IGD surplus of a further £350 million.

In summary, the findings of the Prudential Group's stress testing and sensitivity analysis, which are part of the continual process of assessing the resilience of the Prudential Group's IGD capital position to withstand significant further deterioration in market conditions include:

- An instantaneous 20% fall in equity markets from 31 December 2009 levels would reduce IGD surplus by £150 million.
- A 40% fall in equity markets (comprising an instantaneous 20% fall followed by a further 20% fall over a four-week period) would reduce the IGD surplus by £500 million.
- A 150 bps reduction (subject to a floor of zero) in interest rates from 31 December 2009 would reduce the IGD surplus by £400 million.
- Credit defaults of 10 times the expected level would have an impact of £550 million in excess of the annual reserve release.

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(62) Source: Audited annual regulatory return under Insurance Groups Directive (Form 95)

The Prudential Group believes that the results of these stress tests, together with its strong underlying earnings capacity, its established hedging programmes and its additional areas of financial flexibility, demonstrate that it is in a position to withstand possible significant further deterioration in market conditions.

The Prudential Group also uses an economic capital assessment to monitor its capital requirements across the group, allowing for realistic diversification benefits, and continues to maintain a strong position. This assessment provides valuable insights into its risk profile.

### *Solvency II*

The EU is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The Solvency II Directive, which sets out the new solvency framework for insurers in the European Union, was formally approved by the Economic and Financial Affairs Council in November 2009. The new approach is based on the concept of three pillars — minimum capital requirements, supervisory review of firms' assessments of risk, and enhanced disclosure requirements.

Specifically, Pillar 1 covers the quantitative requirements around own funds, valuation rules for assets and liabilities and capital requirements. Pillar 2 provides the qualitative requirements for risk management, governance and controls, including the requirement for insurers to submit an Own Risk and Solvency Assessment ("ORSA") which will be used by the Regulator as part of the supervisory review process. Pillar 3 deals with the enhanced requirements for supervisory reporting and public disclosure.

A key aspect of Solvency II is that the assessment of risks and capital requirements will be aligned more closely with economic capital methodologies. Companies may be allowed to make use of internal economic capital models if approved by the local regulator.

The European Commission has already initiated the process of developing the detailed rules that complement the high-level principles in the Directive, referred to as 'implementing measures'. These are subject to a consultation process that is not expected to be finalised until late 2011.

In particular, the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") published a number of consultation papers in 2009 covering advice to the European Commission on the implementing measures but there remains significant uncertainty regarding the outcome from this process. Prudential is actively participating in shaping the outcome through its involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Fora, together with the Association of British Insurers ("ABI") and the Comité Européen des Assurances ("CEA").

Many of the issues being actively debated have received considerable focus both within the industry and from national bodies.

Having assessed the high-level requirements of Solvency II, an implementation programme was initiated with dedicated teams to manage the required work across the Prudential Group. The activity of the local Solvency II teams is being coordinated by Group Head Office to achieve consistency in the understanding and application of the requirements.

The Prudential Group is progressing its implementation plans further and remaining in regular contact with the FSA as it prepares for the initial stage of the approval process for the internal model.

### *Capital allocation*

Prudential's approach to capital allocation takes into account a range of factors, especially risk-adjusted returns on capital, the impact of alternative capital measurement bases (accounting, regulatory, economic and ratings agency assessments), tax efficiency, and wider strategic objectives.

The Prudential Group optimises capital allocation across the group by using a consistent set of capital performance metrics across all business units to ensure meaningful comparison. Capital utilisation, return on capital and new business value creation are measured at a product level. The use of these capital performance metrics is embedded into its decision-making processes for product design and product pricing.

Capital performance metrics are based on economic capital, which provides a view of the Prudential Group's capital requirements across the group, allowing for realistic diversification benefits. Economic capital also provides valuable insights into the Prudential Group's risk profile and is used both for risk measurement and capital management.

## *Risk mitigation and hedging*

The Prudential Group manages its actual risk profile against its tolerance of risk. To do this, it maintains risk registers that include details of the risks it has identified and of the controls and mitigating actions it employs in managing them. Any mitigation strategies involving large transactions – such as a material derivative transaction – are subject to review at group level before implementation.

The Prudential Group uses a range of risk management and mitigation strategies. The most important of these include: adjusting asset portfolios to reduce investment risks (such as duration mismatches or overweight counterparty exposures); using derivatives to hedge market risks; implementing reinsurance programmes to limit insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.

## **16. Dividend policy**

The Directors recommended a final dividend for 2009 of 13.56 pence per share payable on 27 May 2010 to shareholders on the register at the close of business on 9 April 2010. The total dividend relating to the 2009 reporting period was £502 million (2008 £471 million, 2007 £444 million). Based on the number of issued shares as at 14 May 2010 (being the latest practicable date prior to the publication of this prospectus) of 2,534,472,474 this equates to a dividend of 19.8 pence (2008: 18.6 pence, 2007: 17.5 pence).

The Board intends to maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account the Prudential Group's financial flexibility and the Directors' assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate. The 2009 IFRS operating earnings after tax and minorities cover the full-year dividend 2.2 times (2008: 2.1 times).

## **17. Review of EEV basis results**

### **Basis of EEV discussion**

#### *Overview*

In addition to IFRS basis results, the Prudential Group prepares results in accordance with the EEV Principles issued by the Chief Financial Officers' Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance of EEV Disclosures published in October 2005. Over the life of any given product, the total profit recognised will be the same under either the IFRS or the EEV basis. However, the two methods recognise the emergence of that profit in different ways, with profits emerging earlier under the EEV basis than under IFRS.

In broad terms, IFRS profits for long-term business reflect the aggregate of statutory transfers from UK-style with-profits funds and profit on a traditional accounting basis for other long-term business. By their nature, the products sold by the life insurance industry are long-term, as insurance companies commit to service these products for many years into the future. The profit on these insurance sales is generated over this long-term period. In Prudential's view, the result under IFRS does not properly reflect the inherent value of these future profits, as it focuses instead on the amounts accruing to shareholders in the current year. See "Description of EEV Basis Reporting" below for further information regarding how EEV differs from IFRS and why it is used by the Prudential Group. The following discussion and analysis of the Prudential Group's EEV basis supplementary results should be read in conjunction with the Prudential Group's EEV basis supplementary information and the related notes to the Prudential Group's EEV basis supplementary information as of and for the years ended 31 December 2008 and 2009 set out in Part XV of this prospectus. Where appropriate the EEV basis results include the effects of adoption of IFRS.

The EEV basis results are not determined in accordance with IFRS or any other generally accepted accounting principles, and should not be considered as alternatives to performance measures derived in accordance with IFRS. Other insurance companies may calculate EEV basis results differently, and consequently, the Prudential Group's presentation of these results may not be readily comparable to other companies' figures.

The results discussed below are not necessarily indicative of the results to be expected in any future periods. This discussion contains forward-looking statements based on current expectations, which involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in these forward-looking statements due to a number of factors, including those set out in Part II (*Risk Factors*).

## ***Description of EEV Basis Reporting***

### *Embedded Value*

Embedded value (“EV”) is the present value of the shareholders’ interest in the earnings distributable from assets allocated to the life businesses after allowing for aggregate risks. This includes the present value (PV) of future cash flows from in-force business and capital tied-up in the life funds, the cost of holding additional capital, and shareholders’ free surplus. EV is a broadly defined concept and different applications of the principle can lead to very different financial results. This has led to attempts to standardise the application of EV in order to improve the rigour of, and comparability between companies’ EV results. EEV results are prepared in accordance with Principles issued by the CFO Forum of European Insurance Companies in May 2004 (and expanded by the Additional Guidance of EEV Disclosures published in October 2005), and are a standardised calculation of embedded value that has been adopted by many European life insurance companies to improve credibility and comparability of EV results.

A common set of principles are used under EEV that provide consistent definitions, a framework for setting actuarial assumptions, and a more explicit approach to the underlying methodology and disclosures. So for example:

- The allowance for risk is explicit for EEV through: (i) an allowance for the cost of capital (at the higher of economic capital and the local statutory minimum), (ii) stochastic or other appropriate modelling of financial options and guarantees to ensure that an allowance for their cost is allowed irrespective of their value at the balance sheet date, and (iii) an explicit allowance in the risk discount rate for financial and non-financial risks. EV has no prescribed way for allowing for the risk and uncertainty that is inherent in forecasting future cash flows (typically this has been achieved by including an implicit allowance for risk in the risk discount rate);
- EEV specifically allows for the look-through into profits arising in shareholder service companies, most notably the profit arising in investment management companies from managing the insurance companies funds for covered business;
- There are extensive disclosures required for EEV on all aspects of the calculations, including the methodology adopted and the analysis of return.

The EEV basis not only provides a good indication of the value being added by management in a given accounting period, but also helps demonstrate whether shareholder capital is being deployed to best effect. Indeed insurance companies in many countries use comparable bases of accounting for management purposes.

The EEV basis is a value-based method of reporting in that it reflects the change in value of the business over the accounting period. This value is called the shareholders’ funds on the EEV basis which, at a given point in time, is the value of future profits expected to arise from the current book of long-term insurance business plus the net worth of the company. In determining these expected profits, full allowance is made for the risks attached to their emergence and the associated cost of capital, and takes into account recent experience in assessing likely future persistency, mortality and expenses.

The change in value is typically analysed into the following components:

- the value added from new business sold during the year;
- the change in value from existing business already in place at the start of the year;
- short-term fluctuations in investment returns;
- changes in economic assumptions;
- change in the time value of cost of options and guarantees and economic assumption changes;
- other items (for example, profit from other group operations, tax, foreign exchange, exceptional items); and
- dividends.

The value added from new business — defined as the present value of the future profits arising from new business written in the year — is a key metric that the Prudential Group uses in the management of its business. The change in value of business in-force at the start of the year demonstrates how the existing book is being managed. Together, these metrics provide management and shareholders with valuable information about the underlying development of the Prudential Group’s business and the success or otherwise of management actions.

EEV basis results are prepared first of all by setting ‘best estimate’ assumptions, by product, for all relevant factors including expenses, surrender levels and mortality. Economic assumptions as to future investment returns and

inflation are generally based on a combination of market data and long-term assumptions. 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 risks associated with the cash flows. The risk discount rate is determined by adding a risk margin to the appropriate risk-free rate of return. The actual outcome may differ from that projected, in which case the effect will be reflected in the experience variances for that year.

The assumptions used for the EEV basis of accounting are set out in the notes that accompany the supplementary EEV basis information. An indication of the sensitivity of the results to changes in key assumptions is also provided within that information.

The publication of the EEV Principles represented a significant step towards the harmonisation of embedded value reporting in Europe. However, even with these principles and the accompanying guidance, a divergence of approaches between companies has emerged in practice. In June 2008, in an effort to improve the consistency and transparency of embedded value reporting, the CFO Forum published the Market Consistent Embedded Value (“MCEV”) Principles. However, the MCEV Principles were designed during a period of relatively stable market conditions and their application could, in the current turbulent markets, lead to misleading results. In December 2008, the CFO Forum announced that it intended to conduct a review of the impact of turbulent market conditions on the MCEV Principles, the result of which may lead to changes in the published principles or the issue of additional guidance. In May 2009, the CFO Forum announced that it had decided to perform further work to seek to improve the consistency in the adjustments made for liquidity premium and volatilities. In light of these developments, mandatory MCEV reporting was deferred for member firms until 2011. In October 2009, the CFO Forum announced changes to the MCEV Principles to allow the inclusion of a liquidity premium. The changes to the Principles were high level, with little detail included on how the liquidity premium should be determined or which products it should be applied to. The CFO Forum is currently conducting further work in these areas.

### **Basis of preparation, methodology and accounting presentation**

The EEV basis results have been prepared in accordance with the EEV Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005. Where appropriate, the EEV basis results include the effects of adoption of IFRS.

#### ***Covered business***

The EEV results for the Prudential Group are prepared for ‘covered business’, as defined by the EEV Principles. Covered business represents the Prudential Group’s long-term insurance business for which the value of new and in-force contracts is attributable to shareholders. The EEV basis results for the Prudential Group’s covered business are then combined with the IFRS basis results of the Prudential Group’s other operations.

The definition of long-term business operations comprises those contracts falling under the definition of long-term insurance business 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. Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management.

With two principal exceptions, covered business comprises the Prudential Group’s long-term business operations. The principal exceptions are for the closed Scottish Amicable Insurance Fund (“SAIF”) and for the presentational treatment of the financial position of the Prudential Group’s principal defined benefit pension scheme, the Prudential Staff Pension Scheme (“PSPS”). A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

SAIF is a ring-fenced sub-fund of the 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.

As regards PSPS, the deficit funding liability attaching to the shareholder-backed business is included in the total for other operations, reflecting the fact that the deficit funding is being paid for by Prudential.

## ***Methodology***

### ***(i) Embedded value***

#### *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 Prudential Group's long-term business comprises:

- present value of future shareholder cash flows from in-force covered business (value of in-force business), less a deduction for the cost of locked-in (encumbered) capital;
- locked-in (encumbered) capital; and
- shareholders' net worth in excess of encumbered capital (free surplus).

The value of future new business is excluded from the embedded value.

Notwithstanding the basis of presentation of results (as explained below) no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or profit before tax. Separately, the analysis of profit is delineated between operating profit based on longer-term investment returns and other constituent items, as explained below.

#### *Valuation of new business*

The contribution from new business represents profits determined by applying non-economic assumptions as at the end of the year.

In determining the new business contribution for UK immediate annuity and lifetime mortgage business, which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market condition consistent with how the business is priced. For other business within the Prudential Group end-of-period economic assumptions are used.

#### *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 reflects the aggregate of the IFRS results and the movements on the additional shareholders' interest recognised on the EEV basis. Thus the starting point for the calculation of the EEV results for Jackson, as for other businesses, reflects the market value movements recognised on the IFRS basis.

However, in determining the movements on the additional shareholders' interest, the basis for calculating the Jackson EEV result 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 are broadly speaking 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 on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

#### *Value of in-force business*

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency and mortality. 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.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same as that calculated under the IFRS basis. Since the embedded value basis reflects discounted future cash flows, under this methodology the profit emergence is advanced thus more closely aligning the timing of the

recognition of profits with the efforts and risks of current management actions, particularly with regard to business sold during the year.

### *Cost of capital*

A charge is deducted from the embedded value for the cost of capital supporting the Prudential Group's long-term business. This capital is referred to as encumbered capital. 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 investment earnings (net of tax) 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 encumbered 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 release over time and no further adjustment is necessary in respect of encumbered capital.

### *Financial options and guarantees*

#### *(a) Nature of options and guarantees in Prudential Group's long-term business*

##### *(1) Asian operations*

Subject to local market circumstances and regulatory requirements, the guarantee features described below in respect of UK business broadly apply to similar types of participating contracts principally written in the PAC Hong Kong branch, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

Non-participating long-term products are the only ones where the insurer is contractually obliged to provide guarantees on all benefits. Whole of life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not subsequently vary with market conditions are written in the Korean life operations. This is to a much lesser extent than the policies written by the Taiwan Life business which was sold in the first half of 2009.

##### *(2) US operations (Jackson)*

The principal options and guarantees in Jackson are associated with the fixed annuity 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 varied from 1.5% to 5.5% in 2009 (2008: 1.5% to 5.5%), depending on the particular product, jurisdiction where issued, and date of issue. As at 31 December 2009, 82% (2008: 83 %) of the account values on fixed annuities related to policies with guarantees of 3% or less. The average guarantee rate was 3% as at 31 December 2009 (2008: 3%).

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 VA contracts where it contractually guarantees to the contract holder 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 at specified dates during the accumulation period (Guaranteed Minimum Withdrawal Benefit ("GMWB")) and minimum accumulation, death and income benefits. Jackson hedges these risks using equity options and futures contracts.

These guarantees generally protect the policyholder's value in the event of poor equity market performance.

Jackson also issues fixed index annuities that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns would be of a similar nature to those described above for fixed annuities.

##### *(3) UK insurance operations*

The only significant financial options and guarantees in the UK insurance operations arise in the with-profits fund and SAIF.

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. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits fund held a provision on the Pillar I Peak 2 basis of £31 million as at 31 December 2009 (2008: £42 million) to honour guarantees on a small amount of guaranteed annuity option products.

Beyond the generic features and the provisions held in respect of guaranteed annuities described above, there are very few explicit options or guarantees of the with-profits fund such as minimum investment returns, surrender values, or annuity values at retirement and any granted have generally been at very low levels.

The Prudential Group's main exposure to guaranteed annuity options in the UK is through SAIF and a provision on the Pillar I Peak 2 basis of £284 million was held in SAIF as at 31 December 2009 (2008: £391 million) to honour the guarantees.

#### *(4) Time value*

The value of financial options and guarantees comprises two parts. One is given by a deterministic valuation on best estimate assumptions (the intrinsic value). The other 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 value of the in-force business including the cost of capital. A deterministic valuation of the in-force business is also derived using consistent assumptions and the time value of the financial options and guarantees is derived as the difference between the two.

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 Prudential 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.

#### *(ii) Level of encumbered capital*

In adopting the EEV Principles, Prudential Group has based encumbered capital on its internal targets for economic capital subject to it fulfilling at least the local statutory minimum requirements. Economic capital is assessed using internal models but, when applying the EEV Principles, Prudential does not take credit for the significant diversification benefits that exist within the Prudential Group. 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 encumbered capital requirements. For shareholder-backed business, the following capital requirements apply:

- Asian operations: the level of encumbered capital has been set at the higher of local statutory requirements and the economic capital requirement;
- US operations: the level of encumbered capital has been set to an amount at least equal to 235% of the risk-based capital required by the National Association of Insurance Commissioners ("NAIC") at the Company Action Level ("CAL"); and
- UK insurance operations: the capital requirements are set at the higher of Pillar I and Pillar II requirements for shareholder-backed business of UK insurance operations as a whole, which for 2009 and 2008 was Pillar I.

#### *(iii) 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 equal to risk-free rates plus a risk margin. 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. Prudential has selected a granular approach to better reflect differences in market risk inherent in each product group. The risk discount rate so derived does not reflect an overall Prudential Group market beta but instead reflects the expected volatility associated with the cash flows for each product category in the embedded value model.

Since financial options and guarantees are explicitly valued under the EEV methodology, 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. The majority of non-market and non-credit risks are considered to be diversifiable.

#### *Market risk allowance*

The allowance for market risk represents the multiple of beta x equity risk premium. Except for UK shareholder-backed annuity business such an approach has been used for all of the Prudential 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 are calculated each year. They are combined with the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

#### *Additional credit risk allowance*

The Prudential Group's methodology is to allow appropriately for credit risk. The allowance for credit risk is to cover:

- expected long-term defaults;
- credit risk premium (to reflect the volatility in 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 which are 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.

#### *Asian operations*

For Asian operations, the allowance for credit risk incorporated in the projected rates of return and the market risk allowance are sufficient. Accordingly, no additional allowance for credit risk is required.

#### *US business*

For Jackson business, the allowance for long-term defaults is reflected in the risk margin reserve charge which is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

For 2009, the risk discount rate incorporates an additional allowance for credit risk premium and short-term defaults. The allowance for 2009 is 150 basis points for spread-based business and 30 basis points for variable annuity business to reflect the fact that a proportion of the variable annuity business is allocated to the general account.

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. For 2008 and previously, allowance for these elements of credit risk was recognised only in the risk margin reserve charge and to the extent implicit within the market risk allowance.

#### *UK business*

##### *(a) Shareholder-backed annuity business*

For the Prudential Group's UK shareholder-backed annuity business, Prudential Group 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, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on Prudential Group's assessment of the expected return on the assets backing the annuity liabilities after allowing for expected long-term defaults, credit risk premium and short-term downgrades and defaults. For the purposes of presentation in the EEV results, the results on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for expected long-term defaults and, where necessary, an additional allowance for an element of short-term downgrades and defaults to bring the allowance in the earned rate up to best estimate levels. The allowances for credit risk premium and additional short-term default allowance are incorporated into the risk margin included in the discount rate.

*(b) With-profits fund PAL annuity business*

For UK annuity business written by PAL for 2008, the allowance for credit risk was for best estimate defaults. For 2009, the basis for determining the appropriate aggregate allowance for credit risk has been aligned with that of UK shareholder-backed annuity business so as also to include provision for short-term defaults. The allowance for credit risk in PAL is taken into account in determining the projected cash flows to the with-profits fund, which are in turn discounted at the risk discount rate applicable to all of the projected cash flows of the fund.

*(c) With-profits fund holdings of debt securities*

The UK with-profits fund holds debt securities as part of its investment portfolio backing policyholder liabilities and unallocated surplus. For 2008, given the expectation that the widening of credit spreads observed in 2008 would not be maintained, the Prudential Group considered it appropriate to assume an unchanged level of credit spreads, an unchanged level of default allowance and an unchanged risk discount rate methodology relative to those used as at 31 December 2007. For 2009, the approach for with-profits holdings has been refined. For equities and properties the projected earned rate is defined as the risk-free rate plus a long-term risk premium. Under the revised methodology a similar approach is adopted for corporate bonds i.e. the assumed earned rate is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults.

*Allowance for non-diversifiable non-market risks*

Finance theory cannot be used to determine the appropriate component of beta for non-diversifiable non-market risks since there is no observable risk premium associated with it that is akin to the equity risk premium. Recognising this, a pragmatic approach has been applied.

For UK shareholder-backed annuity business, a margin of 100 basis points is used to cover the non-diversifiable non-market risks associated with the business. For the Prudential Group's other business a margin of 50 basis points is applied with, where necessary, an additional allowance for emerging market risk. The additional 50 basis points for UK annuities business reflects the longevity risk which is of particular relevance.

*(iv) Management actions*

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, the following areas:

- investment allocation decisions;
- levels of reversionary bonuses and credited rates; and
- total claim values.

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.

*(v) 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%. 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 those few extreme 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 Prudential Group's Asian operations.

*(vi) Pension costs*

The Prudential Group operates three defined benefit schemes in the UK. The principal scheme is the Prudential Staff Pension Scheme ("PSPS"). The other two, much smaller, schemes are the Scottish Amicable and M&G schemes. There is also a small scheme in Taiwan but as part of the sale of the Taiwan agency business completed in June 2009, the Prudential Group settled the majority of the obligations under the scheme as a significant number of employees were transferred out.

Under IFRS the surpluses or deficits attaching to these schemes are accounted for in accordance with the provisions of IAS 19 that apply the principles of IFRIC 14, which was adopted in 2008 providing guidance on assessing the limit in IAS 19 on the amount of surplus in a defined benefit pension scheme that can be recognised as an asset.

Under the EEV basis the IAS 19 basis surpluses (to the extent not restricted under IFRIC 14) or deficits are initially allocated in the same manner. The shareholders' 10% interest in the PAC with-profits fund estate is determined after inclusion of the portion of the IAS 19 basis surpluses or deficits attributable to the fund. Adjustments under EEV in respect of accounting for surpluses or deficits on the Scottish Amicable Pension Scheme are reflected as part of UK operations and for other defined benefit schemes the adjustments are reflected as part of 'Other operations', as shown in note 7 of the EEV Basis Supplementary Information set out in Part XIV of this prospectus.

Separately, the projected cash flows of in-force covered business include the cost of contributions to the defined benefit schemes for future service based on the contribution basis applying to the schemes at the time of the preparation of the results.

*(vii) Debt capital*

Core structural debt liabilities are carried at market value. As the liabilities are generally held to maturity or for the long term, no deferred tax asset or liability has been established on the difference, compared to the IFRS carrying value. Accordingly, no deferred tax credit or charge is recorded in the results for the reporting period in respect of the mark to market value adjustment.

*(viii) Foreign currency translation*

Foreign currency profits and losses have been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year-end rates of exchange. The purpose of translating the profits and losses at average exchange rates, notwithstanding the fact that EEV profit represents the incremental value added on a discounted cash flow basis, is to maintain consistency with the methodology applied for IFRS basis reporting.

**Accounting presentation**

*(i) Analysis of profit before tax*

To the extent applicable, presentation of the EEV profit for the year is consistent with the basis that the Prudential Group applies for analysis of IFRS basis profits before shareholder taxes between operating and non-operating results. Operating results reflect the underlying results including longer-term investment returns and, except as explained in note (iv) below, the unwind of discount on the value of in-force business. Operating results include the impact of routine changes of estimates and non-economic assumptions. Non-operating results comprise short-term fluctuations in investment returns, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, the mark to market value movements on core borrowings and the effect of changes in economic assumptions and changes in the time value of cost of options and guarantees arising from changes in economic factors. During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Prudential Group incurred non-recurrent costs from an exceptional short dated hedge to protect against tail events on the Prudential Group IGD capital position in addition to regular operational hedging programmes. These costs have been shown separately within short-term fluctuations in investment returns. Also, in June 2009, the Group completed the disposal of the Taiwan agency business. The effect of this disposal and the results of the Taiwan agency business have been presented separately outside of the operating result.

(ii) **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 purposes of calculating the longer-term investment return to be included in the operating results of the PAC with-profits fund of UK operations, where assets backing the liabilities and unallocated surplus are subject to market volatility, values of assets at the beginning of the reporting period are adjusted to remove the effects of short-term market movements.

For the purposes of determining the long-term returns for debt securities of US operations and for fixed annuity and other general account business, a risk margin 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 year-end risk-free rates and equity risk premium. For US variable annuity separate account business, operating profit includes the unwind of discount on the opening value of in-force adjusted to reflect year-end projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with the 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 reflected in the result for the year. In general, the effect is booked in operating results. However, in 2008 the element due to the exceptional spread widening in the market since 31 December 2006 was booked in the effect of change in economic assumptions.

(iii) **Effect of changes in operating assumptions**

Operating profits include the effect of changes to operating assumptions on the value of in-force business at the end of the period. For presentational purposes, the effect of change is delineated to show the effect on the opening value of in-force business with the experience variance being determined by reference to the end of period assumptions.

(iv) **Unwind of discount and other expected returns**

The unwind of discount and other expected returns is determined by reference to the value of in-force business, required capital and surplus assets at the start of the period as adjusted for the effect of changes in economic and operating assumptions reflected in the current period. For UK insurance operations the amount included within operating results based on longer-term returns represents the unwind of discount on the value of in-force business at the beginning of the period (adjusted for the effect of current period assumption changes), the unwind of discount on additional value representing the shareholders' share of smoothed surplus assets retained within the PAC with-profits fund, and the expected return on shareholders' assets held in other UK long-term business operations. Surplus assets retained within the PAC with-profits fund are smoothed for this purpose to remove the effects of short-term investment volatility from operating results. In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed.

(v) **Pension costs**

*Profit before tax*

Movements on the shareholders' share of surplus (to the extent not restricted by IFRIC 14) and deficits of the Prudential Group's defined benefit pension schemes adjusted for contributions paid in the year are recorded within the income statement. Consistent with the basis of distribution of bonuses and the treatment of the estate described above, the shareholders' share incorporates 10% of the proportion of the financial position attributable to the PAC with-profits fund. The financial position is determined by applying the requirements of IAS 19.

*Actuarial and other gains and losses*

For pension schemes in which the IAS 19 position reflects the difference between the assets and liabilities of the scheme, actuarial and other gains and losses comprise:

- the difference between actual and expected return on the scheme assets;
- experience gains and losses on scheme liabilities;
- the impact of altered economic and other assumptions on the discounted value of scheme liabilities; and

- for pension schemes where the IAS 19 position reflects a deficit funding obligation, actuarial and other gains and losses reflect the movement in estimates of deficit funding requirements.

These items are recorded in the income statement but, consistent with the IFRS basis of presentation, are excluded from operating results.

(vi) *Effect of changes in economic assumptions and time value of cost of options and guarantees*

Movements in the value of in-force business at the beginning of the period caused by changes in economic assumptions and the time value of cost of options and guarantees resulting from changes in economic factors are recorded in non-operating results.

(vii) *Taxation*

The EEV profit for the year for covered business is in most cases calculated initially at the post-tax level. The post-tax profit is then grossed up for presentation purposes at the effective rate of tax. In general, the effective rate corresponds to the corporation tax rate on shareholder profits of the business concerned.

## Results of operations

The following table sets forth a summary of the Prudential Group's EEV basis results for the years ended 31 December 2008 and 2009.

### EEV basis operating profit

	<u>2008</u>	<u>2009</u>
	£m	£m
Long-term insurance business		
Asia .....	1,213	1,105
US .....	586	1,233
UK .....	1,037	870
Development expenses .....	<u>(26)</u>	<u>(6)</u>
<b>Long-term business profit</b> .....	<u>2,810</u>	<u>3,202</u>
UK general insurance commission .....	44	51
Asset management business:		
M&G .....	286	238
Asia asset management .....	52	55
Curian .....	(3)	(6)
US broker dealer and asset management .....	<u>10</u>	<u>10</u>
	<u>345</u>	<u>297</u>
Other income and expenditure .....	(302)	(433)
Restructuring costs .....	<u>(32)</u>	<u>(27)</u>
<b>Total EEV basis operating profit</b> .....	<u>2,865</u>	<u>3,090</u>
Short-term fluctuations in investment returns .....	(4,967)	351
Mark to market value movements on core borrowings .....	656	(795)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes .....	(14)	(84)
Effect of changes in economic assumptions and time value of cost of options and guarantees .....	(398)	(910)
Profit on sale and results of Taiwan agency business .....	<u>(248)</u>	<u>91</u>
<b>Profit (loss) from continuing operations before tax</b> .....	(2,106)	1,743
Tax attributable to shareholders' profit (loss) .....	771	(481)
Discontinued operations (net of tax) .....	—	(14)
Minority interests .....	<u>(3)</u>	<u>(3)</u>
<b>Profit (loss) after minority interests</b> .....	<u>(1,338)</u>	<u>1,245</u>

### Overview

In 2009, total EEV basis operating profits based on longer-term investment returns of £3,090 million were up 8% from £2,865 million in 2008, primarily due to an increase in the profitability from the Prudential Group's long-term

business operations, which was up 14% to £3,202 million, comprising new business profit of £1,607 million, in-force profits of £1,601 million and development expenses of £6 million. New business profits, at £1,607 million, were 34% higher than in 2008, with higher margins in all businesses, particularly the US, and a 1% increase in sales volumes year-on-year. The average Prudential Group new business profit margin was 56% (2008: 42%) on an APE basis and 8% (2008: 6%) on a present value of new business premiums (PVNBP) basis. This rise reflected increased average margins across the businesses as the Prudential Group concentrated on maximising sales of its most profitable products.

Overall, there was a 2% decrease in the contribution from in-force business (before development expenses) in 2009, down by £35 million to £1,601 million. The movement reflected a growing level of unwind of discount, up by £210 million, reflecting the increased in-force business offset by a reduction in the level of contribution from changes to operating assumptions, experience variances and other items of, in aggregate, £245 million. The growth in the Prudential Group's EEV operating profit was held back by a lower contribution from the asset management businesses (down £48 million to £297 million) reflecting reduced market values in 2009. There was also a negative impact on Prudential Group EEV operating profit from other income and expenditure of £131 million due to lower returns on central funds and higher interest payable on core structural borrowings.

The total EEV profit before tax for 2009 of £1,743 million compared with a loss of £2,106 million for 2008. The increase of £3,849 million reflected the growth in operating profit of £225 million and an increase in the aggregate effect of non-operating items of £3,624 million which mostly arose from the net effects of improved financial markets. Within the non-operating items of negative £1,347 million, there were positive contributions of £351 million for short-term fluctuations in investment returns and the £91 million from the profit on sale and results of the Taiwan agency business that was sold in June 2009. However, these amounts were offset by reductions of £795 million for the change in the mark to market value of the Prudential Group's borrowings as credit spreads normalised, a charge of £910 million for the effect of changes in economic assumptions and time value of cost of options and guarantees arising from increasing interest rates and the application of higher risk discount rates across the businesses and an £84 million charge for actuarial and other losses for the Prudential Group's defined benefit pension schemes.

### ***EEV basis operating profit — insurance operations***

#### *Asia*

Total EEV operating profit for the Prudential Group's Asia insurance operations before development expenses was £1,105 million in 2009 (2008: £1,213 million), including £713 million of new business profit (2008: £634 million).

Average new business profit margins increased from 52% for 2008 to 57% for 2009. The major drivers of this increase were a shift in average country mix where the Prudential Group has seen lower proportions of new business from the lower margin markets of Korea and India and the positive impact of the shift in product mix towards higher margin health and protection products. Total new business profits of £713 million in 2009 were up 12% over 2008. Despite the unforeseen and very challenging environment, the Prudential Group exceeded the target it set itself in December 2006 of doubling 2005 new business profits by 2009 by £39 million.

During the first half of 2009 the Prudential Group did see a deterioration of persistency, principally in Korea, and it reported adverse assumption changes and experience variances to reflect this. During the second half of 2009, the situation improved as a result of management actions and an improvement in market conditions. During the second half only an additional £47 million of assumption changes and experience variances relating to persistency were incurred, resulting in a full-year charge of £154 million. Overall assumption changes and experience variances for 2009 netted out at a charge of £97 million, representing an improvement from the charge of £124 million reported at the half year. Given the scale of the EEV shareholder funds of the long-term business at £5.8 billion, these experience variances and assumption changes remain small. The contribution to in-force earnings arising from the unwind of the discount rate and other operating investment returns amounted to £489 million, up 20% on the prior year, reflecting the growing scale of the business.

#### *United States*

Total EEV basis operating profit for the long-term business in 2009 was £1,233 million, compared to £586 million in 2008. In-force EEV profits of £569 million in 2009 were 94% higher than the 2008 profit of £293 million, reflecting both the greater contribution to earnings from the unwind of the discount rate and the beneficial impact of updating the assumption relating to GMWB utilisation rates to reflect recent experience studies.

## *United Kingdom*

EEV total operating profit based on longer-term investment returns of £921 million, including £51 million from general insurance commission, was down 15% on 2008. This was mainly due to the £118 million benefit arising in 2008 from rebalancing the credit portfolio that supports the shareholder-backed annuity business compared with £22 million in 2009. The 2009 in-force operating result included £588 million from the unwind of the discount rate on the value of in-force business, which was 3% higher than 2008.

Prudential UK continues to manage actively the retention of the in-force book. During 2009, the experience at an aggregate level was in line with long-term assumptions.

### ***EEV basis operating profit — other items***

Operating profit from the asset management business decreased to £297 million, down 14% from £345 million in 2008, reflecting reduced market values in 2009 compared to 2008.

Other income and expenditure totalled a net expense of £433 million in 2009 compared with £302 million in 2008, a difference of negative £131 million of which £47 million was due to the impact of the non-recurrence in 2009 of a positive one-off 2008 item of profit on the sale of a seed capital investment in an Indian mutual fund. The remaining difference principally related to lower interest received on central shareholders' funds as a result of falling interest rates and an increase in interest payable on core structural borrowings.

### ***EEV basis non-operating profit items***

#### *Short-term fluctuations in investment returns*

In the Prudential Group's calculation of EEV operating profit, it uses longer-term investment return assumptions rather than actual investment returns achieved. Short-term fluctuations represent the difference between the actual investment return and the unwind of discount on the value of in-force business and expected returns on net worth.

Short-term fluctuations in investment returns for insurance operations of positive £481 million in 2009 comprised a positive £437 million for Asia, negative £401 million for the Prudential Group's US operations and positive £445 million in the UK.

For the Prudential Group's Asian business, short-term fluctuations of positive £437 million in 2009 (versus negative £903 million in 2008) primarily reflected the effect of strong equity market performance, in particular for participating business and unit linked business where the in-force value benefits from increases in shareholder transfers and from the capitalisation of increased projected fees due to the higher asset base at the end of the year.

For the Prudential Group's US business, short-term fluctuations in investment returns were negative £401 million versus negative £1,344 million in 2008, and primarily reflected the excess of impairment losses for fixed income securities incurred in the year over the long-term charge included within operating profit.

For the Prudential Group's UK business, the short-term fluctuations in investment returns were positive £445 million in 2009 (versus negative £2,407 million in 2008), including positive £430 million relating to with-profits business, primarily reflecting the difference between the 15.5% investment return arising in the year on the investments of the with-profits life fund (covering policyholder liabilities and unallocated surplus) and the long-term assumed return of 6.9%.

For other operations, the principal component of short-term fluctuations in investment returns in 2009 was a one-off £235 million cost arising from the hedge temporarily put in place during the first quarter, to protect the Prudential Group IGD capital surplus in the light of exceptional market conditions. During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to its regular operational hedging programmes. The residual short-term fluctuations in investment returns for other operations of positive £105 million in 2009 included £66 million for unrealised appreciation on Prudential Capital's debt securities portfolio and £28 million on swaps held centrally to manage the Prudential Group assets and liabilities.

#### *Mark to market movement on core borrowings*

The mark to market movement on core borrowings was negative £795 million in 2009, as credit spreads incorporated in the market value of the debt narrowed to more normal levels.

### Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes of a negative £84 million in 2009 reflected the impact of a reduced discount rate and other assumption changes on the measurement of the liabilities of the Scottish Amicable and M&G schemes and an increase in the deficit funding provision for the Prudential Staff Pension Scheme.

### Effect of changes in economic assumptions and time value of cost of options and guarantees

The effect of changes in economic assumptions and time value of cost of options and guarantees of negative £910 million in 2009 comprised negative £963 million for the effect of changes in economic assumptions partially offset by positive £53 million for the change in the time value of cost of options and guarantees arising from changes in economic factors. In the Prudential Group's Asian business, economic assumption changes were negative £165 million, primarily driven by increases in risk discount and fund earned rates across a number of territories. In the Prudential Group's US business, economic assumption changes were negative £528 million, primarily reflecting an increase in the risk discount rates following an increase in the US 10-year Treasury rate and an increase in the allowance for credit risk for fixed annuity and variable annuity business of 1.5% and 0.3% respectively, partially offset by the effect of an increase in the separate account return assumption from 5.8% to 7.4% arising from the increase in risk-free rates. In the Prudential Group's UK business, economic assumption changes were negative £270 million, primarily relating to with-profits business, reflecting the fact that the risk discount rate has increased by significantly more than the earned rate as a result of revised correlation assumptions, a lower equity backing ratio and very low cash return.

### Profit on sale and results of Taiwan agency business

In June 2009, the Prudential Group completed the sale of its Taiwan agency business. The 2009 result of £91 million reflected the profit on sale. The 2008 loss of £248 million was the total result for this business, including short-term fluctuations in investment returns.

### EEV shareholder funds

The following table sets forth a summary of the movement in the Prudential Group's EEV shareholders' funds for the years ended 31 December 2008 and 2009:

	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>
Operating profit based on longer-term investment returns . . . . .	2,865	3,090
Items excluded from operating profit . . . . .	(4,971)	(1,347)
<b>Total profit (loss) before tax . . . . .</b>	<b>(2,106)</b>	<b>1,743</b>
Tax, discontinued operations and minority interests . . . . .	768	(498)
<b>Profit (loss) for the period . . . . .</b>	<b>(1,338)</b>	<b>1,245</b>
Exchange movements, net of related tax . . . . .	2,129	(750)
Dividends . . . . .	(453)	(481)
New share capital subscribed . . . . .	170	141
Other . . . . .	(152)	162
<b>Net increase in shareholders' funds . . . . .</b>	<b>356</b>	<b>317</b>
Shareholders' funds at beginning of period . . . . .	<u>14,600</u>	<u>14,956</u>
<b>Shareholders' funds at end of period . . . . .</b>	<b><u>14,956</u></b>	<b><u>15,273</u></b>
Comprising		
Long-term business		
Free surplus . . . . .	447	2,065
Required capital . . . . .	<u>4,117</u>	<u>2,994</u>
Net worth . . . . .	4,564	5,059
Value of in-force business . . . . .	<u>9,958</u>	<u>10,283</u>
Total . . . . .	14,522	15,342
Other business . . . . .	<u>434</u>	<u>(69)</u>
<b>Total . . . . .</b>	<b><u>14,956</u></b>	<b><u>15,273</u></b>

On an EEV basis, which recognises the shareholders' interest in long-term business, shareholder funds as at 31 December 2009 were £15.3 billion, an increase of £0.3 billion from the 2008 year-end level. This increased level

of shareholders' funds reflected the profit after tax of £1.2 billion, the adverse effects of exchange movements of £0.7 billion and dividend payments of £0.5 billion, which were partially offset by new share capital subscribed of £0.1 billion and other movements of £0.2 billion.

The shareholders' funds at the end of 2009 relating to long-term business of £15.3 billion comprised £5.8 billion for the Prudential Group's Asian long-term business operations, £4.1 billion for the Prudential Group's US long-term business operations and £5.4 billion for the Prudential Group's UK long-term business operations.

As at 31 December 2009, the embedded value for the Prudential Group's Asian long-term business operations was £5.8 billion. The embedded value for the established markets of Hong Kong, Singapore and Malaysia was £3.8 billion. There was also substantial embedded value in Indonesia (£584 million), Korea (£408 million), and Vietnam (£199 million).

For the Prudential Group's other Asian markets, following the sale of the Taiwan agency business, the embedded value was £848 million in aggregate as at 31 December 2009.

### Free surplus generation

The Prudential Group free surplus at the end of the period comprises free surplus for the insurance businesses, representing the excess of the net worth over the required capital included in the EEV results, and IFRS net assets for the asset management businesses excluding goodwill. The free surplus generated during the period comprises the movement in this balance excluding foreign exchange, capital movements, and other reserve movements. Specifically it includes amounts maturing from the in-force operations during the period less the investment in new business, the effect of market movements and other one-off items.

For asset management operations the Prudential Group has defined free surplus generation to be total post-tax IFRS profit for the period. The Prudential Group free surplus generated also includes the general insurance commission earned during the period and excludes restructuring and shareholders' centrally arising other income and expenditure.

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

	<u>2008</u>	<u>2009</u>
	£m	£m
<i>Free surplus generation</i>		
Expected in-force cash flows (including expected return on net assets) . . . . .	1,623	1,914
Changes in operating assumptions and variances . . . . .	(65)	175
Underlying free surplus generated in the period . . . . .	1,558	2,089
Provisions for additional allowance for credit risk . . . . .	(770)	—
Market-related items . . . . .	(689)	(198)
Investment in new business . . . . .	(806)	(675)
Free surplus generated in the period from retained businesses . . . . .	(707)	1,216
Effect of disposal and trading results of Taiwan agency business . . . . .	(276)	987
Net cash remitted by the business units . . . . .	(515)	(688)
Other movements and timing differences . . . . .	442	157
Total movement during the period . . . . .	(1,056)	1,672
Free surplus at 1 January . . . . .	<u>1,915</u>	<u>859</u>
Free surplus at 31 December . . . . .	<u>859</u>	<u>2,531</u>
Comprises:		
Free surplus relating to long-term insurance business . . . . .	447	2,065
Free surplus of other insurance business . . . . .	—	37
IFRS net assets of asset management businesses excluding goodwill . . . . .	<u>412</u>	<u>429</u>
Total free surplus . . . . .	859	2,531

During 2009, the Prudential Group generated total free surplus from the retained businesses of £1,216 million (2008: negative £707 million). Underlying free surplus generated from the in-force book increased 34% from £1,558 million in 2008 to £2,089 million in 2009, reflecting favourable exchange rates, the underlying growth of the portfolio, and positive changes in operating assumptions and variances of £175 million for the life businesses (2008: negative £65 million). These positive changes included £158 million arising in the UK (2008: £118 million) and £115 million arising in the US (2008: negative £1 million), consistent with management's ongoing focus on capital

preservation, and were offset by the negative changes in Asia of £98 million (2008: negative £182 million) principally arising from adopting higher required capital level assumptions in a number of businesses.

Underlying free surplus generated has been used by the life businesses to invest in new business. Investment in new business fell by £131 million to £675 million in 2009. This reduction reflected the Prudential Group's deliberate focus on conserving capital and was in part due to the substantially reduced levels of wholesale business sales in the UK and the US.

Market-related movements improved from negative £689 million in 2008 to negative £198 million in 2009. These improvements were driven by higher equity returns in Asia, and improved market performance in the US, offset by the one-off profit in 2008 arising from the rebalancing of the credit portfolio in the UK not being repeated in 2009.

In June 2009, the Prudential Group completed the sale of the Taiwan agency business. As anticipated, this gave rise to an increase in free surplus of £987 million, representing the release of negative free surplus that previously applied. This compared to an increase in IGD capital of £800 million. The difference arose predominantly because the calibrations underpinning the capital requirements on a regulatory (IGD) basis are different from those applied on an economic capital (EEV) basis.

## PART XIII

### OPERATING AND FINANCIAL REVIEW OF THE AIA GROUP

The following review should be read in conjunction with Part VIII (*Information about the AIA Group*) and Part XV (*Historical Financial Information for AIA Group*).

Unless otherwise indicated, the financial data relating to the AIA Group in this Part XIII has been extracted without material adjustment from the historical financial information of the AIA Group as reported on by PricewaterhouseCoopers set out at Part XV (*Historical Financial Information for AIA Group*) of this prospectus or from AIA Group's unaudited accounting records, operating systems and other information prepared by AIA or Prudential.

For the purposes of reading this Part of the prospectus, you should refer to the list of explanations in paragraph 15 of this Part XIII which contains explanations of certain terms used only in Part VIII (*Information about the AIA Group*) and this Part XIII of this prospectus. These terms and their meanings may not always correspond to standard industry meaning or usage of these terms.

#### 1. Business overview

The AIA Group is a leading life insurance organisation in the Asia Pacific region that traces its roots in the region back more than 90 years. It provides individuals and businesses with products and services for their evolving insurance, protection, savings, investments and retirement needs. As of 30 November 2009, the AIA Group (excluding AIA India, a joint venture in which the AIA Group has a 26% equity interest) had approximately 15,500 employees serving the holders of its approximately 21.3 million in-force policies and approximately 9 million participating members of its clients for group life, medical, credit life coverage and pension products. As of 30 November 2009, the AIA Group's tied agency force consisted of approximately 162,720 agents (excluding those who serve AIA India). More recently, it has developed its other distribution channels, particularly bancassurance and direct marketing, to create a multi-channel distribution platform. The AIA Group derives substantially all of its premiums from its 15 geographical markets across the Asia Pacific region. Its individual local operating units are significant businesses in their own right, with Hong Kong, Singapore and Thailand each generating more than US\$350 million of operating profit in FY 2009. At the same time, the AIA Group's business is well diversified with no more than 25% of TWPI arising from any one geographical market in FY 2008 and FY 2009.

#### 2. Financial overview of the AIA Group's business

The AIA Group had TWPI and operating profit before tax of US\$11,632 million and US\$1,835 million, respectively, in FY 2009, US\$12,203 million and US\$1,943 million, respectively, in FY 2008 and US\$11,358 million and US\$1,742 million, respectively, in FY 2007. Applying the average US dollar exchange rates for a particular financial year to results reported in local currency for the previous financial year, which the AIA Group refers to as "on a constant exchange rate basis", the increase in TWPI from FY 2008 to FY 2009 was 1.1% and the increase in TWPI from FY 2007 to FY 2008 was 6.4%.

The AIA Group evaluates its financial results on a geographical market basis. Its business provides life insurance, health and protection insurance, and pension and annuity products to customers in each of its geographical markets. The AIA Group's reporting segments are categorised as follows: (i) each Key Market; (ii) combined results for Other Markets; and (iii) Corporate and Other reporting segment. The Key Markets consist of the individual results of: Hong Kong (including Macau); Thailand; Singapore (including Brunei); Malaysia; China and Korea. The Other Markets segment consists of the combined results of: Australia, the Philippines, Indonesia, Vietnam, Taiwan and New Zealand, and the AIA Group's interest in its joint venture in India. The Corporate and Other segment includes the AIA Group's corporate functions, shared services and eliminations of intragroup transactions.

The AIA Group's reporting segments had the following results:

	Year ended 30 November					
	2007	2008	2009	2007	2008	2009
	TWPI			Operating profit/(loss) <sup>(1)</sup>		
	(in US\$ millions)					
Hong Kong . . . . .	2,845	2,916	2,861	408	590	698
Thailand . . . . .	2,164	2,351	2,373	401	424	358
Singapore . . . . .	1,514	1,641	1,524	348	333	356
Malaysia . . . . .	667	727	707	123	123	150
China . . . . .	806	934	1,018	122	85	89
Korea . . . . .	2,178	2,268	1,759	269	281	81
Other Markets <sup>(2)</sup> . . . . .	1,184	1,366	1,390	170	188	191
Corporate and Other . . . . .	—	—	—	(99)	(81)	(88)
<b>Total</b> . . . . .	<b><u>11,358</u></b>	<b><u>12,203</u></b>	<b><u>11,632</u></b>	<b><u>1,742</u></b>	<b><u>1,943</u></b>	<b><u>1,835</u></b>

(1) Operating profit/(loss) is stated before the effect of tax.

(2) The results of the AIA Group's interest in its joint venture in India are reflected in the operating profit of the Other Markets reporting segment, but are not included in TWPI because the AIA Group accounts for this interest using the equity method.

### 3. Major factors affecting the AIA Group's financial condition and results of operations

The AIA Group's financial condition and results of operations, as well as the comparability of its results of operations between periods, are affected by a number of factors, including: (i) economic conditions and demographic fundamentals in the Asia Pacific region; (ii) fluctuations in market interest rates and credit risk; (iii) fluctuations in equity markets; (iv) fluctuations in foreign exchange rates; (v) regulatory environment; (vi) customer sentiment and policyholder behaviour; (vii) claims experience; (viii) product mix and multi-channel distribution; and (ix) competition in its geographical markets.

#### *Economic conditions and demographic fundamentals in the Asia Pacific region*

The Asia Pacific region's economic growth trends, household savings rates, demographic profiles and life insurance penetration rates are some of the key factors affecting the performance of the region's life insurance industry. As the AIA Group operates in 15 geographical markets across the Asia Pacific region and provides a range of products to different customer segments in each market, its performance is less susceptible to adverse trends in any one geographical market. However, if the economic conditions in the Asia Pacific region deteriorate, or the impact on the AIA Group's business is different from what it expects, its business may be materially and adversely affected.

#### *Fluctuations in market interest rates and credit risk*

The AIA Group is affected by fluctuations in market interest rates as a substantial portion of its investment portfolio is held in debt securities, in particular fixed income government securities. Movements in interest rates may affect the level and timing of recognition of gains and losses on debt securities and other investments held in its investment portfolio. A sustained period of lower interest rates would generally reduce the investment yield of the AIA Group's investment portfolio over time as higher yielding investments mature or are redeemed and proceeds are reinvested in new investments with lower yields. However, declining interest rates would also increase realised and unrealised gains on its existing investments. Conversely, rising interest rates should, over time, increase its investment income, but may reduce the market value of its investment portfolio. The AIA Group's holding of debt securities also exposes it to corporate, sovereign and other credit risk.

In addition, interest rate risk arises from the AIA Group's insurance and investment contracts with guaranteed features. These contracts carry the risk that interest income from the financial assets backing the liabilities is insufficient to fund the guaranteed benefits payable as interest rates fall or fail to meet customer expectations for participating products. In periods of rapidly increasing interest rates, policy loans, surrenders and withdrawals may increase. These events may result in cash payments by the AIA Group requiring the sale of invested assets at a time of declining prices, which may result in realised losses.

#### *Fluctuations in equity markets*

Fluctuations in equity markets may affect the AIA Group's investment returns and sales of AIA investment-linked products. Its exposure to equity markets is significantly less than its exposure to debt markets, with equity securities representing only 6.4% of the total carrying value of other policyholder and shareholder financial investments as of

30 November 2009. Other policyholder and shareholder investments form 17.9% of the total fair value of the AIA Group's equity securities as of 30 November 2009. The investment risk in respect of investments held to back AIA investment-linked contracts is borne wholly by holders of AIA investment-linked contracts whereas the investment risk associated with investments held by participating funds is shared between policyholders and AIA's shareholders.

Sales of AIA investment-linked products typically decrease in periods of protracted or steep declines in equity markets and increase in periods of rising equity markets. Customers may be reluctant to commit to new investment-linked savings products in times of uncertainty or market volatility, although some customers with regular premium paying policies may choose to maintain their payments of regular premiums as markets decline, following a strategy of dollar cost averaging. Policy loans, surrenders and withdrawals may increase at times of declining equity markets. Lower investment returns for AIA investment-linked contracts would also reduce the asset management and other fees earned by the AIA Group, certain of which are based on the account balance of these contracts.

### ***Fluctuations in foreign exchange rates***

The AIA Group's business spans 15 geographical markets in the Asia Pacific region. As each of its operating units operates largely in its local currency, the AIA Group faces foreign exchange rate risk arising from the conversion of the functional currencies of its local operations to its reporting currency, the US dollar. In addition, this means that profits generated in local currencies by its operating units must be converted to US dollars at the exchange rate in effect on the date at which they are repatriated to AIA.

The AIA Group's exposure to foreign exchange rate risk in each operating unit is partially mitigated because assets and liabilities in the local functional currency of each operating unit are usually matched. Premiums and deposits are largely received in the local functional currency, insurance and investment contract liabilities are largely determined in that currency and operating units typically invest in assets denominated in that currency to match insurance and investment contract liabilities. In addition, the AIA Group undertakes hedging activities to mitigate its foreign exchange exposure to certain operating units, in particular Thailand, Singapore and Korea.

On a local operating unit level, foreign exchange rate risk could arise from transactions denominated in currencies that are different from the functional currency of the operating unit. For example, despite a significant increase in annuity surrenders in Korea in the fourth quarter of FY 2008, the AIA Group chose to maintain its investment in a portfolio of US dollar denominated assets originally held to back the annuity business, thereby creating a temporary currency mismatch that resulted in an underlying currency exposure to US dollars in its Korean operating unit.

In addition, there have been significant fluctuations in the exchange rate between the Korean Won and US dollar between FY 2007 and FY 2009. The average exchange rate of Korean Won to US dollar depreciated from 929.37 in FY 2007 to 1,047.12 in FY 2008 and further depreciated to 1,287.00 in FY 2009 which has had an adverse impact on the AIA Group's reported financial results.

### ***Regulatory environment***

The AIA Group is subject to the regulatory oversight of a number of financial services, insurance, securities and related regulators. These regulators have broad authority over its business, including its capital requirements, where it is authorised to operate and its ability to enter certain lines of business, expand its operations, offer new products, enter into distribution arrangements and declare dividends. These regulators oversee the AIA Group's operations in each of the geographical markets in which it operates and, as a result of this broad and diverse oversight, it is occasionally subject to overlapping, conflicting and/or expanding regulation. The AIA Group's efforts to comply with changes in regulations may lead to increased operating and administrative expenses. In addition, pursuant to the insurance laws, rules and regulations of the various geographical markets in which it operates, it is restricted to a specified range of investment activities. These restrictions may limit the AIA Group's ability to diversify investment risks and improve returns on its investment portfolio, thereby affecting its results of operations. Furthermore, the AIA Group is subject to the tax regime of each geographical market in which it operates. If the tax regime, or the application of the tax regime to it, changes, its tax liabilities in each of these geographical markets could also materially change.

### ***Customer sentiment and policyholder behaviour***

As an insurer with a long-established track record, a significant portion of the AIA Group's business is on a recurring premium basis, which has given it a recurring stream of renewal premiums over the track record period. However, customer sentiment and actual policyholder behaviour (such as policy take-up rates, premium holidays, lapses and surrenders) may differ from the AIA Group's expectations due to factors that are outside of its control. In

particular, AIA persistency varies over time and from one type of product to another. AIA persistency measures the proportion of customers who continue to maintain their policies with the AIA Group, which the AIA Group calculates by reference to the percentage of insurance policies remaining in-force from month to month, as measured by premiums. Factors that cause policy take-up, lapses and surrender rates to vary over time include changes in investment performance of the assets underlying the contract (in the case of AIA investment-linked contracts), changes in the rate of policyholder dividends declared relative to competitors, regulatory changes that make alternative products more attractive, customer perception of the insurance industry in general and the AIA Group in particular, and general economic conditions in each of its Key Markets. These factors can cause its results of operations and the value of its business to fluctuate from year to year.

For example, the decline in Asian and global equity markets in the second half of 2008 resulted in lower demand for AIA investment-linked contracts, while demand for protection-based contracts increased in some of its Key Markets. Customers may also perceive particular value in AIA investment-linked contracts with guaranteed features at times of low market interest rates and thus lapses may be less than expected.

### ***Claims experience***

The AIA Group's results are affected by its claims experience, which may vary from the assumptions that the AIA Group makes both when it designs and prices its products and when it calculates its insurance contract liabilities. Claims experience varies over time and from one type of product to another, and may be impacted by specific events and changes in macroeconomic conditions, population demographics, mortality, morbidity and other factors.

### ***Product mix and multi-channel distribution***

The AIA Group designs and distributes a broad range of insurance products. The performance of its businesses, and the revenue it generates, are affected by its ability to deliver the most suitable products to targeted customer segments through multiple distribution channels in each of its key markets on a timely basis. Its ability to expand and build alternative distribution channels, including bancassurance, direct marketing and IFA/brokerage channels, may affect the performance of its businesses.

### ***Competition in the AIA Group's geographical markets***

Competition may negatively affect the AIA Group's business and future business prospects by reducing its market share in the geographical markets in which it operates, decreasing its margins and spreads, increasing policy acquisition costs and operating expenses and reducing the growth of its customer base. The AIA Group's competitors include insurance companies, mutual fund companies, banks and investment management firms.

### ***Revenues, expenses and profitability***

The AIA Group derives revenues primarily from:

- insurance premiums from the sale of life insurance policies and annuity contracts, as well as health and protection insurance products;
- policy fees for AIA investment-linked products; and
- investment returns from its investment portfolio.

The AIA Group's expenses consist primarily of:

- the change in insurance and investment contract liabilities;
- insurance and investment benefits, and claims paid to policyholders;
- commission and other acquisition expenses;
- operating expenses, including employee salaries and benefits, information technology, advertising, marketing, training, rental, depreciation and amortisation;
- investment management expenses and finance costs; and
- restructuring and separation costs.

The AIA Group's profitability depends mainly on its ability to: (i) attract new customers; (ii) retain existing customers; (iii) price and manage risk on insurance products; (iv) manage its investment portfolio; and (v) control its expenses. Specific drivers of its profitability include:

- its ability to design and distribute products and services that meet market needs and are delivered on a timely basis;

- its ability to manage AIA persistency. Maintaining a high level of AIA persistency is important to the AIA Group's financial results, as a large block of in-force policies provides it with recurring revenues in the form of renewal premiums. In addition, its ability to convert first year premiums into renewal premiums — thereby increasing the number of in-force policies — is an important factor affecting the AIA Group's financial condition and results of operations, as well as the long-term growth of its revenues and profitability;
- its ability to price its insurance products at a level that enables it to earn a margin over the cost of providing benefits and the expense of acquiring new policies and administering those products. The adequacy of the AIA Group's product pricing is, in turn, primarily a function of:
  - its mortality and morbidity experience on individual and group insurance;
  - the adequacy of its methodology for underwriting insurance policies and establishing reserves for future policyholder benefits and claims; and
  - the extent to which its actual expenses and investment performance meet assumptions;
  - its ability to actively manage its investment portfolio to earn an acceptable return while managing liquidity, credit and duration risks in its asset and policy portfolios through asset liability management; and
  - its ability to control expenses in order to maintain the target margins for its insurance products.

#### **4. Accounting policies**

##### **4.1 Critical accounting policies**

The preparation of historical financial information of the AIA Group requires selection of accounting policies and making estimates and assumptions that affect items reported in the consolidated income statement, consolidated statement of financial position, other primary statements and notes to the consolidated financial information. Critical accounting policies are considered to be those where a diverse range of accounting treatments is permitted by IFRS as adopted by the EU and significant judgements and estimates are required.

##### ***Product classification***

IFRS 4, *Insurance Contracts*, requires contracts written by insurers to be classified either as insurance contracts or investment contracts, depending on the level of insurance risk. Insurance contracts are those contracts that transfer significant insurance risk, while investment contracts are those contracts without significant insurance risk. Some insurance and investment contracts, referred to as participating business, have discretionary participation features, which may entitle the customer to receive, as a supplement to guaranteed benefits, additional non-guaranteed benefits, such as policyholder dividends or bonuses. The AIA Group applies the same accounting policies for the recognition and measurement of obligations arising from investment contracts with AIA discretionary participation features ("AIA DPF") as it does for insurance contracts.

Accordingly, the AIA Group performs a product classification exercise covering its portfolio of contracts to determine the classification of contracts to these categories. Product classification requires the exercise of significant judgement to determine whether there is a scenario (other than those lacking commercial substance) in which an insured event would require the AIA Group to pay significant additional benefits to its customers. In the event the AIA Group has to pay significant additional benefits to its customers, the contract is accounted for as an insurance contract. For investment contracts that do not contain AIA DPF, IAS 39, *Financial Instruments: Measurement and Recognition*, and, if the contract includes an investment management element, IAS 18, *Revenue Recognition*, are applied. IFRS 4 permits the continued use of previously applied accounting policies for insurance contracts and investment contracts with AIA DPF, and this basis has been adopted by the AIA Group in accounting for such contracts, except for participating business written in participating funds where in addition to policy liabilities a liability is recorded for the net assets of the participating fund.

The judgements exercised in determining the level of insurance risk deemed to be significant in product classification affect the amounts recognised in the consolidated financial information as insurance and investment contract liabilities and deferred acquisition and origination costs.

##### ***Insurance contract liabilities including liabilities in respect of investment contracts with AIA DPF***

IFRS 4 permits a wide range of accounting treatments to be adopted for the recognition and measurement of insurance contract liabilities, including liabilities in respect of insurance and investment contracts with DPF. The AIA Group calculates insurance contract liabilities for traditional life insurance using a net level premium valuation method, whereby the liability represents the present value of estimated future policy benefits to be paid, less the

present value of estimated future net premiums to be collected from policyholders. This method uses best estimate assumptions adjusted for a provision for the risk of adverse deviation for mortality, morbidity, expected investment yields, policyholder dividends (for other participating business), surrenders and expenses set at the policy inception date. These assumptions remain locked in thereafter, unless a deficiency arises on liability adequacy testing. Interest rate assumptions can vary by geographical market, year of issuance and product. Mortality, surrender and expense assumptions are based on actual experience by each geographical market, modified to allow for variations in policy form. The AIA Group exercises significant judgement in making appropriate assumptions.

For contracts with an explicit account balance, such as universal life and AIA investment-linked contracts, insurance contract liabilities represent the accumulation value, which represents premiums received and investment returns credited to the policy less deductions for mortality and morbidity costs and expense charges. Significant judgement is exercised in making appropriate estimates of gross profits, which are also regularly reviewed by the AIA Group.

Participating business, consisting of contracts with AIA DPF, is distinct from other insurance and investment contracts as the AIA Group has discretion as to either the amount or the timing of the benefits declared. In some geographical markets, participating business is written in a participating fund which is distinct from the other assets of the operating unit or branch. The allocation of benefits from the assets held in such participating funds is subject to minimum policyholder participation mechanisms which are established by applicable regulations. The extent of such policyholder participation may change over time.

The AIA Group accounts for insurance contract liabilities for participating business written in participating funds by establishing a liability for the present value of guaranteed benefits less estimated future net premiums to be collected from policyholders. In addition, an insurance liability is recorded for the net assets of participating funds. As such, income is recognised only when dividend or bonus declarations are made, to the extent that a portion of such declarations is attributable to the AIA Group. Establishing these liabilities requires the exercise of significant judgement. In addition, the assumption that all relevant performance is declared as a policyholder dividend may not be borne out in practice. The AIA Group accounts for other participating business by establishing a liability for the present value of guaranteed benefits and non-guaranteed participation, less estimated future net premiums to be collected from policyholders.

The judgements exercised in the valuation of insurance contract liabilities (including contracts with AIA DPF) affect the amounts recognised in the consolidated financial information as insurance contract benefits and insurance contract liabilities.

#### ***Deferred policy acquisition and origination costs***

The costs of acquiring new insurance contracts, including commission, underwriting and other policy issue expenses which vary with and are primarily related to the production of new business or renewal of existing business, are deferred as an asset. Deferred acquisition costs are assessed for recoverability in the year of policy issue to ensure that these costs are recoverable out of the estimated future margins to be earned on the policy. Deferred acquisition costs are assessed for recoverability at least annually thereafter. Future investment income is also taken into account in assessing recoverability. To the extent that acquisition costs are not considered to be recoverable at inception or thereafter, these costs are expensed in the consolidated income statement.

Deferred acquisition costs for traditional life insurance and annuity policies are amortised over the expected life of the contracts as a constant percentage of expected premiums. Expected premiums are estimated at the date of policy issue and are applied consistently throughout the life of the contract unless a deficiency occurs when performing liability adequacy testing.

Deferred acquisition costs for universal life and AIA investment-linked contracts are amortised over the expected life of the contracts on a constant percentage of the present value of estimated gross profits expected to be realised over the life of the contract or on a straight-line basis. Estimated gross profits include expected amounts for mortality, administration, investment and surrenders, less benefit claims in excess of policyholder balances, administrative expenses and interest credited. The interest rate used to compute the present value of estimates of expected gross profits is based on the AIA Group's estimate of the investment performance of the assets held to match these liabilities. Estimates of gross profits are revised regularly. Deviations of actual results from estimated experience are reflected in earnings. The expensing of acquisition costs is accelerated following adverse investment performance. Likewise, in periods of favourable investment performance, previously expensed acquisition costs are reversed, not exceeding the amount initially deferred.

The costs of acquiring investment contracts with investment management services, including commissions and other incremental expenses directly related to the issue of each new contract, are deferred and amortised over the

period that investment management services are provided. Such deferred origination costs are tested for recoverability at each reporting date. The costs of acquiring investment contracts without investment management services are included as part of the effective interest rate used to calculate the amortised cost of the related investment contract liabilities.

The judgements exercised in the deferral and amortisation of acquisition and origination costs affect amounts recognised in the consolidated financial information as deferred acquisition and origination costs and insurance and investment contract benefits.

### ***Liability adequacy testing***

The AIA Group evaluates the adequacy of its insurance and investment contract liabilities at least annually. Liability adequacy is assessed by portfolio of contracts in accordance with the AIA Group's manner of acquiring, servicing and measuring the profitability of its insurance contracts. The AIA Group performs liability adequacy testing separately for each geographical market in which it operates.

For traditional life insurance contracts, insurance contract liabilities, reduced by deferred acquisition costs and value of business acquired on acquired insurance contracts are compared with the gross premium valuation calculated on a best estimate basis, as of the valuation date. If there is a deficiency, the unamortised balance of deferred acquisition costs and value of business acquired on acquired insurance contracts are written down to the extent of the deficiency. If, after writing down deferred acquisition costs for the specific portfolio of contracts to nil, a deficiency still exists, the net liability is increased by the amount of the remaining deficiency.

For universal life and investment contracts, deferred acquisition costs, net of unearned revenue liabilities, are compared to estimated gross profits. If a deficiency exists, deferred acquisition costs are written down.

Significant judgement is exercised in determining the level of aggregation at which liability adequacy testing is performed and in selecting best estimate assumptions. The judgements exercised in liability adequacy testing affect amounts recognised in the consolidated financial information as commission and other acquisition expenses, deferred acquisition costs and insurance contract benefits and insurance and investment contract liabilities.

### ***Financial assets at fair value through profit or loss***

The AIA Group designates financial assets at fair value through profit or loss if this eliminates or reduces an accounting mismatch between the recognition and measurement of its assets and liabilities, or if the related assets and liabilities are actively managed on a fair value basis. This is the case for:

- financial assets held to back AIA investment-linked contracts and held by participating funds;
- financial assets managed on a fair value basis; and
- compound instruments containing an embedded derivative which would otherwise require bifurcation.

### ***Available-for-sale financial assets***

The available for sale category of financial assets is used where the relevant investments are not managed on a fair value basis. These assets principally consist of the AIA Group's holding of shares of AIG and the AIA Group's portfolio of debt securities (other than those backing participating fund liabilities and AIA investment-linked contracts). Available-for-sale financial assets are initially recognised at fair value plus attributable transaction costs and are subsequently measured at fair value. Changes in the fair value of available for sale securities, except for impairment losses and foreign exchange gains and losses on monetary items, are recorded in a separate fair value reserve within total equity, until such securities are disposed of.

The classification and designation of financial assets, either as at fair value through profit or loss, or as available-for-sale, determines whether movements in fair value are reflected in the consolidated income statement or in the consolidated statement of comprehensive income respectively.

### ***Fair values of financial assets***

The AIA Group determines the fair values of financial assets traded in active markets using quoted bid prices as of each reporting date. The fair values of financial assets that are not traded in active markets are typically determined using a variety of other valuation techniques, such as prices observed in recent transactions and values obtained from current bid prices of comparable investments. More judgment is used in measuring the fair value of financial assets for which market observable prices are not available or are available only infrequently.

Changes in fair value of financial assets held by the AIA Group's participating funds affect not only the value of financial assets, but are also reflected in corresponding movements in insurance and investment contract liabilities. This is due to an insurance liability being recorded for the net assets of the participating funds as described above. Both of the foregoing changes are reflected in the consolidated income statement.

Changes in the fair value of financial assets held to back AIA investment-linked contracts result in a corresponding change in insurance and investment contract liabilities. Both of the foregoing changes are also reflected in the consolidated income statement.

#### ***Impairment of financial assets***

Financial assets, other than those at fair value through profit or loss, are assessed for impairment regularly. This requires the exercise of significant judgement. A financial investment is impaired if its carrying value exceeds the estimated recoverable amount and there is objective evidence of impairment to the investment.

#### **4.2 Alignment of accounting policies with those of Prudential**

The IFRS basis information included in Parts XIV and XV of this prospectus for the Prudential Group and the AIA Group respectively have been prepared applying consistent IFRS accounting policies. These policies differ in three respects from those applied previously by the AIA Group. The effect of alignment for these policies on the movement in the AIA Group's total equity attributable to shareholders equity for the years to 30 November 2007, 2008 and 2009 are summarised in the table below.

#### **Summary reconciliation of AIA results on altering from AIA Group to Prudential accounting policies**

##### ***Effect of accounting policy adjustments reflected in Historical Financial Information***

	Adjustments for application of altered accounting policies to align with those of Prudential					Prudential basis
	AIA basis	Defined Benefit Pension schemes (note (a))	Investment property (note (b))	Participating funds (note (c))	Total effect of adjustments	
(in US\$ millions)						
<b>Shareholders' equity at 30 November 2006</b>	<b>12,542</b>	<b>(1)</b>	<b>424</b>	<b>(442)</b>	<b>(19)</b>	<b>12,523</b>
<b>2007 Profit before tax attributable to shareholders' profits</b>	<b>2,509</b>	<b>11</b>	<b>221</b>	<b>(13)</b>	<b>219</b>	<b>2,728</b>
Tax (expense) credit attributable to shareholders' profits	(581)	(3)	(6)	11	2	(579)
Non-controlling interests	(14)		(2)		(2)	(16)
Net profit attributable to shareholders of AIA Group Limited	1,914	8	213	(2)	219	2,133
Foreign currency translation reserve, fair value reserve and other movements accounted for directly in shareholders' equity	(1,016)	1	17	(42)	(24)	(1,040)
<b>Shareholders' equity at 30 November 2007</b>	<b>13,440</b>	<b>8</b>	<b>654</b>	<b>(486)</b>	<b>176</b>	<b>13,616</b>
<b>2008 Profit before tax attributable to shareholders' profits</b>	<b>58</b>	<b>(5)</b>	<b>(39)</b>	<b>118</b>	<b>74</b>	<b>132</b>
Tax (expense) credit attributable to shareholders' profits	355		4	(12)	(8)	347
Non-controlling interests	(5)		(1)		(1)	(6)
Net profit attributable to shareholders of AIA Group Limited	408	(5)	(36)	106	65	473
Foreign currency translation reserve, fair value reserve and other movements accounted for directly in shareholders' equity	(4,940)	(5)	(13)	45	27	(4,913)

	Adjustments for application of altered accounting policies to align with those of Prudential					Prudential basis
	AIA basis	Defined Benefit Pension schemes (note (a))	Investment property (note (b))	Participating funds (note (c))	Total effect of adjustments	
(in US\$ millions)						
<b>Shareholders' equity at 30 November 2008</b>	<b>8,908</b>	<b>(2)</b>	<b>605</b>	<b>(335)</b>	<b>268</b>	<b>9,176</b>
<i>2009 Profit before tax attributable to shareholders' profits</i>	<i>2,274</i>	<i>7</i>	<i>218</i>	<i>(56)</i>	<i>169</i>	<i>2,443</i>
Tax(expense) credit attributable to shareholders' profits	(517)	3	(5)	13	11	(506)
Non-controlling interests	(3)		(18)		(18)	(21)
Net profit attributable to shareholders of AIA Group Limited	1,754	10	195	(43)	162	1,916
Foreign currency translation reserve, fair value reserve and other movements accounted for directly in shareholders' equity	4,246	1	6	(93)	(86)	4,160
<b>Shareholders' equity at 30 November 2009</b>	<b>14,908</b>	<b>9</b>	<b>806</b>	<b>(471)</b>	<b>344</b>	<b>15,252</b>

#### Notes

- (a) Defined benefit pension schemes — The adjustment is to apply full recognition of the scheme financial position rather than 'corridor' accounting whereby actuarial gains and losses may not be recognised.
- (b) Investment property — The adjustment is to reflect fair value in the consolidated statement of financial position rather than depreciated cost.
- (c) Participating funds — The adjustment is to reflect the statutory transfer basis of profit recognition rather than the shareholders' share of pre-bonus income of the participating/with-profits funds. The unallocated surpluses representing the net assets of the funds are accounted for as liabilities rather than allocated between policyholders and shareholders using the ratio applicable for distribution of the costs of bonuses.

## 5. Key performance indicators

The AIA Group measures its performance using the key indicators set out in the table below. These key performance indicators have been presented on a consistent basis for the three years ended 30 November 2009.

	Year ended 30 November		
	2007	2008	2009
(in US\$ millions, except ratios)			
TWPI	11,358	12,203	11,632
Investment income <sup>(1)</sup>	2,706	3,144	3,059
Operating expenses <sup>(2)</sup>	962	1,089	981
Operating profit	1,742	1,943	1,835
Operating profit after tax attributable to shareholders of AIA	1,270	1,588	1,438
Net profit attributable to shareholders of AIA	<u>2,133</u>	<u>473</u>	<u>1,916</u>
Ratios <sup>(3)</sup> :			
Expense ratio	8.5%	8.9%	8.4%
AIA operating margin	15.3%	15.9%	15.8%
Operating return on allocated equity	13.6%	14.8%	11.6%
Net return on equity	16.3%	4.2%	15.7%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Definitions of key performance indicators are set forth in the section headed "Definitions of KPIs" below.

### Year ended 30 November 2009 compared with year ended 30 November 2008

TWPI was US\$11,632 million in FY 2009, a 4.7% decrease compared to FY 2008. This decrease was influenced by foreign currency movements; on a constant exchange rate basis, TWPI increased by 1.1% over the period. Renewal premiums represented 84.1% of TWPI in FY 2009 compared with 80.5% in FY 2008. Despite growth in most of the AIA Group's geographical markets, operating profit decreased 5.6% to US\$1,835 million in FY 2009 compared

with US\$1,943 million in FY 2008, due to the effects of the depreciation of most of the currencies in the Asia Pacific region, other than the Renminbi, against the US dollar. Of the geographical markets in which the AIA Group operates, the most significant impact of local currency depreciation was in Korea, where the average Korean Won exchange rate depreciated against the US dollar by 22.9% between FY 2008 and FY 2009, from 1,047.12 Korean Won to 1 US dollar in FY 2008 to 1,287.00 Korean Won to 1 US dollar in FY 2009. On a constant exchange rate basis, the decrease in operating profit was 0.2% over the period. Factors affecting the profitability of each of the geographical markets are discussed in greater detail in section 7 (Segmental information) below. The AIA Group's expense ratio decreased to 8.4% in FY 2009 compared with 8.9% in FY 2008 due to expense reduction from operational efficiency initiatives, notwithstanding further investments in strategic initiatives, such as broadening distribution capability, which increased by 148.0% from US\$25 million in FY 2008 to US\$62 million in FY 2009. AIA's operating margin was 15.8% in FY 2009, a slight decrease from 15.9% in FY 2008. Operating return on allocated equity declined to 11.6% in FY 2009 compared with 14.8% in FY 2008, primarily reflecting the growth of the AIA Group's capital base between FY 2008 and FY 2009, in the absence of significant dividends in FY 2009. Net profit attributable to shareholders of AIA increased by 305.1% to US\$1,916 million in FY 2009 compared with US\$473 million in FY 2008, driven in part by the increase in non-operating investment return to a net positive of US\$665 million in FY 2009 compared with a net negative of US\$2,412 million in FY 2008. The increase in non-operating investment return in FY 2009 compared with FY 2008 contributed to a significant improvement in the AIA Group's net profit and its net return on equity, which increased to 15.7% in FY 2009 compared with 4.2% in FY 2008. The AIA Group's withdrawal from securities lending was largely completed by November 2009. Excluding securities lending, the AIA Group recorded non-operating investment return of a net positive US\$802 million in FY 2009, compared with a net negative of US\$2,325 million in FY 2008. Similarly, excluding the effects of securities lending, operating profit was US\$1,851 million in FY 2009 and US\$1,949 million in FY 2008, and the corresponding net profit attributable to shareholders of AIA was US\$2,069 million and US\$566 million respectively in FY 2009 and FY 2008.

#### ***Year ended 30 November 2008 compared with year ended 30 November 2007***

The aggregate increase in TWPI was 7.4% in FY 2008 from FY 2007. The biggest contributor to the AIA Group's TWPI was renewal premiums, representing 80.5% of TWPI in FY 2008, compared with 78.1% in FY 2007. Operating profit increased by 11.5% to US\$1,943 million in FY 2008 from US\$1,742 million in FY 2007, primarily due to an increase in renewal premiums and increased investment income, which collectively grew at a faster rate than the AIA Group's expense base, as well as the beneficial effect of a reinsurance recapture described below. The expense ratio increased to 8.9% in FY 2008 compared with 8.5% in FY 2007 principally due to the effect of recapturing a portfolio of business previously reinsured to another company in the AIG Group and costs associated with strategic initiatives in certain geographical markets primarily associated with expanding the AIA Group's multi-channel distribution capability. The recapture was effective from 1 March 2008 and increased the AIA Group's operating expense ratio related to such business. Overall, the recapture was beneficial to the AIA Group in generating non-operating income in FY 2008 of US\$447 million. Following the AIG Events and the significant declines in the global capital markets during the fourth quarter of FY 2008, the AIA Group experienced a significant increase in policy surrenders in certain of its geographical markets. This generated surrender fee income which more than offset the acceleration of DAC amortisation relating to these surrendered policies. Net profit attributable to shareholders of AIA decreased 77.8% to US\$473 million in FY 2008 from US\$2,133 million in FY 2007. This decrease was principally a result of the adverse non-operating investment return of US\$2,412 million caused by declines in market values compared with a net gain of US\$837 million in FY 2007, partially offset by the increase in operating profit, a US\$447 million gain arising on the reinsurance recapture, and the release of a withholding tax provision of US\$275 million on the clarification of a tax treaty. As discussed above, the AIA Group's withdrawal from securities lending was largely completed by November 2009. Excluding securities lending, the AIA Group recorded non-operating investment return of a net negative US\$2,325 million in FY 2008, compared with a net positive of US\$837 million in FY 2007. Similarly, excluding the effects of securities lending, operating profit was US\$1,949 million in FY 2008 and US\$1,742 million in FY 2007, and the corresponding net profit attributable to shareholders of AIA was US\$566 million and US\$2,133 million respectively in FY 2008 and FY 2007.

#### ***Definition of KPIs***

TWPI provides an indicative volume measure of transactions undertaken in the reporting period that have the potential to generate profits for shareholders. TWPI consists of 100% of renewal premiums, 100% of first year premiums and 10% of single premiums (referred to as weighted single premiums) across all lines of business and includes deposits and contributions for contracts that are accounted for as deposits in accordance with the AIA Group's accounting policies. The AIA Group applies a factor of 10% to single premiums because such weighting makes the value of a single premium sale broadly equivalent to the same dollar amount of first year premiums. As

such, it provides an indication of longer-term business volumes by taking into account changes in the mix of regular and single premium business.

Investment income (excluding investment income related to AIA investment-linked contracts) is one of the key drivers of the AIA Group's profitability, and affects to a significant extent its ability to meet its obligations under its policies and offer attractive returns to its policyholders and shareholders. Investment income has been presented excluding investment income related to AIA investment-linked contracts as investment income from these contracts is not attributable to its shareholders. Investment income includes interest, dividend and rental income.

Operating expenses is used as a key measure at the group level and in each geographical market to monitor and manage operational efficiency, which is one of the critical factors driving the AIA Group's profitability.

Operating profit measures the AIA Group's ability to generate earnings from its operations before tax expense, and is a key measure of the underlying profitability of its operations.

Operating profit after tax attributable to shareholders of AIA measures its ability to generate earnings from its operations for the shareholders of AIA, after tax expense and deducting non-controlling interests.

Net profit attributable to shareholders of AIA, consisting of profit for the year after tax, measures profitability, including non-operating items.

Expense ratio measures the AIA Group's ability to manage its cost base as it grows its business. Expense ratio represents operating expenses as a percentage of TWPI.

AIA operating margin measures the operating profitability of the AIA Group's business relative to the volume of the business it generates. AIA operating margin is calculated as operating profit as a percentage of TWPI.

Operating return on allocated equity measures the efficiency of use of capital in operations. Operating return on allocated equity is calculated as operating profit after tax attributable to shareholders of AIA, expressed as a simple average of opening and closing total equity attributable to shareholders of AIA, less the fair value and foreign currency translation reserves, and adjusted for subordinated intercompany debt. Both AIA operating margin and operating return on allocated equity are influenced to an extent by the level of surplus capital retained at each operating unit and on a group-wide basis as any such surplus capital retained may earn investment returns.

Net return on equity measures AIA's ability to generate returns for its shareholders. Net return on equity is calculated as net profit attributable to shareholders of AIA as a percentage of average total equity attributable to shareholders of AIA, which is a simple average of the opening and closing balances.

## **6. Results of operations**

The table below provides a summary of the results of operations for the AIA Group presented on a consistent basis for the three years ended 30 November 2007, 2008 and 2009. Certain financial information related to AIA Group is presented on a constant exchange rate basis to facilitate a comparison of year-on-year performance without the impact of movements in the functional currencies of its operating units against the US dollar and, where applicable, this is explicitly stated.

*Selected results of operations*

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
<b>TWPI</b> .....	<b><u>11,358</u></b>	<b><u>12,203</u></b>	<b><u>11,632</u></b>
Net premiums, fee income and other operating revenue (net of reinsurance ceded) .....	8,817	10,361	10,173
Investment income <sup>(1)</sup> .....	2,706	3,144	3,059
<b>Total revenue<sup>(1)</sup></b> .....	<b><u>11,523</u></b>	<b><u>13,505</u></b>	<b><u>13,232</u></b>
Net insurance and investment contract benefits <sup>(2)</sup> .....	7,586	8,630	8,624
Commission and other acquisition expenses .....	947	1,563	1,648
Operating expenses <sup>(3)</sup> .....	962	1,089	981
Investment management expenses and finance costs <sup>(4)</sup> .....	286	252	123
<b>Total expenses<sup>(2)(3)(4)</sup></b> .....	<b><u>9,781</u></b>	<b><u>11,534</u></b>	<b><u>11,376</u></b>
Share of loss from associates and joint ventures .....	—	(28)	(21)
<b>Operating profit</b> .....	<b><u>1,742</u></b>	<b><u>1,943</u></b>	<b><u>1,835</u></b>
Tax on operating profit .....	(461)	(348)	(392)
Sub-total .....	1,281	1,595	1,443
Less: amounts attributable to non-controlling interests .....	(11)	(7)	(5)
<b>Operating profit after tax attributable to shareholders of AIA</b> .....	<b><u>1,270</u></b>	<b><u>1,588</u></b>	<b><u>1,438</u></b>
Operating profit may be reconciled to net profit as follows:			
<b>Operating profit</b> .....	<b>1,742</b>	<b>1,943</b>	<b>1,835</b>
Add: non-operating investment return <sup>(5)</sup> .....	837	(2,412)	665
Add: non-operating item — gain on recapture of reinsurance from former parent company .....	—	447	—
Add: non-operating item — restructuring and separation costs .....	—	(10)	(89)
Add: non-operating items — other <sup>(5)</sup> .....	219	74	169
<b>Profit before tax</b> .....	<b><u>2,798</u></b>	<b><u>42</u></b>	<b><u>2,580</u></b>
Tax on operating profit .....	(461)	(348)	(392)
Add: tax on non-operating items .....	(190)	518	(262)
Add: other non-operating tax items .....	2	267	11
<b>Tax (expense)/credit</b> .....	<b><u>(649)</u></b>	<b><u>437</u></b>	<b><u>(643)</u></b>
Sub-total .....	2,149	479	1,937
Less: amounts attributable to non-controlling interests .....	(16)	(6)	(21)
<b>Net profit attributable to shareholders of AIA</b> .....	<b><u>2,133</u></b>	<b><u>473</u></b>	<b><u>1,916</u></b>

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Includes corresponding changes in insurance and investment contract liabilities from participating funds investment income (the amount that would be attributable to policyholders assuming all investment income were to be declared as a dividend based upon local regulations) and excludes (i) other changes in insurance and investment contract liabilities from participating fund investment income and (ii) changes in insurance and investment contract liabilities from participating fund AIA investment experience and (iii) corresponding changes in investment income and AIA investment experience related to AIA investment-linked contract.

(3) Excluding non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(4) Excludes investment management expenses related to AIA investment-linked contracts.

(5) Details of non-operating investment return and other non operating items — other, are set out in Part XV, note 5.

*Selected balance sheet information*

	As of 30 November		
	2007	2008	2009
	(in US\$ millions)		
<b>Assets</b>			
Deferred acquisition and origination costs . . . . .	10,044	10,047	10,976
Financial investments . . . . .	70,630	55,324	73,480
Assets — other than the above . . . . .	<u>8,241</u>	<u>7,307</u>	<u>7,089</u>
<b>Total assets</b> . . . . .	<b><u>88,915</u></b>	<b><u>72,678</u></b>	<b><u>91,545</u></b>
<b>Liabilities</b>			
Insurance and investment contract liabilities . . . . .	64,240	57,462	71,583
Borrowings . . . . .	1,461	661	688
Obligations under securities lending and repurchase agreements . . . . .	5,395	2,718	284
Liabilities — other than the above . . . . .	<u>4,142</u>	<u>2,641</u>	<u>3,658</u>
<b>Total liabilities</b> . . . . .	<b><u>75,238</u></b>	<b><u>63,482</u></b>	<b><u>76,213</u></b>
<b>Equity</b>			
Issued share capital and shares yet to be issued, share premium and other reserves . . . . .	699	1,434	1,848
Retained earnings . . . . .	<u>9,632</u>	<u>9,760</u>	<u>11,651</u>
<b>Allocated equity</b> . . . . .	<b><u>10,331</u></b>	<b><u>11,194</u></b>	<b><u>13,499</u></b>
Amounts reflected in other comprehensive income . . . . .	<u>3,285</u>	<u>(2,018)</u>	<u>1,753</u>
<b>Total equity attributable to shareholders of AIA</b> . . . . .	<b><u>13,616</u></b>	<b><u>9,176</u></b>	<b><u>15,252</u></b>
Non-controlling interests . . . . .	<u>61</u>	<u>20</u>	<u>80</u>
<b>Total equity</b> . . . . .	<b><u>13,677</u></b>	<b><u>9,196</u></b>	<b><u>15,332</u></b>
<b>Total liabilities and equity</b> . . . . .	<b><u>88,915</u></b>	<b><u>72,678</u></b>	<b><u>91,545</u></b>

*Year ended 30 November 2009 compared with year ended 30 November 2008*

*Discussion of selected results of operations*

**TWPI**

The table below analyses TWPI by premium type and by product line for the periods indicated.

	Year ended 30 November 2008			
	Renewal premium	First year premium	Weighted single premium	TWPI
	(in US\$ millions)			
TWPI includes:				
Ordinary individual life insurance . . . . .	6,651	762	27	7,439
AIA investment-linked insurance products . . . . .	1,526	831	175	2,532
Standalone health and protection . . . . .	1,077	348	1	1,426
Group . . . . .	530	165	9	704
Other . . . . .	<u>43</u>	<u>14</u>	<u>45</u>	<u>102</u>
<b>Total</b> . . . . .	<b><u>9,827</u></b>	<b><u>2,119</u></b>	<b><u>257</u></b>	<b><u>12,203</u></b>
	Year ended 30 November 2009			
	Renewal premium	First year premium	Weighted single premium	TWPI
	(in US\$ millions)			
TWPI includes:				
Ordinary individual life insurance . . . . .	6,342	884	59	7,285
AIA investment-linked insurance products . . . . .	1,741	295	33	2,069
Standalone health and protection . . . . .	1,089	261	1	1,349
Group . . . . .	573	293	10	877
Other . . . . .	<u>34</u>	<u>11</u>	<u>7</u>	<u>52</u>
<b>Total</b> . . . . .	<b><u>9,779</u></b>	<b><u>1,744</u></b>	<b><u>109</u></b>	<b><u>11,632</u></b>

The 4.7% decrease in TWPI between FY 2009 and 2008 was influenced by foreign currency movements. On a constant exchange rate basis, TWPI increased 1.1% over the period led by a 5.0% increase in renewal premiums. Renewal premiums contributed 84.1% to the AIA Group's TWPI in FY 2009, up from 80.5% in FY 2008.

The trend in TWPI was also impacted by the fall in first year premiums of US\$375 million, or 17.8% (10.3% on a constant exchange rate basis). New business activity recovered in the second half of FY 2009, with first year premiums and weighted single premiums growing at 33.5% and 93.5%, respectively, between the first and second halves of FY 2009. Most of the AIA Group's geographical markets experienced this improvement in first year premiums across most lines of business in the second half of FY 2009, with Hong Kong and Thailand leading with higher sales of ordinary individual life insurance.

Premiums associated with ordinary individual life insurance, including health and protection riders where applicable, decreased 2.1% to US\$7,285 million in FY 2009 from US\$7,439 million in FY 2008. On a constant exchange rate basis, TWPI for ordinary individual life increased 2.6%, led by strong growth in first year premiums and single premiums of 23.0% and 125.3%, respectively, in FY 2009. The growth in first year premiums was particularly evident in Hong Kong (growth of US\$136 million or 142.0%), Thailand (growth of US\$31 million or 11.7%, on a constant exchange rate basis) and China (growth of US\$24 million or 31.1%, on a constant exchange rate basis). The growth in weighted single premiums was led by Singapore (US\$12 million or 126.6%, on a constant exchange rate basis), China (US\$12 million or 1,050.2%, on a constant exchange rate basis) and Hong Kong (US\$10 million or 2,332.0%). These positive trends were muted by a decline in Korea, where renewal premiums fell by US\$24 million or 3.9%, on a constant exchange rate basis, and Other Markets, by a decline of US\$17 million or 3.2%, on a constant exchange rate basis. Overall, ordinary individual life assurance accounted for 62.6% of TWPI in FY 2009, as compared to 61.0% in FY 2008, as the AIA Group focused on providing protection-based products to its customers, given the recent economic uncertainties.

AIA investment-linked products TWPI decreased 18.3% to US\$2,069 million in FY 2009 from US\$2,532 million in FY 2008. Despite a 13.2% decrease on a constant exchange rate basis, most Key Markets experienced increases in renewal premiums for AIA investment-linked products. This trend was consistent with FY 2008 which also saw growth in renewal premiums. This was offset by a fall in first year premiums for AIA investment-linked products led by Korea (decrease of US\$169 million or 59.0%, on a constant exchange rate basis), Hong Kong (decrease of US\$183 million or 64.3%) and Other Markets (decrease of US\$72 million or 62.9%, on a constant exchange rate basis). With improving economic conditions at the end of 2009, the AIA Group experienced an increase in sales of AIA investment-linked products in the second half of FY 2009.

Standalone health and protection insurance premiums decreased 5.4% to US\$1,349 million in FY 2009 from US\$1,426 million in FY 2008, but increased 6.4% on a constant exchange rate basis. The AIA Group experienced a decrease in first year premiums of 25.4%, or 15.9% on a constant exchange rate basis, mainly attributable to its Korean operations, the results of which were adversely affected in the first half of 2009 by their association with the AIG brand, prior to re-branding as AIA Life Korea in May 2009, as well as by the effects of the depreciation of the Korean Won. Despite this, the AIA Group's renewal premiums grew 1.1% (or 13.6% on a constant exchange rate basis) from US\$1,077 million in FY 2008, to US\$1,089 million in FY 2009, growing on a constant exchange rate basis in all reporting segments. On a constant exchange rate basis, this growth was led by Korea at US\$73 million or 15.3%, Other Markets at US\$18 million or 21.3%, China at US\$16 million or 14.9% and Hong Kong at US\$11 million or 9.2%.

Group insurance premiums continued an upward trend from FY 2008, increasing by 24.5% to US\$877 million in FY 2009 from US\$704 million in FY 2008. On a constant exchange rate basis, the increase was 31.9%. China and Other Markets were the main contributors to this increase, growing at 52.6% and 59.6% on an actual exchange rate basis, respectively, between FY 2008 and 2009. The AIA Group's operations in Australia, part of the Other Markets segment, continued to experience strong growth in group products, with TWPI for this product line increasing 69.6% year-on-year. Australia represented 45.3% of total TWPI with respect to group premiums in FY 2009 as compared to 33.2% in FY 2008, due mainly to the acquisition of a number of large new corporate accounts during FY 2009.

Other product lines, which include annuities and personal lines, collectively decreased to US\$52 million in FY 2009 compared to US\$102 million in FY 2008 largely due to the effects of foreign exchange and a decrease in Korean annuities business during FY 2009.

### *Net premiums, fee income and other revenues*

	Year ended 30 November	
	2008	2009
	(in US\$ millions)	
Net premiums . . . . .	9,425	9,275
Fee income . . . . .	857	827
Other revenues . . . . .	79	71
<b>Total</b> . . . . .	<b>10,361</b>	<b>10,173</b>

Net premiums, fee income and other revenues, which are stated net of reinsurance ceded, decreased 1.8% to US\$10,173 million in FY 2009 from US\$10,361 million in FY 2008. The decrease was primarily due to the effect of the depreciation of most of the currencies in the Asia Pacific region, other than Renminbi, against the US dollar. On a constant exchange rate basis, net premiums, fee income and other revenues increased 4.0%, consistent with a 5.0% increase on a constant exchange rate basis in renewal premiums, which represent a substantial portion of the AIA Group's premium income.

Premiums ceded to reinsurers amounted to US\$331 million in FY 2009 compared with US\$392 million in FY 2008. This primarily reflects a reduction in amounts ceded to reinsurers by the Hong Kong segment as the reinsurance recapture took place at the start of the second quarter of FY 2008 (so the AIA Group ceded such premiums for one quarter of FY 2008), partially offset by an increase in amounts ceded to reinsurers by the Other Markets segment, reflecting the growth in the Group business product line in FY 2009.

Fee income decreased 3.5% to US\$827 million in FY 2009 from US\$857 million in FY 2008 in line with lower sales of AIA investment-linked products during FY 2009 whilst annual management charges increased, reflecting the growth in assets under management during FY 2009. Other revenues, which mainly comprise asset management fees on pension business, remained relatively stable during the period.

### *Investment income*

	Year ended 30 November	
	2008	2009
	(in US\$ millions)	
<b>Investment income<sup>(1)</sup></b>		
Interest income . . . . .	2,900	2,870
Dividend income . . . . .	181	122
Rental income . . . . .	63	67
<b>Total</b> . . . . .	<b>3,144</b>	<b>3,059</b>

(1) Excludes investment income related to AIA investment-linked contracts.

Investment income, consisting of interest, dividends and rental income, excluding investment income related to AIA investment-linked contracts, decreased marginally to US\$3,059 million in FY 2009 from US\$3,144 million in FY 2008. A significant proportion of the AIA Group's assets are invested in fixed income government securities and investment grade corporate bonds.

Interest income fell to US\$2,870 million in FY 2009 from US\$2,900 million in FY 2008 mainly due to a reduction in interest income from securities lending to US\$23 million in FY 2009 from US\$102 million in FY 2008. The AIA Group's withdrawal from securities lending was largely completed during the year.

Dividend income decreased to US\$122 million in FY 2009 from US\$181 million in FY 2008 due to lower yields from the AIA Group's equity portfolio primarily due to a reduction in dividends in response to challenging economic conditions in FY 2009.

*Net insurance and investment contract benefits*

	<u>Year ended 30 November</u>	
	<u>2008</u>	<u>2009</u>
	(in US\$ millions)	
<b>Net insurance and investment contract benefits<sup>(1)</sup></b>		
Insurance contract benefits . . . . .	5,402	5,375
Net change in insurance and investment contract liabilities . . . . .	<u>3,476</u>	<u>3,500</u>
Insurance and investment contract benefits . . . . .	8,878	8,875
Insurance and investment contract benefits ceded . . . . .	<u>(248)</u>	<u>(251)</u>
<b>Total . . . . .</b>	<b><u>8,630</u></b>	<b><u>8,624</u></b>

(1) Includes corresponding changes in insurance and investment contract liabilities from participating funds investment income (the amount that would be attributable to policyholders assuming all investment income were to be declared as a dividend based upon local regulations) and excludes (i) other changes in insurance and investment contract liabilities from participating fund investment income and (ii) changes in insurance and investment contract liabilities from participating fund AIA investment experience and (iii) corresponding changes in investment income and AIA investment experience related to AIA investment-linked contract.

Net insurance and investment contract benefits (on a basis consistent with the table above) reflect the cost of all maturities, surrenders, withdrawals and claims arising during the reporting period and the net movement in the associated liabilities as a result of new business, benefit payments and changes to expected future benefits payable to policyholders, excluding AIA investment-linked contracts and participating funds.

The investment risk in respect of investments held to back AIA investment-linked contracts is wholly borne by policyholders. This means that any increase or decrease in the value of investments held to back such contracts is matched by the same movement in insurance and investment contract benefits and there is no impact on the AIA Group’s results, except as regards the asset management and other fees earned by the AIA Group which are based on the account balance of these contracts.

Because benefits related to AIA investment-linked contracts are based on the investment return on the invested assets underlying such contracts, including them in the presentation of net insurance and investment contract benefits would subject the AIA Group’s financial results to significant fluctuations due to market volatility, such as in FY 2008, which may adversely affect an investor’s ability to easily compare its period-to-period operating results. For these reasons the AIA Group chooses to present net insurance and investment contract benefits (excluding AIA investment-linked contracts) as this is consistent with the basis on which it measures operating profit. Net insurance and investment contract benefits, including AIA investment-linked contracts and participating funds, were US\$10,397 million, US\$1,109 million and US\$13,629 million in FY 2007, FY 2008 and FY 2009, respectively.

Net insurance and investment contract benefits, excluding corresponding changes in insurance and investment contract liabilities from AIA investment experience for AIA investment-linked contracts and participating funds and investment income related to AIA investment-linked contracts, were largely stable between FY 2009 and 2008. The increase in surrender activity that the AIA Group saw in the fourth quarter of FY 2008 abated in most geographical markets during FY 2009. For further details, please see “Significant events affecting FY 2009” below.

*Commission and other acquisition expenses*

	<u>Year ended 30 November</u>	
	<u>2008</u>	<u>2009</u>
	(in US\$ millions)	
<b>Commission and other acquisition expenses</b>		
Commission and other acquisition expenses incurred . . . . .	2,269	1,855
Deferral and amortisation of acquisition costs . . . . .	<u>(706)</u>	<u>(207)</u>
<b>Total . . . . .</b>	<b><u>1,563</u></b>	<b><u>1,648</u></b>

Commission and other acquisition expenses incurred decreased due to weaker sales activity in the first half of 2009, resulting in an overall decrease to US\$1,855 million in FY 2009 from US\$2,269 million in FY 2008.

Deferral and amortisation of acquisition costs fell to US\$207 million in FY 2009 from US\$706 million in FY 2008. This decrease was attributable to the beneficial effects of lower amortisation of DAC and deferred origination costs, principally in Hong Kong, Singapore and Malaysia, due to an increase in assets under management in FY 2009.

This decrease was partially offset by a revision of AIA persistency assumptions in respect of investment-linked and variable universal life policies in Korea of approximately US\$90 million where the AIA Group experienced higher than anticipated surrenders and premium holidays in FY 2009.

### *Operating expenses*

	<u>Year ended 30 November</u>	
	<u>2008</u>	<u>2009</u>
	(in US\$ millions)	
<b>Operating expenses</b>		
Operating expenses excluding strategic initiative expenses . . . . .	1,069	913
Strategic initiative expenses . . . . .	<u>25</u>	<u>62</u>
<b>Total</b> . . . . .	<b><u>1,094</u></b>	<b><u>975</u></b>

Operating expenses excluding strategic initiative expenses decreased 14.6% to US\$913 million in FY 2009 from US\$1,069 million in FY 2008 primarily due to active control of day-to-day operational expenses, reductions based on operational efficiency initiatives undertaken in FY 2008 and the beneficial effects of foreign exchange. In addition, the AIA Group's operating expenses in FY 2008 included certain period-specific items, which are discussed in greater detail for each segment at paragraph 7 below.

Strategic initiative expenses, which consist of expenses relating to enhancing the AIA Group's growth initiatives, such as distribution capability and operational efficiency and other initiatives administered by the AIA Group's Strategic Initiative Office, increased 148.0% between FY 2008 and FY 2009, and represented 6.4% of total operating expenses in FY 2009 compared with 2.3% in FY 2008.

### *Investment management expenses and finance costs*

	<u>Year ended 30 November</u>	
	<u>2008</u>	<u>2009</u>
	(in US\$ millions)	
<b>Investment management expenses and finance costs<sup>(1)</sup>:</b>		
Investment management expenses . . . . .	93	73
Finance costs . . . . .	<u>159</u>	<u>50</u>
<b>Total</b> . . . . .	<b><u>252</u></b>	<b><u>123</u></b>

(1) Excludes investment management expenses related to AIA investment-linked contracts.

Investment management expenses and finance costs decreased significantly to US\$73 million and US\$50 million, respectively, in FY 2009 from US\$93 million and US\$159 million, respectively, in FY 2008, primarily resulting from the withdrawal from securities lending which was largely completed during FY 2009, lower finance costs due to a reduction in interest rates in relation to a term loan financing the group office in Hong Kong and a reduction in operational borrowings. Finance costs in respect of securities lending decreased to US\$39 million in FY 2009 from US\$109 million in FY 2008.

### *Operating profit*

Operating profit fell 5.6% to US\$1,835 million in FY 2009 compared with US\$1,943 million in FY 2008, despite an improvement in operating profit in local currency terms in most of the reporting segments. This decrease was mainly due to the effects of depreciation in average local currency to US dollar exchange rates, in particular the depreciation of the Korean Won. On a constant exchange rate basis, operating profit decreased 0.2% over the period.

Operating profit was adversely affected by weaker performance of the AIA Group's operations in Korea and Thailand, which reported operating profit of US\$81 million and US\$358 million, respectively, in FY 2009 compared with US\$281 million and US\$424 million, respectively, in FY 2008. Factors affecting the profitability of the Korean and Thailand operations are discussed in greater detail in section 7 below.

Excluding securities lending from which the AIA Group largely withdrew in FY 2009, operating profit was US\$1,851 million in FY 2009, compared with US\$1,949 million in FY 2008.

### *Tax on operating profit*

The AIA Group operates in 15 principal jurisdictions, each with its own tax regime, and the change in the tax expense (or credit) from one year to the next is affected by changes in the mix of income by jurisdiction. The tax expense on operating profit in FY 2009 was largely in line with the prior financial year, excluding the impact of tax changes, as the tax charge for FY 2008 reflected the benefit of a US\$41 million tax credit arising from changes in tax laws in Malaysia and Korea.

### *Profit before tax*

Profit before tax increased significantly to US\$2,580 million in FY 2009 compared with US\$42 million in FY 2008, mainly reflecting stable operating profit and the recovery in equity markets which led to a strongly positive non-operating investment return.

Non-operating investment return improved to a net positive of US\$665 million in FY 2009 from a net negative of US\$2,412 million in FY 2008. The main contributor to the improvement in non-operating investment return was net fair value gains of US\$533 million on Thai equity securities.

The improvement in profit before tax was also attributable to lower impairment losses in respect of available-for-sale debt securities of US\$67 million in FY 2009, compared with US\$142 million in FY 2008.

### *Income tax*

	<u>Year ended 30 November</u>	
	<u>2008</u>	<u>2009</u>
	(in US\$ millions)	
Current income tax . . . . .	401	321
Deferred income tax		
Temporary differences . . . . .	(563)	322
Release of withholding tax provision . . . . .	<u>(275)</u>	<u>—</u>
<b>Tax (credit)/expense . . . . .</b>	<b><u>(437)</u></b>	<b><u>643</u></b>
Of which:		
Tax (credit)/expense attributable to policyholders' returns . . . . .	(90)	137
Tax (credit)/expense attributable to shareholders' profits . . . . .	<u>(347)</u>	<u>506</u>
	<u>(437)</u>	<u>643</u>

The AIA Group's tax expense may be analysed in two components: the tax charged on shareholders' profits of US\$506 million in 2009 compared with a tax credit of US\$347 million in FY 2008, and the tax that the AIA Group bears on behalf of its participating policyholders of US\$137 million in FY 2009 compared with a tax credit of US\$90 million in FY 2008. The tax charged on shareholders' profits plus the tax expense attributable to policyholders' returns total to a tax expense of US\$643 million in FY 2009, as compared with a tax credit of US\$437 million in FY 2008.

The tax on shareholders' profits for FY 2009 reflected factors affecting the tax charge on operating profit discussed above whereas the tax credit in FY 2008 included the effects of a release of a provision for withholding tax of US\$275 million. Tax attributable to policyholders' returns reflects gains and losses arising in participating funds, and so does not directly relate to net profit. The tax expense on operating profit may be reconciled to the tax expense for the year by adding the tax on non-operating items, primarily non-operating investment return and non-operating expense and other items, and the release of the provision for withholding tax in FY 2008.

### *Net profit attributable to shareholders of AIA*

Net profit attributable to shareholders of AIA increased by 305.1% to US\$1,916 million in FY 2009 as compared with US\$473 million in FY 2008. This increase largely reflected the after-tax effect of a significant improvement in non-operating investment return of positive US\$403 million in FY 2009 compared to a loss after tax of US\$1,894 million in FY 2008. Included in net profit attributable to shareholders of AIA is US\$89 million of non-operating restructuring and separation costs in FY 2009, compared with US\$10 million in FY 2008.

Excluding securities lending, from which the AIA Group largely withdrew in FY 2009, and restructuring and separation expenses, net profit attributable to shareholders of AIA was US\$2,158 million in FY 2009, as compared with US\$576 million in FY 2008.

### ***Significant events affecting FY 2009***

During FY 2009, the AIA Group largely withdrew from securities lending. The AIA Group earned interest income and fees from securities lending of US\$23 million, and in addition it incurred finance costs consisting of interest expense on its related obligations of US\$39 million and recorded net realised losses on disposal of US\$137 million, in FY 2009. During FY 2008, the AIA Group earned interest income and fees of US\$102 million and incurred finance costs of US\$109 million, with realised losses of US\$87 million, including impairment losses of US\$52 million. In FY 2007, it earned interest income and fees from securities lending of US\$145 million and incurred finance costs of US\$143 million. The lower interest income and finance costs in FY 2009 reflected the gradual winding-down of the securities lending during the year. As of 30 November 2009, the AIA Group had largely ceased all securities lending and had repaid all obligations under agreements related to securities lending, whereas as of 30 November 2008, it held financial investments with a carrying value of US\$1,480 million and cash of US\$160 million in connection with securities lending and had obligations under securities lending of US\$1,963 million. The balance of US\$284 million as of 30 November 2009 shown in the line item "Obligations under securities lending and repurchase agreements" is entirely in respect of the AIA Group's outstanding repurchase agreements. The cumulative effect of its securities lending was a loss of US\$153 million in FY 2009 and a loss of US\$93 million in FY 2008, giving a cumulative loss of US\$246 million during the track record period. Excluding securities lending, the AIA Group's operating profit was US\$1,851 million in FY 2009 and US\$1,949 million in FY 2008, and its net profit attributable to shareholders of AIA was US\$2,069 million in FY 2009 and US\$566 million in FY 2008.

During the fourth quarter of FY 2008, the AIA Group experienced a significant increase in surrender activity following the AIG Events, while the month-on-month AIA persistency, measuring the proportion of customers who continue to pay their premiums, declined significantly, recovering moderately to 89.3% in November 2008, compared with 93.9% at the start of FY 2008. Surrenders peaked at over US\$250 million in September 2008. AIA persistency has since recovered during FY 2009, reaching 95.1%, above the level at the start of FY 2008, with surrenders of less than US\$75 million in both October and November 2009. New business activity has also increased significantly in the second half of FY 2009.

During FY 2009, the AIA Group entered into a strategic exclusive bancassurance joint venture in the Philippines with BPI, in which Philamlife acquired a 51% interest in Ayala Life, the life insurance subsidiary of BPI, and entered into a bancassurance distribution agreement with BPI. The total consideration payable by Philamlife was US\$39 million. This amount is subject to purchase price adjustment, estimated to be US\$7 million, based on the adjusted net worth as at the date of acquisition. As the acquisition took place immediately before the end of the AIA Group's financial year, there was no impact on the results of operations in FY 2009.

In October 2009, the AIA Group sold its 60% interest in PT Asuransi AIA Indonesia, its joint venture operation in Indonesia, for US\$65 million, giving rise to a loss on disposal of US\$29 million before tax. The AIA Group continues to operate in Indonesia through its wholly-owned subsidiary, PT AIA Financial. These transactions are discussed in section 7.7 below.

### ***Discussion of selected balance sheet information***

#### ***Assets***

The AIA Group's total assets grew 26.0% to US\$91,545 million as of 30 November 2009 from US\$72,678 million as of 30 November 2008, primarily reflecting a recovery in the market values of its financial investments, the majority of which are carried at fair value.

The table below sets forth the AIA Group's financial investments by asset class based on how they are accounted for as of the dates indicated.

	As of 30 November							
	2008			2009				
	Policyholder and shareholder	Investment-linked	Total	Policyholder and shareholder	Investment-linked	Total		
	Other policyholder and shareholder	Participating funds		Other policyholder and shareholder	Participating funds			
(in US\$ millions)								
<b>Financial investments includes:</b>								
<b>Debt securities</b>								
Available for sale . . . . .	29,934	—	—	29,934	37,722	—	—	37,722
At fair value through profit or loss . . . . .	852	10,070	1,467	12,389	944	11,809	1,726	14,479
<b>Total debt securities . . . . .</b>	<b>30,786</b>	<b>10,070</b>	<b>1,467</b>	<b>42,323</b>	<b>38,666</b>	<b>11,809</b>	<b>1,726</b>	<b>52,201</b>
<b>Equity securities</b>								
Available for sale . . . . .	87	—	—	87	62	—	—	62
At fair value through profit or loss . . . . .	1,855	1,123	5,682	8,660	2,827	2,209	11,080	16,116
<b>Total equity securities . . . . .</b>	<b>1,942</b>	<b>1,123</b>	<b>5,682</b>	<b>8,747</b>	<b>2,889</b>	<b>2,209</b>	<b>11,080</b>	<b>16,178</b>
<b>Loans and receivables . . . . .</b>	<b>2,908</b>	<b>986</b>	<b>108</b>	<b>4,002</b>	<b>3,598</b>	<b>942</b>	<b>108</b>	<b>4,648</b>
<b>Derivative financial instruments . . . . .</b>	<b>165</b>	<b>87</b>	<b>—</b>	<b>252</b>	<b>213</b>	<b>240</b>	<b>—</b>	<b>453</b>
<b>Total financial investments . . . . .</b>	<b>35,801</b>	<b>12,266</b>	<b>7,257</b>	<b>55,324</b>	<b>45,366</b>	<b>15,200</b>	<b>12,914</b>	<b>73,480</b>

All debt and equity securities are carried at fair value and, consequently, the values reported in the AIA Group's financial information reflect current market values as of the end of each reporting period. The carrying value of its financial investments increased to US\$73,480 million as of 30 November 2009 compared with US\$55,324 million as of 30 November 2008, driven by a recovery in equity markets during the second half of 2009 and as credit spreads narrowed and risk-free interest rates fell.

Financial investments held to back other policyholder and shareholder liabilities (shown in the column "Other policyholder and shareholder"), which consist mainly of fixed income debt securities, increased to US\$45,366 million as of 30 November 2009 compared with US\$35,801 million as of 30 November 2008. Despite disposals made during FY 2009, including the sale of US\$1,840 million of debt securities previously held as collateral in respect of securities lending, impairments of US\$67 million and net realised losses of US\$162 million and the effects of foreign exchange, the fair value of other policyholder and shareholder debt securities increased 25.6% to US\$38,666 million reflecting a recovery in the market values of these securities. The recovery in the market value of available-for-sale financial assets is reflected in the fair value reserve which increased to US\$1,511 million as of 30 November 2009 from a net negative position of US\$1,564 million as of 30 November 2008.

Financial investments held in respect of participating funds (shown in the column "Participating funds") increased to US\$15,200 million as of 30 November 2009 from US\$12,266 million as of 30 November 2008.

During FY 2009, as equity markets improved, investment-linked assets under management grew US\$5,657 million, net of new funds invested. Holders of AIA investment-linked contracts benefit from changes in the market value of financial investments backing AIA investment-linked contracts (shown in the column "Investment-linked") and therefore these changes do not directly affect net profit, except for asset management fees earned on account balances.

The AIA Group held debt securities with a fair value of US\$52,201 million as of 30 November 2009 compared with US\$42,323 million as of 30 November 2008, despite disposals made during FY 2009, including US\$1,840 million of debt securities previously held as collateral under the AIA Group's programme related to securities lending. Government bonds and bonds issued by government agencies comprised a substantial proportion of the AIA Group's fixed income debt portfolio, representing 49.6% of its debt securities as of 30 November 2009 as compared with 53.0% as of 30 November 2008. Investment-grade corporate bonds and investment-grade structured securities accounted for 47.1% of debt securities as of 30 November 2009, as compared with 44.0% as of 30 November 2008.

The AIA Group's equity securities had a fair value of US\$16,178 million as of 30 November 2009 compared with US\$8,747 million as of 30 November 2008 mainly as a result of a recovery in asset prices. Equity securities held in respect of AIA investment-linked contracts accounted for a significant proportion of its overall holdings of equity

securities — 68.5% as of 30 November 2009 and 65.0% as of 30 November 2008. Holders of AIA investment-linked contracts receive the benefit of positive movements in the market value of the securities held to back AIA investment-linked contracts. Of the increase in the carrying value of the AIA Group's equity securities between FY 2008 and FY 2009 of US\$7,431 million, US\$5,398 million is attributable to investments held to back AIA investment-linked contracts. This amount is credited to the value of the policies held by the holders of AIA investment-linked contracts.

The AIA Group's loans and receivables outstanding were US\$4,648 million as of 30 November 2009 compared with US\$4,002 million as of 30 November 2008. This increase was mainly attributable to an increase in policy loans of US\$207 million and an increase in term deposits of US\$236 million between FY 2009 and FY 2008.

Within the AIA Group's assets, other than those discussed above, cash and cash equivalents decreased to US\$3,405 million as at 30 November 2009, compared with US\$4,164 million as at 30 November 2008, reflecting the gradual re-deployment of cash holdings during FY 2009.

### *Liabilities*

	<b>Year ended 30 November</b>	
	<b>2008</b>	<b>2009</b>
	(in US\$ millions)	
Insurance and investment contract liabilities . . . . .	57,462	71,583
Borrowings . . . . .	661	688
Obligations under securities lending and repurchase agreements . . . . .	2,718	284
Liabilities — other than the above . . . . .	<u>2,641</u>	<u>3,658</u>
<b>Total liabilities . . . . .</b>	<b><u>63,482</u></b>	<b><u>76,213</u></b>

Total liabilities increased 20.1% to US\$76,213 million as of 30 November 2009 compared with US\$63,482 million as of 30 November 2008 mainly due to higher insurance and investment contract liabilities. The increased insurance and investment contract liabilities resulted from growth in the in-force portfolio, accretion of interest and investment returns accrued on participating funds. The increase in investment contract liabilities comprises the investment return on matching assets, net deposits or withdrawals and fees and expenses charged against account balances.

The AIA Group's borrowings, which comprise mainly bank overdrafts and a term loan facility financing its group office building in Hong Kong, remained largely unchanged at US\$688 million in FY 2009 compared with US\$661 million in FY 2008. The AIA Group's capital base is comprised solely of shareholders' equity and it had no structural borrowings, hybrid capital, loan notes or commercial paper in issue as of 30 November 2009. The marginal increase in bank borrowings was more than offset by the significant decrease in the AIA Group's obligations under its securities lending and repurchase agreements, which fell to US\$284 million in FY 2009 compared with US\$2,718 million in FY 2008, as the AIA Group wound down and largely withdrew from securities lending in November 2009.

Liabilities other than insurance and investment contract liabilities, borrowings and obligations under securities lending and repurchase agreements increased to US\$3,658 million compared with US\$2,641 million in FY 2008 mainly reflecting an increase in deferred tax liabilities of US\$530 million during FY 2009.

### *Equity*

Total equity attributable to shareholders of the AIA Group increased 66.2% to US\$15,252 million as of 30 November 2009 compared to US\$9,176 million as of 30 November 2008. This mainly reflected an increase in retained earnings, recovery in the fair value of the AIA Group's available-for-sale financial investments and foreign exchange movements, which together contributed to an increase in other comprehensive income from negative US\$2,018 million as of 30 November 2008 to positive US\$1,753 million as of 30 November 2009.

The AIA Group's equity reflects a capital contribution of US\$408 million from AIG during FY 2009, primarily in relation to separation activities linked to the withdrawal from securities lending, reimbursement of other separation costs, and consideration for the sale of its investment management operations to AIG and the disposal of other entities to third parties.

## Year ended 30 November 2008 compared with year ended 30 November 2007

### Discussion of selected results of operations

#### TWPI

The table below analyses TWPI by premium type and by product line for the periods indicated.

	Year ended 30 November 2007			
	Renewal premium	First year premium	Weighted single premium	TWPI
	(in US\$ millions)			
TWPI includes:				
Ordinary individual life insurance . . . . .	6,397	796	23	7,216
AIA investment-linked insurance products . . . . .	1,130	814	279	2,223
Standalone health and protection . . . . .	906	397	1	1,304
Group . . . . .	398	97	7	502
Other . . . . .	43	12	58	113
<b>Total</b> . . . . .	<b>8,874</b>	<b>2,116</b>	<b>368</b>	<b>11,358</b>
	Year ended 30 November 2008			
	Renewal premium	First year premium	Weighted single premium	TWPI
	(in US\$ millions)			
TWPI includes:				
Ordinary individual life insurance . . . . .	6,651	762	27	7,439
AIA investment-linked insurance products . . . . .	1,526	831	175	2,532
Standalone health and protection . . . . .	1,077	348	1	1,426
Group . . . . .	530	165	9	704
Other . . . . .	43	14	45	102
<b>Total</b> . . . . .	<b>9,827</b>	<b>2,119</b>	<b>257</b>	<b>12,203</b>

TWPI increased 7.4% to US\$12,203 million in FY 2008 from US\$11,358 million in FY 2007, increasing 6.4% on a constant exchange rate basis.

A significant portion of the AIA Group's business is on a renewal premium basis, representing 80.5% of TWPI in FY 2008, compared with 78.1% of TWPI in FY 2007. The AIA Group experienced an increase in TWPI across its major product lines in FY 2008 compared with FY 2007, with renewal premiums providing the biggest contribution to the increase.

Premiums associated with ordinary individual life insurance including health and protection riders where applicable, increased 3.1% to US\$7,439 million in FY 2008 from US\$7,216 million in FY 2007. On a constant exchange rate basis, the increase was 1.1%. The AIA Group's operating units in Thailand, China and Singapore recorded the largest increases in ordinary individual life insurance premiums at 8.1%, 13.1% and 6.7%, respectively. Renewal premiums for ordinary individual life insurance products were the largest contributor to TWPI. Whereas first year premiums for ordinary individual life insurance overall decreased 4.3%, the AIA Group's operating unit in Hong Kong recorded a growth of 68.5%, following the launch of "Executive Life", a new suite of protection products. In addition, in the second half of FY 2008, the AIA Group's operating unit in Singapore experienced a shift back to demand for traditional ordinary life insurance products, primarily due to the economic slowdown and the resulting decline in equity market prices, as well as investment restrictions introduced by the Central Provident Fund discussed below.

Premiums related to AIA investment-linked products increased 13.9% to US\$2,532 million in FY 2008 from US\$2,223 million in FY 2007. On a constant exchange rate basis, the increase was 13.2%. The reporting segments driving this growth were the AIA Group's operations in Korea and Other Markets at 76.1% and 38.7%, respectively. The AIA Group's operating unit in Korea experienced significant demand for AIA investment-linked products. The increase in Other Markets was principally due to the expansion of the bancassurance distribution channel in Indonesia during 2008. Renewal premiums for AIA investment-linked insurance products grew 35.0%, while first year premiums and weighted single premiums increased 2.1% and decreased 37.3%, respectively. The increase in renewal premiums for AIA investment-linked products may be due to customers with regular premium paying policies choosing to maintain their payments of regular premiums as markets declined, following a strategy of

dollar cost averaging. Conversely, the decline in weighted single premiums, particularly in its operating unit in Hong Kong, may be due to customers' reluctance to commit to new investment-linked savings products during times of uncertainty, such as the AIG Events, or market volatility. Sales of single premium AIA investment-linked products exceeded US\$1 billion in FY 2007 in the AIA Group's operations in Singapore, as policyholders invested savings from their Central Provident Fund Ordinary Accounts in search of higher returns. However, in April 2008, investment restrictions introduced by the Central Provident Fund on the use of Central Provident Fund Ordinary Accounts resulted in substantially lower weighted single premiums for AIA investment-linked products for the remainder of FY 2008 in Singapore.

Standalone health and protection insurance premiums increased 9.4% to US\$1,426 million in FY 2008 from US\$1,304 million in FY 2007. On a constant exchange rate basis, the increase was 14.1%. The increase in standalone health and protection insurance premiums was primarily driven by renewal premiums, led by the AIA Group's operating units in Korea, Other Markets and China at 18.0%, 46.0% and 30.7%, respectively. The AIA Group's operations in Korea were the largest contributor to this increase, as it was the largest market for its standalone health and protection insurance products, representing 52.9% of the AIA Group's standalone health and protection insurance business in FY 2008. The growth of standalone health and protection renewal premiums in the AIA Group's Korean operations was 33.8% on a constant exchange rate basis, which more than offset the impact of the depreciation of the Korean Won against the US dollar in the second half of 2008. The increase in the AIA Group's operations in Other Markets was driven by growth in its operations in Australia, primarily resulting from higher sales achieved through greater focus on the IFA channel during 2008. In its operations in China, the increase was driven primarily by stable AIA persistency and growth in sales of health and protection insurance products. Renewal premiums for standalone health and protection insurance products increased 18.9%. First year premiums for standalone health and protection insurance products decreased 12.3%, with the largest decrease in premiums attributable to the AIA Group's operating unit in Korea, exacerbated by the depreciation of the Korean Won against the US dollar offsetting growth in other geographical markets.

Group premiums were the AIA Group's fastest growing product line in FY 2008, increasing 40.4% to US\$704 million from US\$502 million in FY 2007. On a constant exchange rate basis, the increase was 35.5%. The AIA Group's operating units in Other Markets, Singapore, Hong Kong and China had the highest growth with increases of 50.2%, 33.4%, 27.1% and 136.2%, respectively. The AIA Group's operations in Australia, which are aggregated as part of its Other Markets segment, represented 33.2% of overall group product business in FY 2008 and grew 57.8% year-on-year. The increase occurred across all premium types with renewal premiums growing at 33.1%, first year premiums at 71.4% and weighted single premiums at 28.0%.

Other product lines, which consist of annuities and personal lines, collectively decreased 10.7% to US\$102 million in FY 2008 from US\$113 million in FY 2007. The decrease was primarily due to a decline in single premium annuities in Korean operations.

*Net premiums, fee income and other revenues*

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	(in US\$ millions)	
Net premiums . . . . .	8,178	9,425
Fee income . . . . .	562	857
Other revenues . . . . .	<u>77</u>	<u>79</u>
<b>Total</b> . . . . .	<b><u>8,817</u></b>	<b><u>10,361</u></b>

Net premiums, which are premiums net of reinsurance ceded, increased 15.2% to US\$9,425 million in FY 2008 from US\$8,178 million in FY 2007. The increase in net premiums was primarily due to an increase in renewal premiums in all the AIA Group's major product lines and the continued expansion of its policyholder base. Moreover, in FY 2008, the AIA Group recaptured a portfolio of business written by the AIA Group in Hong Kong which had been previously reinsured to another company in the AIG Group, as discussed further in "Factors affecting certain of AIA Group's geographical markets in FY 2008" below.

Premiums ceded to reinsurers amounted to US\$392 million in FY 2008 compared with US\$833 million in FY 2007.

Fee income from AIA investment-linked products increased 52.5% to US\$857 million in FY 2008 from US\$562 million in FY 2007, primarily due to growth in investment-linked insurance products. Other revenues, largely consisting of asset management fees on pensions business, remained stable during this period.

## Investment income

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	(in US\$ millions)	
<b>Investment income<sup>(1)</sup></b>		
Interest income . . . . .	2,507	2,900
Dividend income . . . . .	174	181
Rental income . . . . .	<u>25</u>	<u>63</u>
<b>Total . . . . .</b>	<b><u>2,706</u></b>	<b><u>3,144</u></b>

(1) Excludes investment income related to AIA investment-linked contracts.

Investment income, excluding investment income from AIA investment-linked contracts, increased 16.2% to US\$3,144 million in FY 2008 from US\$2,706 million in FY 2007, with Hong Kong, Thailand and Singapore recording increases of 26.4%, 18.0% and 14.5%, respectively.

## Net insurance and investment contract benefits

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	(in US\$ millions)	
<b>Net insurance and investment contract benefits<sup>(1)</sup></b>		
Insurance contract benefits . . . . .	4,555	5,402
Net change in insurance and investment contract liabilities . . . . .	<u>3,684</u>	<u>3,476</u>
Insurance and investment contract benefits . . . . .	8,239	8,878
Insurance and investment contract benefits ceded . . . . .	<u>(653)</u>	<u>(248)</u>
<b>Total . . . . .</b>	<b><u>7,586</u></b>	<b><u>8,630</u></b>

(1) Includes corresponding changes in insurance and investment contract liabilities from participating funds investment income (the amount that would be attributable to policyholders assuming all investment income were to be declared as a dividend based upon local regulations) and excludes (i) other changes in insurance and investment contract liabilities from participating fund investment income and (ii) changes in insurance and investment contract liabilities from participating fund AIA investment experience and (iii) corresponding changes in investment income and AIA investment experience related to AIA investment linked contracts.

Insurance and investment contract benefits (on a basis consistent with the table above) increased 7.8% to US\$8,878 million in FY 2008 from US\$8,239 million in FY 2007, with Thailand, China and Singapore recording increases of 8.8%, 25.7% and 7.8%, respectively. The increase in insurance and investment contract benefits (excluding corresponding changes in insurance and investment contract liabilities from AIA investment experience for AIA investment-linked contracts and participating funds, and investment income related to AIA investment-linked contracts) was largely due to the reinsurance recapture in Hong Kong described below in “Factors affecting certain of AIA Group’s geographical markets in FY 2008” and growing in-force portfolios across all the AIA Group’s geographical markets. However, there was an increase in policy surrenders in the fourth quarter of FY 2008. Total surrenders in FY 2008 amounted to US\$1,283 million, of which US\$663 million arose in the fourth quarter. This may be due to local customer sentiment being affected by the general economic downturn and the AIG Events in the fourth quarter of 2008 in certain geographical markets, as demonstrated by AIA persistency ratios. The AIA persistency ratio declined from 93.9% at the start of FY 2008 before the AIG Events, to end the year at 89.3%. By the end of FY 2009, the ratio had improved to 95.1%, above the levels the AIA Group experienced at the beginning of FY 2008.

Insurance and investment contract liabilities ceded (or reinsured) decreased 62.0% to a recovery of US\$248 million in FY 2008 from a recovery of US\$653 million in FY 2007, primarily due to the reinsurance recapture described below in “Factors affecting certain of AIA’s geographical markets in FY 2008”.

### *Commission and other acquisition expenses*

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	<i>(in US\$ millions)</i>	
<b>Commission and other acquisition expenses</b>		
Commission and other acquisition expenses incurred . . . . .	2,282	2,269
Deferral and amortisation of acquisition costs . . . . .	<u>(1,335)</u>	<u>(706)</u>
<b>Total</b> . . . . .	<u><b>947</b></u>	<u><b>1,563</b></u>

Commission and other acquisition expenses incurred decreased 0.6% to US\$2,269 million in FY 2008 from US\$2,282 million in FY 2007, in line with the decrease in new business sales.

The deferral and amortisation of acquisition costs decreased 47.1% to US\$706 million in FY 2008 from US\$1,335 million in FY 2007. The decrease reflects a higher charge for amortisation of acquisition costs, increasing 56.5% to US\$1,387 million in FY 2008 from US\$886 million in FY 2007. The higher charge was due in part to the adverse market conditions prevailing in the second half of FY 2008 which resulted in accelerated amortisation of acquisition costs.

### *Operating expenses*

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	<i>(in US\$ millions)</i>	
<b>Operating expenses</b>		
Operating expenses excluding strategic initiative expenses . . . . .	951	1,069
Strategic initiative expenses . . . . .	<u>—</u>	<u>25</u>
<b>Total</b> . . . . .	<u><b>951</b></u>	<u><b>1,094</b></u>

The AIA Group's operating expenses excluding strategic initiative expenses increased 12.4% to US\$1,069 million in FY 2008 from US\$951 million in FY 2007 which was principally driven by the reinsurance recapture described above in "Investment income" and higher employee benefit expenses. Costs of strategic initiatives in FY 2008 include costs associated with expansion of distribution channels, optimisation of back office support functions and increasing agency and customer services infrastructure in China to 127 centres in FY 2008 from 104 centres in FY 2007.

### *Investment management expenses and finance costs*

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	<i>(in US\$ millions)</i>	
<b>Investment management expenses and finance costs<sup>(1)</sup></b>		
Investment management expenses . . . . .	83	93
Finance costs . . . . .	<u>203</u>	<u>159</u>
<b>Total</b> . . . . .	<u><b>286</b></u>	<u><b>252</b></u>

(1) Excludes investment management expenses related to AIA investment-linked contracts.

The AIA Group's investment management expenses and finance costs decreased 11.9% to US\$252 million in FY 2008 from US\$286 million in FY 2007. This decrease was principally the result of lower financing costs relating to securities lending and repurchase agreements, as the AIA Group continued to reduce its participation in securities lending and repurchase agreements.

### *Operating profit*

As a result of the foregoing, operating profit increased 11.5% to US\$1,943 million in FY 2008 from US\$1,742 million in FY 2007. As discussed above, the increase in operating profit was primarily due to growth in renewal premiums and increased investment income, which collectively increased at a faster rate than the AIA Group's expense base and the impact of the increased level of surrenders in the fourth quarter of FY 2008, as well as the beneficial effect of the reinsurance recapture in Hong Kong. Excluding securities lending, from which the AIA

Group largely withdrew in FY 2009, the AIA Group's operating profit was US\$1,949 million in FY 2008, compared with US\$1,742 million in FY 2007.

### ***Tax expense on operating profit***

The AIA Group operates in 15 principal jurisdictions, each with its own tax regime, and the change in the tax expense (or credit) from one year to the next is affected by changes in the mix of income by jurisdiction. The impact of the change in the mix of income by jurisdiction together with a tax credit of US\$41 million relating to a change of tax law in Malaysia, a reduction in the corporate tax rate in Korea, which is set to fall to 22% from 2012, which reduced deferred tax liabilities, and the tax savings from consolidated tax filing in China reduced the weighted average corporate tax rate on operating profit to approximately 18% in FY 2008 from approximately 26% in FY 2007.

### ***Profit before tax***

Profit before tax fell 98.5% to a profit of US\$42 million in FY 2008 compared to US\$2,798 million in FY 2007. This decrease was primarily driven by adverse non-operating investment return arising from a decrease in the market value of the AIA Group's investment portfolio in FY 2008 of US\$2,412 million compared to a gain of US\$837 million in FY 2007. This loss in FY 2008 was partially offset by a US\$447 million gain on settlement of the reinsurance recapture in Hong Kong. For more information, please see "Factors affecting certain of AIA Group's geographical markets in FY 2008" in this section.

### ***Income tax***

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	(in US\$m)	
Current income tax . . . . .	464	401
Deferred income tax . . . . .		
Temporary differences . . . . .	185	(563)
Release of withholding tax provision . . . . .	—	(275)
Tax expense/(credit) . . . . .	<u>649</u>	<u>(437)</u>
Of which:		
Tax expense/(credit) attributable to policyholders returns . . . . .	70	(90)
Tax expense/(credit) attributable to shareholders' profits . . . . .	<u>579</u>	<u>(347)</u>
	<u>649</u>	<u>(437)</u>

Current income tax decreased 13.6% to US\$401 million in FY 2008 from US\$464 million in FY 2007. The amount of current taxes paid on the AIA Group's overseas operations was primarily attributable to its operations in Thailand and Korea, where the local corporate tax rates are among the highest in the region and local tax rules for life insurance companies accelerate the recognition of profits generating current taxes.

Excluding the release of the withholding tax provision, the AIA Group had a deferred income tax credit of US\$563 million in FY 2008 compared with a deferred income tax charge of US\$185 million in FY 2007, reflecting a decline in the market value of its investments and the impact of the factors set out above which affected its weighted average corporate tax rate.

A US\$275 million withholding tax provision was released in FY 2008 as a result of the clarification of a tax treaty.

### ***Net profit attributable to shareholders of AIA***

Net profit attributable to shareholders of AIA decreased 77.8% to US\$473 million in FY 2008 from US\$2,133 million in FY 2007. The decline was primarily due to a negative non-operating investment return of US\$2,412 million caused by declining market values, of which US\$87 million was attributable to securities lending, from which the AIA Group largely withdrew in FY 2009, partially offset by the increase in operating profit after tax, a US\$447 million gain arising on the reinsurance recapture in Hong Kong and the release of the provision for withholding tax of US\$275 million discussed above. Excluding the effects of securities lending, from which it largely withdrew in FY 2009, the AIA Group's net profit attributable to shareholders of AIA was US\$566 million in FY 2008, compared with US\$2,133 million in FY 2007.

### ***Significant events during fourth quarter FY 2008***

During the fourth quarter of FY 2008, following the AIG Events, credit spreads widened and equity capital markets declined significantly. At the same time, the AIA Group experienced a sharp increase in surrenders of its products. This temporary increase in surrender activity had an adverse effect on AIA persistency.

The AIG Events had a significant impact on the AIA Group's results of operations in FY 2008, in particular:

- A decline in new business production of single premium AIA investment-linked products, especially in Hong Kong and Singapore. New business activities improved in the second half of FY 2009 compared with the first half of the year, as demonstrated by growth in first year premiums and single premiums products, when compared to the first half of 2009, in most of the AIA Group's geographical markets. Trends in each of the geographical markets in FY 2009 are discussed in greater detail in "Segmental information" in this section.
- A short-term increase in surrender fee income as such income more than offset the accelerated amortisation of DAC on the surrendered policies. In particular, annuity surrenders in Korea, which operated under the AIG brand during that period, were US\$1,023 million in FY 2008, compared with US\$250 million in FY 2007.
- Surrender trends have improved in FY 2009 with AIA persistency ratio of the AIA Group's overall in-force policies increasing to 93.4% in the second half of FY 2009 compared with 91.4% in the second half of FY 2008 (excluding Philamlife which joined the AIA Group in November 2009).
- The AIA Group accelerated a planned reorganisation and retrenchment programme resulting in a restructuring cost of US\$10 million being recognised in FY 2008. This reduced the AIA Group's headcount by approximately 200 and contributed to an improvement in its expense ratio to 8.4% in FY 2009 from 8.9% in FY 2008, despite a 148.0% increase in spending on strategic initiatives during the year.

### ***Factors affecting certain of AIA Group's geographical markets in FY 2008***

In Hong Kong, the AIA Group recaptured a portfolio of reinsurance business which had previously been reinsured to another company in the AIG Group. The recapture had no impact on TWPI since this is stated before the effects of ceded reinsurance but resulted in a one-time gain of US\$447 million arising on the recapture. The gain arose because the fair value of financial assets received on recapture exceeded the insurance and investment contract liabilities, deferred acquisition and origination costs and the recapture fee of US\$190 million.

In Singapore, the AIA Group experienced strong growth in AIA investment-linked products in FY 2007 and the first half of FY 2008. In the second half of FY 2008, Singapore experienced a shift back to demand for traditional ordinary life insurance products, primarily due to the economic slowdown and the resulting decline in equity market prices, as well as the changes to the regulations relating to the Central Provident Fund. Sales by AIA Singapore of single premium AIA investment-linked products exceeded US\$1 billion in FY 2007 as policyholders reinvested savings from their Central Provident Fund in search of higher returns. In April 2008, a change in Central Provident Fund regulations introduced restrictions on the use of Central Provident Fund Ordinary Accounts, thereby resulting in substantially lower sales of single premium AIA investment-linked products for the remainder of FY 2008. New business activities improved during FY 2009 as demonstrated by growth in first year premiums and single premiums products between the first half and second half of FY 2009, as described in "Segmental Information — Singapore — Year ended 30 November 2009 compared with year ended 30 November 2008" in this section.

In China, the AIA Group's operating expenses increased 35.4% to US\$172 million in FY 2008 from US\$127 million in FY 2007 due to increased headcount from an expansion of its operations and an increase in its agency and customer services infrastructure to 127 centres in FY 2008 from 104 centres in FY 2007. (This contributed to the growth in TWPI from the AIA Group's branch network in China to over US\$1,000 million in FY 2009. Performance of the AIA Group's operations in China during FY 2009 is discussed further in section 7.5 below.)

### ***Discussion of selected balance sheet information***

#### ***Assets***

The AIA Group's total assets as of 30 November 2008 amounted to US\$72,678 million, compared with US\$88,915 million as of 30 November 2007. This decrease primarily reflected the decline in market value of its financial investments, the majority of which were carried at fair value.

The table below sets forth the AIA Group's financial investments by asset class and type of business as of dates indicated.

	As of 30 November							
	2007			2008				
	Policyholder and shareholder		Investment-linked	Policyholder and shareholder		Investment-linked	Total	
	Other policyholder and shareholder	Participating funds	Total	Other policyholder and shareholder	Participating funds			
(in US\$ millions)								
<b>Financial investments includes:</b>								
<b>Debt securities</b>								
Available for sale . . . . .	30,955	—	—	30,955	29,934	—	—	29,934
At fair value through profit or loss . . . . .	<u>1,148</u>	<u>10,813</u>	<u>1,488</u>	<u>13,449</u>	<u>852</u>	<u>10,070</u>	<u>1,467</u>	<u>12,389</u>
<b>Total debt securities . . . . .</b>	<b><u>32,103</u></b>	<b><u>10,813</u></b>	<b><u>1,488</u></b>	<b><u>44,404</u></b>	<b><u>30,786</u></b>	<b><u>10,070</u></b>	<b><u>1,467</u></b>	<b><u>42,323</u></b>
<b>Equity securities</b>								
Available for sale . . . . .	2,520	—	—	2,520	87	—	—	87
At fair value through profit or loss . . . . .	<u>4,258</u>	<u>2,321</u>	<u>11,040</u>	<u>17,619</u>	<u>1,855</u>	<u>1,123</u>	<u>5,682</u>	<u>8,660</u>
<b>Total equity securities . . . . .</b>	<b><u>6,778</u></b>	<b><u>2,321</u></b>	<b><u>11,040</u></b>	<b><u>20,139</u></b>	<b><u>1,942</u></b>	<b><u>1,123</u></b>	<b><u>5,682</u></b>	<b><u>8,747</u></b>
<b>Loans and receivables . . . . .</b>	<b>4,429</b>	<b>1,136</b>	<b>100</b>	<b>5,665</b>	<b>2,908</b>	<b>986</b>	<b>108</b>	<b>4,002</b>
<b>Derivative financial instruments . . . . .</b>	<b><u>175</u></b>	<b><u>247</u></b>	<b><u>—</u></b>	<b><u>422</u></b>	<b><u>165</u></b>	<b><u>87</u></b>	<b><u>—</u></b>	<b><u>252</u></b>
<b>Total financial investments . . . . .</b>	<b><u>43,485</u></b>	<b><u>14,517</u></b>	<b><u>12,628</u></b>	<b><u>70,630</u></b>	<b><u>35,801</u></b>	<b><u>12,266</u></b>	<b><u>7,257</u></b>	<b><u>55,324</u></b>

All debt and equity securities are carried at fair value and, consequently, the values reported in the AIA Group's financial information reflect current market values as of the end of each reporting period. Despite net sales and purchases of debt and equity securities of US\$6,045 million in FY 2008 and receipt of the investment portfolio of US\$2,967 million arising on the reinsurance recapture in FY 2008, the total carrying value of the AIA Group's financial investments decreased to US\$55,324 million as of 30 November 2008 compared to US\$70,630 million as of 30 November 2007.

Other policyholder and shareholder investments comprise mainly available-for-sale debt securities. Of the US\$1,317 million reduction in the value of these debt securities in FY 2008, US\$142 million related to impairments, and a further US\$90 million related to other gains and losses realised during the year, with the balance consisting of fair value movements and disposals made during the year.

Financial investments backing the AIA Group's insurance contract liabilities in participating funds are shown under the column "Participating funds" in the table above. The decrease in financial investments in participating funds to US\$12,266 million as of 30 November 2008 from US\$14,517 million as of 30 November 2007 mainly reflected the general decline in equity market prices that occurred towards the end of FY 2008.

Financial investments backing liabilities related to AIA investment-linked contracts are shown under the column "Investment-linked" in the table above. The investment risk in respect of assets related to AIA investment-linked contracts is generally wholly borne by the AIA Group's customers, and does not affect the profit for the year attributable to AIA's shareholders, except for asset management fees earned on account balances. The decrease in financial investments in respect of AIA investment-linked contracts as of 30 November 2008 compared with 30 November 2007 was mainly due to the general decline in equity market prices that occurred towards the end of FY 2008.

The AIA Group's debt securities had a fair value of US\$42,323 million as of 30 November 2008, compared with US\$44,404 million as of 30 November 2007. This decrease was primarily due to declines in market values as a result of increased credit spreads under adverse market conditions and disposals made during the year. Government bonds or bonds issued by governmental agencies accounted for 53.0% of the AIA Group's debt securities as of 30 November 2008, compared with 52.1% as of 30 November 2007. In addition, investment-grade corporate bonds and structured securities accounted for 44.0% of its debt securities as of 30 November 2008, compared with 44.4% as of 30 November 2007.

The AIA Group's available for sale equity securities had a fair value of US\$87 million as of 30 November 2008, compared with US\$2,520 million as of 30 November 2007. The AIA Group's available for sale equity securities

consist solely of shares in AIG. The decline in fair value primarily reflects the significant decline in AIG's share price during FY 2008.

The AIA Group's equity securities at fair value through profit or loss had a fair value of US\$8,660 million as of 30 November 2008, compared with US\$17,619 million as of 30 November 2007. This decrease was principally a result of declines in prices in the global and major Asian equity markets during the latter part of FY 2008. The majority of its equity securities at fair value through profit or loss are held to back its liabilities related to AIA investment-linked contracts, the investment risk for which is wholly borne by policyholders.

The AIA Group's loans and receivables outstanding were US\$4,002 million as of 30 November 2008, compared with US\$5,665 million as of 30 November 2007. This decrease was primarily due to repayments of inter-company loans of US\$1,560 million from other subsidiaries of AIG.

Within the AIA Group's assets, other than those described above, cash and cash equivalents increased to US\$4,164 million as of 30 November 2008 from US\$2,583 million as of 30 November 2007, reflecting de-risking of its investment portfolio during FY 2008, in response to adverse conditions in both debt and equity markets in the fourth quarter of 2008.

### *Liabilities*

	<u>Year ended 30 November</u>	
	<u>2007</u>	<u>2008</u>
	(in US\$ millions)	
Insurance and investment contract liabilities . . . . .	64,240	57,462
Borrowings . . . . .	1,461	661
Obligations under securities lending and repurchase agreements . . . . .	5,395	2,718
Liabilities — other than the above . . . . .	<u>4,142</u>	<u>2,641</u>
<b>Total liabilities . . . . .</b>	<b><u>75,238</u></b>	<b><u>63,482</u></b>

The AIA Group's total liabilities as of 30 November 2008 were US\$63,482 million, compared with US\$75,238 million as of 30 November 2007. This decrease primarily reflected lower insurance and investment contract liabilities, lower borrowings and obligations in respect of securities lending, and a reduction in "liabilities other than the above". The decrease in insurance and investment contract liabilities was principally due to the movement in liabilities related to AIA investment-linked contracts comprising the investment return on the matching assets, net deposits or withdrawals, fees charged against account balances and the effects of foreign exchange translation. The decrease in borrowings was mainly due to the repayment of loans to subsidiaries of AIG as long-term notes matured. The decrease in obligations under securities lending and repurchase agreements primarily reflected lower securities lending to related parties and third parties, and lower obligations under repurchase agreements. The decrease in "liabilities other than the above" was principally due to a decrease in deferred tax liabilities.

### *Equity*

The AIA Group's total equity attributable to shareholders of AIA was US\$9,176 million as of 30 November 2008, compared with US\$13,616 million as of 30 November 2007. This decrease is primarily related to the decrease in the fair value and foreign currency translation reserves, offsetting an increase in issued share capital and shares yet to be issued and other reserves. Issued share capital, shares yet to be issued, share premium, and other reserves increased to US\$1,434 million in FY 2008 from US\$699 million in FY 2007, primarily due to a capital injection from the AIG Group of US\$731 million. The decrease in the fair value reserve of US\$4,520 million was primarily due to unrealised movements in the fair value of available-for-sale financial investments, including holdings of AIG shares. The decrease in the foreign currency translation reserve of US\$783 million was due to a strengthening of the US dollar in FY 2008. Retained earnings increased by US\$128 million for FY 2008, consisting of net profit attributable to shareholders of AIA Group, of US\$473 million, less dividends paid of US\$346 million.

## **7. Segmental information**

This section provides performance highlights of each of the AIA Group's reporting segments. The AIA Group's reporting segments are categorised as follows: (i) each Key Market; (ii) combined results for Other Markets; and (iii) the Corporate and Other reporting segment. The Key Markets consist of: Hong Kong (including Macau); Thailand; Singapore (including Brunei); Malaysia; China and Korea. The Other Markets segment consists of the combined results of Australia, Indonesia, the Philippines, New Zealand, Taiwan, Vietnam and the interest in the

joint venture in India. The Corporate and Other segment includes the AIA Group's corporate functions, shared services, and elimination of intragroup transactions.

## 7.1 Hong Kong

	<u>Year ended 30 November</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	(in US\$ millions)		
TWPI	2,845	2,916	2,861
Investment income <sup>(1)</sup>	607	767	779
Operating expenses <sup>(2)</sup>	133	183	163
Operating profit	408	590	698
Operating profit after tax attributable to shareholders of AIA	368	568	653
Allocated segment equity	2,928	3,839	4,657
Net capital in/(out) flow <sup>(3)</sup>	(7)	684	(30)
Ratios:			
Expense ratio	4.7%	6.3%	5.7%
AIA operating margin	14.3%	20.2%	24.4%
Operating return on allocated equity	14.1%	16.8%	15.4%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	<u>Year ended 30 November</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	(in US\$ millions)		
TWPI includes:			
Renewal premium	2,274	2,455	2,487
First year premium	482	414	357
Weighted single premium (10% of single premium)	89	47	17
<b>Total</b>	<b><u>2,845</u></b>	<b><u>2,916</u></b>	<b><u>2,861</u></b>

### *Year ended 30 November 2009 compared with year ended 30 November 2008*

The Hong Kong reporting segment is the AIA Group's largest geographical market based on TWPI, generating 24.6% of total TWPI in FY 2009 and more than US\$2,400 million of renewal premiums in both FY 2009 and FY 2008. Ordinary individual life insurance and AIA investment-linked products represented 52.5% and 37.7%, respectively, of total TWPI generated in the Hong Kong reporting segment during FY 2009 as compared with 47.0% and 43.3%, respectively, in FY 2008.

Between FY 2008 and FY 2009 renewal premiums increased as AIA persistency remained largely stable, while first year premiums and weighted single premiums decreased, largely driven by a fall in demand for AIA investment-linked products in the first half of FY 2009. Demand for AIA investment-linked products improved significantly in the second half of FY 2009, with growth in first year premiums and weighted single premiums of 68.9% and 149.9%, respectively, compared with the first half of FY 2009. First year premiums in respect of ordinary individual life insurance also increased by 138.3% in the second half of FY 2009 compared with the first half of the year following the launch of an enhanced regular savings product with health and protection benefits. Ordinary individual life remains AIA Hong Kong reporting segment's most significant product line, with TWPI increasing to US\$1,503 million in FY 2009, as compared with US\$1,370 million in FY 2008, an increase of 9.8%.

Investment income (excluding investment income from AIA investment-linked contracts) grew 1.6% to US\$779 million in FY 2009 from US\$767 million in FY 2008 due to an increase in the average size of the investment portfolio following the recapture of an intragroup reinsurance arrangement in March 2008 and positive results of operations in FY 2009.

Operating expenses decreased 10.9% to US\$163 million in FY 2009 compared with US\$183 million in FY 2008 due in part to the inclusion of certain non-recurring items in FY 2008. The reduction in operating expenses had a positive impact on the expense ratio which improved to 5.7% in FY 2009 compared with 6.3% in FY 2008.

Operating profit grew by 18.3% and operating profit after tax attributable to shareholders of AIA grew by 15.0% to US\$698 million and US\$653 million, respectively, in FY 2009 from US\$590 million and US\$568 million, respectively, in FY 2008. These increases were mainly due to the full-year beneficial impact of the reinsurance recapture in FY 2009, lower DAC amortisation as assets under management increased reflecting the strong recovery in investment performance in FY 2009, higher policy surrenders in the first quarter of FY 2009 and reduced finance costs. Investment management expenses and finance costs in FY 2009 of US\$52 million decreased 63.1% from the US\$141 million incurred in FY 2008 as the AIA Group wound down and largely withdrew from securities lending during the year.

AIA operating margin improved to 24.4% in FY 2009 from 20.2% in 2008, in line with the increase in operating profit.

Operating return on allocated equity decreased to 15.4% in FY 2009 from 16.8% in FY 2008, despite the increase in operating profit after tax attributable to shareholders of AIA, due to the retention of surplus capital in the principal insurance business in Hong Kong. Allocated segment equity is stated after the effects of a dividend remittance to the AIA Group of US\$20 million from the pensions trustee business during FY 2009.

*Year ended 30 November 2008 compared with year ended 30 November 2007*

TWPI increased 2.5% to US\$2,916 million in FY 2008 from US\$2,845 million in FY 2007. This increase was primarily driven by growth in renewal premiums as a result of stable AIA persistency, partially offset by lower first year and weighted single premiums. In the first half of FY 2008, the AIA Group's operations in Hong Kong and Macau experienced growth in first year and weighted single premiums. However, in the second half of FY 2008, its first year and weighted single premiums fell significantly due to lower demand. The AIA Group introduced a new suite of protection products called "Executive Life" in Hong Kong in FY 2008, which had a partial mitigating effect, as it increased sales of its ordinary individual life insurance products. As a result, TWPI for ordinary life products increased to US\$1,370 million in FY 2008, from US\$1,348 million in FY 2007, with first year premiums increasing by 68.5%, from US\$57 million in FY 2007 to US\$95 million in FY 2008.

The AIA Group also recaptured a portfolio of reinsurance business which had previously been reinsured to another company in the AIG Group. The recapture had no impact on TWPI since this is stated before the effects of ceded reinsurance but resulted in a gain of US\$447 million arising on the recapture, which is not reflected in operating profit before and after tax because of its one time nature. The gain arose because the fair value of financial assets received on recapture exceeded the insurance and investment contract liabilities, deferred acquisition and origination costs and the recapture fee of US\$190 million.

Investment income (excluding investment income from AIA investment-linked contracts) increased 26.4% to US\$767 million in FY 2008 from US\$607 million in FY 2007, with the substantial majority of this increase attributable to the reinsurance recapture. As part of this recapture, the AIA Group received a US\$2,967 million portfolio of financial investments in FY 2008 which was previously held to match the liabilities ceded by the AIA Group on which investment returns were earned for the last three quarters in FY 2008.

Operating expenses increased 37.6% to US\$183 million in FY 2008 from US\$133 million in FY 2007, with a portion of this increase attributable to the reinsurance recapture, related to the operating expenses on the ceded business. Operating expenses were also impacted by strategic initiative expenses to broaden the Hong Kong operations' distribution channels and build wealth management capabilities. Expense ratio increased to 6.3% in FY 2008 from 4.7% in FY 2007.

Operating profit increased 44.6% to US\$590 million in FY 2008 from US\$408 million in FY 2007. This increase was primarily due to the beneficial effect of the reinsurance recapture, which resulted in more business being retained by the AIA Group, higher investment income and fees on surrenders following the AIG Events. Surrender fees more than offset the acceleration of DAC amortisation relating to surrenders. The growth in operating profit was greater than the growth in TWPI, and AIA operating margin increased to 20.2% in FY 2008 from 14.3% in FY 2007.

Operating return on allocated equity increased to 16.8% in FY 2008 from 14.1% in FY 2007. The increase in operating profit after tax attributable to shareholders of AIA in FY 2008 was partially offset by the impact of a net capital contribution into the AIA Group's Hong Kong operations of US\$684 million.

## 7.2 Thailand

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI	2,164	2,351	2,373
Investment income <sup>(1)</sup>	557	657	640
Operating expenses <sup>(2)</sup>	114	132	135
Operating profit	401	424	358
Operating profit after tax attributable to shareholders of AIA	275	303	251
Allocated segment equity	2,737	2,443	2,919
Net capital in/(out) flow <sup>(3)</sup>	(61)	(74)	(175)
Ratios:			
Expense ratio	5.3%	5.6%	5.7%
AIA operating margin	18.5%	18.0%	15.1%
Operating return on allocated equity	11.0%	11.7%	9.4%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI includes:			
Renewal premium	1,853	2,009	2,024
First year premium	301	326	337
Weighted single premium (10% of single premium)	10	16	12
<b>Total</b>	<b>2,164</b>	<b>2,351</b>	<b>2,373</b>

### Year ended 30 November 2009 compared with year ended 30 November 2008

Thailand is the AIA Group's second largest market based on TWPI and represented 20.4% of total TWPI in FY 2009. TWPI in Thailand is substantially generated by ordinary individual life insurance products, including health and protection insurance policy riders.

TWPI increased 0.9%, or 4.1% on a constant exchange rate basis, to US\$2,373 million in FY 2009 from US\$2,351 million in FY 2008 largely due to growth in renewal and first year premiums. Renewal premiums increased across all product lines mainly as a result of stable AIA persistency in FY 2009, while first year premiums were up 3.2%, or 6.7% on a constant exchange rate basis. First year premiums in respect of ordinary individual life insurance products grew 40.1% in the second half of FY 2009 as compared with the first half of FY 2009.

Investment income (excluding investment income from AIA investment-linked contracts) decreased 2.6% to US\$640 million in FY 2009 as compared with US\$657 million in FY 2008 partly due to the effects of foreign exchange rates; on a constant exchange rate basis, investment income (excluding investment income from AIA investment-linked contracts) increased 1.1% year-on-year. Investment income (excluding investment income from AIA investment-linked contracts) was adversely affected by lower dividends on equity investments in FY 2009.

Operating expenses increased marginally to US\$135 million in FY 2009 from US\$132 million. As a result, the expense ratio remained largely stable at 5.7% in FY 2009 compared with 5.6% in FY 2008.

Operating profit and operating profit after tax attributable to shareholders of AIA decreased to US\$358 million and US\$251 million, respectively, in FY 2009 from US\$424 million and US\$303 million, respectively, in FY 2008, primarily reflecting the effects of depreciation of the Thai Baht during FY 2009.

AIA operating margin decreased to 15.1% in FY 2009 from 18.0% in FY 2008 reflecting the decrease in operating profit. Operating return on allocated equity decreased to 9.4% in FY 2009 from 11.7% in FY 2008 reflecting the deterioration in AIA operating margin and higher allocated segment equity. Allocated segment equity increased to US\$2,919 million as of 30 November 2009 from US\$2,443 million as of 30 November 2008 reflecting contribution from positive results of operations and a significant improvement in non-operating investment return from a loss after tax of US\$493 million in FY 2008 to a gain after tax of US\$403 million. The improvement in non-operating investment return was mainly attributable to the recovery in market values of Thai equity securities, the carrying

value of which increased from US\$781 million at 30 November 2008, to US\$1,322 million at 30 November 2009. Allocated segment equity reflected capital repatriation of US\$180 million of allocated equity from the AIA Group's Thai operations during the year.

*Year ended 30 November 2008 compared with year ended 30 November 2007*

The AIA Group's core operations in Thailand were not significantly affected by the global economic slowdown and political demonstrations in Thailand in FY 2008. TWPI increased 8.7% to US\$2,351 million in FY 2008 from US\$2,164 million in FY 2007. On a constant exchange rate basis, the growth was 4.5%. The increase was generated across renewal premium, first year premium and weighted single premium products, particularly ordinary individual life insurance. Renewal premiums increased across all product lines with an overall increase of 8.4% to US\$2,009 million in FY 2008 from US\$1,853 million in FY 2007. First year premiums increased 8.3% to US\$326 million in FY 2008 from US\$301 million in FY 2007, primarily due to growth in the bancassurance and agency distribution channels. Weighted single premiums grew 59.3% to US\$16 million in FY 2008 from US\$10 million in FY 2007.

Investment income (excluding investment income from AIA investment-linked contracts) increased 18.0% to US\$657 million in FY 2008 from US\$557 million in FY 2007.

Operating expenses increased 15.8% to US\$132 million in FY 2008 from US\$114 million in FY 2007, primarily due to an appreciation in the Thai Baht against the US dollar and to a lesser extent due to strategic initiatives. The expense ratio increased to 5.6% in FY 2008 from 5.3% in FY 2007.

Operating profit increased 5.7% to US\$424 million in FY 2008 from US\$401 million in FY 2007. This increase was principally the result of growth in premiums, an associated increase in investment income and an increase in surrender fees following the AIG Events which more than offset the resulting acceleration of DAC amortisation. Surrenders were significantly higher in the fourth quarter of FY 2008, increasing more than threefold compared with the first quarter of the year, particularly in respect of ordinary life products. Despite an increase in operating profit, AIA operating margin decreased to 18.0% in FY 2008 from 18.5% in FY 2007 as operating expenses rose faster than TWPI.

Operating return on allocated equity increased marginally to 11.7% in FY 2008 from 11.0% in FY 2007 reflecting stable growth in operating profit after tax attributable to shareholders of AIA and TWPI in FY 2008.

### 7.3 Singapore

	<u>Year ended 30 November</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	(in US\$ millions)		
TWPI	1,514	1,641	1,524
Investment income <sup>(1)</sup>	538	616	609
Operating expenses <sup>(2)</sup>	95	129	91
Operating profit	348	333	356
Operating profit after tax attributable to shareholders of AIA	280	233	264
Allocated segment equity	874	871	1,355
Net capital in/(out) flow <sup>(3)</sup>	(319)	(45)	220
Ratios:			
Expense ratio	6.3%	7.9%	6.0%
AIA operating margin	23.0%	20.3%	23.4%
Operating return on allocated equity	33.4%	26.7%	23.7%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	<u>Year ended 30 November</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	(in US\$ millions)		
TWPI includes:			
Renewal premium . . . . .	1,280	1,407	1,373
First year premium . . . . .	115	139	111
Weighted single premium (10% of single premium) . . . . .	<u>119</u>	<u>95</u>	<u>40</u>
<b>Total</b> . . . . .	<b><u>1,514</u></b>	<b><u>1,641</u></b>	<b><u>1,524</u></b>

*Year Ended 30 November 2009 Compared with Year Ended 30 November 2008*

The Singapore reporting segment accounted for 13.1% of TWPI in FY 2009 as compared with 13.4% in FY 2008. TWPI decreased 7.1%, or 4.0% on a constant exchange rate basis, to US\$1,524 million in FY 2009 from US\$1,641 million in FY 2008 largely as a result of a fall in demand for AIA investment-linked products. TWPI for AIA investment-linked products fell 26.4%, or 23.8% on a constant exchange rate basis, as sales in the first half of FY 2008 were boosted by strong growth prior to the introduction of reduced investment options on Central Provident Fund ordinary accounts in April 2008. Sales of AIA investment-linked products improved in the second half of FY 2009 reflecting various sales promotions and the launch of certain wealth management products to target high net worth individuals. These initiatives resulted in growth in first year premiums and weighted single premiums of 29.9% and 183.2%, respectively, between the first and second halves of 2009. TWPI in respect of ordinary individual life products remained stable at US\$1,119 million in FY 2009, as compared with US\$1,169 million in FY 2008, a decline of 4.3%, or 1.2% on a constant exchange rate basis, accounting for 73.4% of total TWPI in FY 2009, as compared with 71.2% in FY 2008.

Investment income (excluding investment income from AIA investment-linked contracts) decreased 1.1% to US\$609 million in FY 2009 from US\$616 million in FY 2008 mainly as a result of the depreciation of the average exchange rate of the Singaporean Dollar against the US dollar and because cash balances were used to repay obligations under repurchase agreements, forgoing investment income in order to reduce finance costs. On a constant exchange rate basis, investment income (excluding investment income from AIA investment-linked contracts) increased 2.4% during the year.

Operating expenses fell 29.5% to US\$91 million in FY 2009 from US\$129 million in FY 2008 as savings in salaries and related expenses were achieved through greater operational efficiency, such as the transfer of certain support functions to a shared service centre in Malaysia. Moreover, operating expenses in FY 2008 included non-recurring items and, as a result, operating expenses in FY 2009 fell to a level more comparable to FY 2007. This resulted in an improvement in expense ratio to 6.0% in FY 2009 from 7.9% in FY 2008, despite the decrease in TWPI.

Operating profit and operating profit after tax attributable to shareholders of AIA increased to US\$356 million and US\$264 million, respectively, in FY 2009, from US\$333 million and US\$233 million, respectively, in FY 2008, mainly attributable to the improvement in expense ratio and a decrease in commission and other acquisition expenses during FY 2009, whereas FY 2008 was adversely affected by accelerated DAC amortisation arising from higher than expected surrenders in the aftermath of the AIG Events in the fourth quarter of 2008.

The increase in operating profit led to an improvement in the AIA operating margin to 23.4% in FY 2009 from 20.3% in 2008. Despite this increase, operating return on allocated equity fell to 23.7% in FY 2009 compared to 26.7% in FY 2008, reflecting an increase in allocated segment equity from the retention of earnings and a capital injection of US\$220 million to increase the regulatory capital position of the Singapore operations.

*Year ended 30 November 2008 compared with year ended 30 November 2007*

In FY 2007 and the first half of FY 2008, the AIA Group's operations in Singapore experienced strong growth in AIA investment-linked products. Sales of single premium AIA investment-linked products exceeded US\$1 billion in FY 2007 as policyholders reinvested savings from their Central Provident Fund Ordinary Accounts in search of higher returns. In April 2008, investment restrictions introduced by the Central Provident Fund on the use of Central Provident Fund Ordinary Accounts resulted in substantially lower sales of single premium AIA investment-linked products for the remainder of FY 2008. In the second half of FY 2008, the AIA Group's operations in Singapore experienced a shift back to demand for traditional ordinary life insurance products, primarily due to the economic slowdown and the resulting decline in equity market values, as well as the investment restrictions introduced by the Central Provident Fund. As a result, TWPI for ordinary individual life increased to US\$1,169 million in FY 2008, from US\$1,096 million in FY 2007, accounting for 71.2% of TWPI in FY 2008, as compared with 72.4% in FY 2007.

Overall, TWPI increased 8.4% to US\$1,641 million in FY 2008 from US\$1,514 million in FY 2007. On a constant exchange rate basis, the growth was 1.1%. The increase was primarily due to a rise in renewal premiums and growth in first year premiums in all major lines of business, particularly following the launch of the “Smart Growth” and “Achiever” ordinary life insurance products. This growth was partially offset by lower sales of weighted single premium AIA investment-linked products.

Investment income (excluding investment income from AIA investment-linked contracts) increased 14.5% to US\$616 million in FY 2008 from US\$538 million in FY 2007.

Operating expenses of the AIA Group’s operations in Singapore increased 35.8% to US\$129 million in FY 2008 from US\$95 million in FY 2007, primarily due to increased expenses of US\$9 million relating to several strategic initiatives to grow the agency distribution channel, build new distribution channels and improve wealth management capabilities and operational efficiency, a provision, and the effects of the appreciation of the Singapore dollar against the US dollar. This led to an increase in expense ratio to 7.9% in FY 2008 from 6.3% in FY 2007.

Operating profit of the AIA Group’s operations in Singapore decreased 4.3% to US\$333 million in FY 2008 from US\$348 million in FY 2007, primarily due to an acceleration of DAC amortisation and an increase in operating expenses. These factors more than offset the fee income arising on surrenders. This led to a decrease in AIA operating margin to 20.3% in FY 2008 from 23.0% in FY 2007, and a decrease in operating profit after tax attributable to shareholders of AIA.

Operating return on allocated equity declined to 26.7% in FY 2008 from 33.4% in FY 2007 largely reflecting lower operating profit after tax attributable to shareholders of AIA.

#### 7.4 Malaysia

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI	667	727	707
Investment income <sup>(1)</sup>	200	230	223
Operating expenses <sup>(2)</sup>	52	64	58
Operating profit	123	123	150
Operating profit after tax attributable to shareholders of AIA	85	112	106
Allocated segment equity	272	325	386
Net capital in/(out) flow <sup>(3)</sup>	(51)	(28)	(54)
Ratios:			
Expense ratio	7.8%	8.8%	8.2%
AIA operating margin	18.4%	16.9%	21.2%
Operating return on allocated equity	34.8%	37.5%	29.8%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI includes:			
Renewal premium	578	627	611
First year premium	78	91	93
Weighted single premium (10% of single premium)	11	9	3
<b>Total</b>	<b>667</b>	<b>727</b>	<b>707</b>

#### Year ended 30 November 2009 compared with year ended 30 November 2008

Operations in Malaysia generated operating profit growth of 22.0% between FY 2008 and FY 2009, despite a decrease in TWPI of 2.8% to US\$707 million in FY 2009 from US\$727 million in FY 2008. The decrease in TWPI was due to the depreciation of the Malaysian Ringgit to US dollar average exchange rate in FY 2009; on a constant exchange rate basis, TWPI increased 3.5% year-on-year. The depreciation also affected renewal premiums and first year premiums. Renewal premiums declined 2.6% but increased 3.8% across all product lines on a constant exchange rate basis over FY 2008, while first year premiums increased 2.0%, or 7.7% on a constant exchange rate

basis, led by sales of ordinary individual life insurance products, which accounted for 67.6% of total TWPI in FY 2009.

Investment income (excluding investment income from AIA investment-linked contracts) decreased 3.0% to US\$223 million in FY 2009 from US\$230 million in FY 2008 due largely to depreciation of the average rate of Malaysian Ringgit against the US dollar. On a constant exchange rate basis, investment income (excluding investment income from AIA investment-linked contracts) grew 3.5% between FY 2008 and FY 2009.

Operating expenses decreased 9.4% to US\$58 million in FY 2009 compared with US\$64 million in FY 2008 primarily because operating expenses in FY 2008 included certain non-recurring expenses associated with converting the Malaysian operations from a branch to a subsidiary and the establishment of the international Takaful operations, but also reflecting the beneficial effects of foreign exchange. There was a corresponding improvement in the expense ratio to 8.2% in FY 2009 as compared with 8.8% in FY 2008.

Operating profit increased 22.0% to US\$150 million in FY 2009 compared with US\$123 million in FY 2008, as a result of lower claims and policyholder dividends in FY 2009, following the maturity of an endowment product in FY 2008. This contributed to a more favourable AIA operating margin of 21.2% in FY 2009 as compared with 16.9% in FY 2008.

Operating profit after tax attributable to shareholders of AIA decreased 5.4% between FY 2008 and FY 2009, despite an increase in operating profit, because the effective tax rate applicable on operating profit in FY 2008 was lower than average due to a tax credit received in that year.

Operating return on allocated equity decreased to 29.8% in FY 2009 from 37.5% in FY 2008 largely reflecting higher allocated segment equity. Allocated segment equity has been stated after the effects of a dividend remittance of US\$69 million to the AIA Group during the year.

*Year ended 30 November 2008 compared with year ended 30 November 2007*

Despite the regional economic slowdown in Asia, the AIA Group's operating unit in Malaysia continued to experience growth in TWPI in FY 2008. TWPI increased 9.1% to US\$727 million in FY 2008 from US\$667 million in FY 2007. On a constant exchange rate basis, the increase was 4.6%. The increase was primarily due to growth in renewal premiums as a result of stable AIA persistency levels and an increase in first year premiums across all product lines. Single premiums declined in FY 2008 as a result of lower demand for AIA investment-linked products due to declining equity market values. Overall, the product mix remained stable, with ordinary individual life and AIA investment-linked products accounting for 68.0% and 17.4% of total TWPI in FY 2008, respectively, as compared to 68.6% and 17.8%, respectively, in FY 2007.

Investment income (excluding investment income from AIA investment-linked contracts) increased 15.0% to US\$230 million in FY 2008 from US\$200 million in FY 2007.

Operating expenses increased 23.1% to US\$64 million in FY 2008 from US\$52 million in FY 2007, partly due to the appreciation of the Malaysian Ringgit against the US dollar and expenses relating to strategic initiatives, such as converting the AIA Group's branch to a wholly-owned subsidiary and costs associated with setting up its Takaful operations. The expense ratio increased to 8.8% in FY 2008 from 7.8% in FY 2007 as growth in operating expenses outpaced growth in TWPI due to certain non-recurring expenses.

Operating profit remained unchanged at US\$123 million in FY 2008 and FY 2007. However, AIA operating margin decreased to 16.9% in FY 2008 from 18.4% in FY 2007 mainly as TWPI increased while operating profit was unchanged.

Operating profit after tax attributable to shareholders of AIA in FY 2008 increased more than the corresponding increase in operating profit mainly due to the recognition of a tax credit of US\$41 million relating to a beneficial change in tax regulation in Malaysia. Operating return on allocated equity increased to 37.5% in FY 2008 from 34.8% in FY 2007 largely reflecting the effect of the increase in operating profit after tax attributable to shareholders of AIA and lower net capital outflows during FY 2008. Net capital outflows were lower in FY 2008 as the AIA Group decided to retain more capital in Malaysia to fund future growth when it converted its branch to a wholly-owned subsidiary.

## 7.5 China

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI	806	934	1,018
Investment income <sup>(1)</sup>	147	184	201
Operating expenses <sup>(2)</sup>	127	172	181
Operating profit	122	85	89
Operating profit after tax attributable to shareholders of AIA	111	88	68
Allocated segment equity	450	489	601
Net capital in/(out) flow <sup>(3)</sup>	—	7	16
Ratios:			
Expense ratio	15.8%	18.4%	17.8%
AIA operating margin	15.1%	9.1%	8.7%
Operating return on allocated equity	30.2%	18.7%	12.5%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI includes:			
Renewal premium	607	755	835
First year premium	161	160	166
Weighted single premium (10% of single premium)	38	19	17
<b>Total</b>	<b>806</b>	<b>934</b>	<b>1,018</b>

### Year ended 30 November 2009 compared with year ended 30 November 2008

Operations in China generated TWPI of US\$1,018 million in FY 2009 as compared to US\$934 million in FY 2008, reflecting the continued efforts to expand distribution capabilities across the branch network. Between FY 2008 and 2009, TWPI increased across all major product lines contributing to an overall growth in TWPI of 9.0%, or 6.6% on a constant exchange rate basis.

Renewal premiums increased 10.6% year-on-year (8.3% on a constant exchange rate basis), as a result of growth in AIA investment-linked products, standalone health and protection products, and group insurance products. First year premiums grew 3.9% between FY 2008 and FY 2009 largely due to improved productivity of the tied agency force. Growth in first year premiums was particularly significant in the second half of FY 2009 as premiums for ordinary individual life insurance increased 46.6% as compared with the first half of FY 2009. TWPI in respect of ordinary individual life products grew 5.0% to US\$745 million in FY 2009, from US\$710 million in FY 2008, or 2.8% on a constant exchange rate basis, accounting for 73.3% of total TWPI in FY 2009, compared with 76.0% in FY 2008.

Investment income (excluding investment income from AIA investment-linked contracts) increased 9.2% to US\$201 million in FY 2009 from US\$184 million in FY 2008, mainly due to a larger average balance of assets under management from net inflow of new funds, of which a larger proportion was invested in financial investments in FY 2009 compared with FY 2008. The AIA Group's operations in China reduced its holding of cash balances to an average of US\$127 million in FY 2009 from US\$255 million as of 30 November 2008.

Operating expenses increased by 5.2% to US\$181 million in FY 2009 from US\$172 million in FY 2008 as the operations in China continued to enhance its agency and customer services network and develop its bancassurance and IFA distribution capabilities during the year and reflecting the strengthening of the Renminbi against the US dollar during FY 2009. Despite higher operating expenses, the expense ratio reduced to 17.8% in FY 2009 compared with 18.4% in FY 2008 as growth in TWPI outpaced growth in operating expenses.

Operating profit increased to US\$89 million in FY 2009 compared with US\$85 million in FY 2008, reflecting higher investment income, whereas operating profit after tax attributable to shareholders of AIA decreased to US\$68 million in FY 2009 from US\$88 million in FY 2008 as the effective tax rate in FY 2008 reflected the receipt

of a one-time tax benefit from filing a consolidated tax return. The effective tax rate on operating profit in FY 2009 of approximately 24% is more closely aligned to the headline corporate income tax rate of 25%.

AIA operating margin for FY 2009 was 8.7% compared with 9.1% in FY 2008 as TWPI grew at a faster rate than operating profit. Operating return on allocated equity fell to 12.5% in FY 2009 compared to 18.7% in FY 2008 influenced by lower operating profit after tax attributable to shareholders of AIA and an increase in allocated equity reflecting retention of earnings from growth of the branch network and an increase in allocated equity of US\$16 million, including a capital injection of US\$6 million into a real estate development project in Guangdong province.

#### *Year ended 30 November 2008 compared with year ended 30 November 2007*

TWPI increased 15.8% to US\$934 million in FY 2008 from US\$806 million in FY 2007. On a constant exchange rate basis, the growth was 6.0%. The increase was primarily due to growth in renewal premiums across all major product lines and a significant increase in group insurance products across all available premium categories, offset by a decrease in single premiums. The decrease in single premiums reflected lower customer demand for AIA investment-linked products in the second half of FY 2008, which was due in large part to the significant decline in Asian and global equity market values.

Investment income (excluding investment income from AIA investment-linked contracts) increased 25.2% to US\$184 million in FY 2008 from US\$147 million in FY 2007.

Operating expenses increased 35.4% to US\$172 million in FY 2008 from US\$127 million in FY 2007, mainly due to higher employee expenses as a result of an increase in headcount combined with an increase in salaries, investments in initiatives to expand the AIA Group's business in China and the appreciation of the Renminbi against the US dollar, but was offset by a refund of US\$7 million of business tax which related to commission expenses. Specifically, AIA China expanded its agency and customer services infrastructure by increasing new sales and services centres to 127 centres in FY 2008 from 104 centres in FY 2007. The expense ratio increased to 18.4% in FY 2008 from 15.8% in FY 2007.

Operating profit decreased 30.3% to US\$85 million in FY 2008 from US\$122 million in FY 2007, principally as a result of the increase in expenses discussed above. AIA operating margin decreased to 9.1% in FY 2008 from 15.1% in FY 2007 largely for the same reasons that led to the decrease in operating profit in FY 2008.

Operating profit after tax attributable to shareholders of AIA in FY 2008 decreased less than the corresponding reduction in operating profit mainly due to tax savings of approximately US\$20 million from the consolidated tax filing of the China branches.

The operating return on allocated equity decreased to 18.7% in FY 2008 from 30.2% in FY 2007 reflecting the decrease in operating profit and an increase in allocated segment equity, including the effect of a capital injection made by the AIA Group relating to a real estate development project in Guangdong province.

#### **7.6 Korea**

	<b>Year ended 30 November</b>		
	<b>2007</b>	<b>2008</b>	<b>2009</b>
	<b>(in US\$ millions)</b>		
TWPI	2,178	2,268	1,759
Investment income <sup>(1)</sup>	233	248	217
Operating expenses <sup>(2)</sup>	136	132	101
Operating profit	269	281	81
Operating profit after tax attributable to shareholders of AIA	192	218	65
Allocated segment equity	950	1,224	1,227
Net capital in/(out) flow <sup>(3)</sup>	60	105	11
<b>Ratios:</b>			
Expense ratio	6.2%	5.8%	5.7%
AIA operating margin	12.4%	12.4%	4.6%
Operating return on allocated equity	23.7%	20.1%	5.3%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	<u>Year ended 30 November</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>
	(in US\$ millions)		
TWPI includes:			
Renewal premium . . . . .	1,421	1,559	1,429
First year premium . . . . .	683	664	322
Weighted single premium (10% of single premium) . . . . .	<u>74</u>	<u>45</u>	<u>8</u>
<b>Total</b> . . . . .	<b><u>2,178</u></b>	<b><u>2,268</u></b>	<b><u>1,759</u></b>

*Year ended 30 November 2009 compared with year ended 30 November 2008*

Performance of operations in Korea in FY 2009 was affected by ongoing uncertainty in the Korean economy and the AIG Events, which had a more pronounced and longer lasting impact than on other operations due to the previous branding of the Korean operations as AIG Life Korea. The impact on results of operations in Korea was exacerbated by further depreciation of the Korean Won against the US dollar during FY 2009, as the average Korean Won to US dollar exchange rate deteriorated 22.9% to 1,287.00 in FY 2009 from 1,047.12 in FY 2008.

TWPI decreased 22.4% to US\$1,759 million in FY 2009 compared to US\$2,268 million in FY 2008, although on a constant exchange rate basis the decrease was 4.7%. The 8.3% decrease in renewal premiums between FY 2008 and 2009 was largely attributable to adverse foreign exchange movements; on a constant exchange rate basis renewal premiums increased 11.9% during FY 2009. This increase was driven by a 60.7% growth on a constant exchange rate basis in renewal premiums for AIA investment-linked products in FY 2009.

First year premiums decreased 51.5%, or 39.5% on a constant exchange rate basis, to US\$322 million in FY 2009 compared with US\$664 million in FY 2008, mainly as a result of weaker sales in the first half of 2009. First year premiums were greater in the second half of FY 2009 as the AIA Group rebranded the Korean operations to AIA Life Korea, led by a 40.2% increase in sales of ordinary individual life insurance in the second half of FY 2009 as compared with the first half.

Investment income (excluding investment income from AIA investment-linked contracts) fell 12.5% to US\$217 million in FY 2009 from US\$248 million in FY 2008 due to the depreciation of the Korean Won against the US dollar as well as the carry-over effect of lower assets under management during FY 2009 following high policy surrenders in the last quarter of FY 2008 and the first quarter of 2009. On a constant exchange rate basis, investment income (excluding investment income from AIA investment-linked contracts) increased 7.5% year-on-year.

Operating expenses decreased 23.5% to US\$101 million in FY 2009 from US\$132 million in FY 2008 mainly as a result of the depreciation of the Korean Won against the US dollar and active cost control measures during the year. On a constant exchange rate basis, the decrease in operating expenses was 5.7%. The expense ratio remained largely stable at 5.7% in FY 2009 compared with 5.8% in FY 2008 as both operating expenses and TWPI were affected by the depreciation in the Korean Won.

Operating profit and operating profit after tax attributable to shareholders of AIA decreased to US\$81 million and US\$65 million, respectively, in FY 2009, from US\$281 million and US\$218 million, respectively, in FY 2008 due to the effects of depreciation of the Korean Won and the impact of increased DAC amortisation in respect of AIA investment-linked contracts and variable universal life products of approximately US\$90 million in FY 2009. This increase in DAC amortisation resulted from a revision to AIA persistency assumptions in respect of investment-linked and variable universal life policies reflecting higher than anticipated surrenders and premium holidays were experienced during FY 2009.

A further factor contributing to the reduction in operating profit was an increase in claims in FY 2009 estimated at US\$40 million, particularly in respect of cancer products, where claims increased significantly due to enhanced awareness of and access to health screening. Steps have since been taken to limit the exposure to products with long-term guaranteed rates that offer protection against cancer risk and to update insurance contract liabilities to reflect the increase in historical claims experience. In addition, operating profit in FY 2008 benefited from approximately US\$40 million of surrender gains following the AIG Events in the last quarter of 2008.

Both AIA operating margin and operating return on allocated equity were adversely affected by the deterioration in operating profit and decreased to 4.6% and 5.3%, respectively, in FY 2009 from 12.4% and 20.1%, respectively, in FY 2008.

*Year ended 30 November 2008 compared with year ended 30 November 2007*

The AIA Group's business in Korea experienced growth in the first half of FY 2008, but was adversely affected by the financial market downturn and the AIG Events in the second half of FY 2008. The depreciation of the Korean Won against the US dollar in FY 2008 also had an adverse impact on the results of the AIA Group's business in Korea.

TWPI increased 4.1% to US\$2,268 million in FY 2008 from US\$2,178 million in FY 2007. On a constant exchange rate basis, the increase was 17.3%. This increase was primarily due to a growth in renewal premiums of 9.6% (24.2% on a constant exchange rate basis), partially offset by a 2.8% decrease in first year premiums, although on a constant exchange rate basis first year premiums increased 8.5%. In the first half of FY 2008, AIA Korea experienced growth in first year and single premiums, particularly with respect to variable universal life products. In the second half of FY 2008, AIA Korea's sales of AIA investment-linked products fell significantly, which was mainly attributable to the significant decline in values in the Asian and global equity markets and the AIG Events. In Korea, response to the AIG Events was particularly marked as the local operations were branded AIG Life Korea, which, in particular, affected the bancassurance distribution channel adversely.

Korea was a significant geographical market with respect to the AIA Group's standalone health and protection insurance product line in FY 2008. During FY 2008, first year premiums for standalone health and protection insurance products decreased 27.7% (19.2% on a constant exchange rate basis) due to declining demand in these products, reflecting increased competition and decline in sales of insurance products through the direct marketing channel, and the depreciation of the Korean Won against the US dollar.

Investment income (excluding investment income from AIA investment-linked contracts) increased 6.4% to US\$248 million in FY 2008 from US\$233 million in FY 2007.

Operating expenses decreased 2.9% to US\$132 million in FY 2008 from US\$136 million in FY 2007, primarily due to the depreciation of the Korean Won against the US dollar in FY 2008. The expense ratio decreased to 5.8% in FY 2008 from 6.2% in FY 2007, partially reflecting greater operational efficiencies.

Operating profit increased 4.5% to US\$281 million in FY 2008 from US\$269 million in FY 2007, primarily as a result of an increase in surrender fees following the AIG Events, which more than offset the resulting acceleration of DAC amortisation relating to such surrendered policies. Surrenders increased significantly in September 2008, particularly in respect of investment-linked and annuity products and products sold through the bancassurance distribution channel.

The Korean operations' AIA operating margin remained at 12.4% in FY 2008 and FY 2007.

The increase in operating profit after tax attributable to shareholders of AIA for FY 2008 compared with FY 2007 was greater than the corresponding increase in operating profit, partly due to a lower deferred tax charge in respect of FY 2008, as a reduction in corporate tax rates to 22% from 24% has been announced (compared to 24% in FY 2008). However, operating return on allocated equity decreased to 20.1% in FY 2008 from 23.7% in FY 2007, despite the increase in operating profit after tax attributable to shareholders of AIA, primarily due to the effects of a depreciation of the Korean Won against the US dollar and a capital contribution from the AIA Group to support local solvency following significant annuity surrenders.

The Korean operations experienced annuity surrenders of US\$1,023 million in FY 2008, compared with US\$250 million in FY 2007. These surrender cash outflows were reflected in the statement of financial position as a decrease in assets, offset by a decrease in liabilities. Given the adverse market conditions at the time, the Korean operations chose to maintain its investment in a portfolio of US dollar denominated assets originally held to back the annuity business, thereby creating a temporary currency mismatch of assets and liabilities. As a result, monthly surrenders for October 2008 and November 2008 of US\$158 million and US\$79 million, respectively, were significantly reduced from the peak in September 2008 of US\$526 million.

## **7.7 Other Markets**

Other Markets includes the results of the AIA Group's operations in Australia, the Philippines, Indonesia, Vietnam, New Zealand and Taiwan, and the AIA Group's interest in its joint venture in India, which is reflected in the AIA Group's consolidated financial information using the equity method of accounting.

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI	1,184	1,366	1,390
Investment income <sup>(1)</sup>	352	397	400
Operating expenses <sup>(2)</sup>	157	173	170
Operating profit	170	188	191
Operating profit after tax attributable to shareholders of AIA	105	153	137
Allocated segment equity <sup>(3)</sup>	1,135	1,314	1,445
Net capital in/(out) flow <sup>(4)</sup>	(1)	118	18
Ratios:			
Expense ratio	13.3%	12.7%	12.2%
AIA operating margin	14.4%	13.8%	13.7%
Operating return on allocated segment equity	10.0%	12.5%	9.9%

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Allocated segment equity includes capital allocations in the form of subordinated inter-company debt.

(4) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
TWPI includes:			
Renewal premium	861	1,015	1,020
First year premium	296	325	358
Weighted single premium (10% of single premium)	27	25	12
<b>Total</b>	<b>1,184</b>	<b>1,366</b>	<b>1,390</b>

#### *Year ended 30 November 2009 compared with year ended 30 November 2008*

The collective performance of the AIA Group's Other Markets segment continued to increase with TWPI and operating profit in FY 2009 exceeding the corresponding amounts in FY 2008 and FY 2007. As the purchase of a 51% interest in Ayala Life was concluded only shortly before the AIA Group year end, this purchase had no impact on TWPI for FY 2009.

TWPI for Other Markets grew 1.7% to US\$1,390 million in FY 2009 from US\$1,366 million in FY 2008, corresponding to an increase of 12.6% on a constant exchange rate basis. In common with the performance of the Key Markets reporting segments, TWPI growth in the second half of FY 2009 was stronger in most of the AIA Group's operations in Other Markets, and across most product lines, compared with the first half of the year. Overall, TWPI grew 24.7% in the second half of FY 2009, as compared with the first half of the year. The increase in TWPI was led by growth in group insurance products, which represented 32.9% of overall TWPI for Other Markets in FY 2009 compared with 20.9% in FY 2008.

The overall growth in TWPI in Other Markets was led by the operations in Australia and Vietnam. TWPI for the Australian operations increased 37.8% to US\$576 million in FY 2009 from US\$418 million in FY 2008, or 53.5% on a constant exchange rate basis, as a result of strong growth in group insurance products and expansion of AIA Australia's distribution channels to include bancassurance in FY 2009. AIA Australia acquired significant new corporate accounts during the year, enabling it to attain a leading position in the Australian group insurance market in FY 2009. In Vietnam, TWPI increased 11.9% to US\$43 million in FY 2009 from US\$38 million in FY 2008, or 21.2% on a constant exchange rate basis, mainly attributable to growth in ordinary individual life insurance products. In October 2009, the AIA Group sold its interest in its joint venture operation in Indonesia, PT Asuransi AIA Indonesia. The sale generated a loss on disposal of US\$29 million. The AIA Group continues to operate in Indonesia through its wholly-owned subsidiary PT AIA Financial.

Investment income (excluding investment income from AIA investment-linked contracts) increased 0.8% to US\$400 million in FY 2009 from US\$397 million in FY 2008. On a constant exchange rate basis, investment income (excluding investment income from AIA investment-linked contracts) grew 10.3% year-on-year.

Operating expenses decreased marginally to US\$170 million in FY 2009 from US\$173 million in FY 2008 but increased 8.3% on a constant exchange rate basis mainly as a result of higher spending on strategic initiatives during

FY 2009, particularly in Australia, as the AIA Group invests in diversifying its distribution capabilities and improving operational efficiency. Its expense ratio improved to 12.2% in FY 2009 compared with 12.7% in FY 2008 as growth in TWPI outpaced the increase in expenses.

Operating profit increased to US\$191 million in FY 2009 from US\$188 million in FY 2008 mainly attributable to a decrease in the AIA Group's share of losses associated with its interest in its joint venture in India, which fell to US\$22 million in FY 2009 from US\$29 million in FY 2008. Despite the growth in operating profit, operating profit after tax attributable to shareholders of AIA decreased to US\$137 million in FY 2009 compared to US\$153 million in FY 2008.

AIA operating margin remained broadly unchanged at 13.7% in FY 2009 and 13.8% in FY 2008, reflecting stable operating profit. Excluding the share of losses from associates and joint ventures, the AIA operating margin was 15.3% in FY 2009, a slight deterioration compared with FY 2008 of 15.9%, but higher than 15.0% in FY 2007.

Operating return on equity declined to 9.9% in FY 2009 as compared with 12.5% in FY 2008, reflecting lower operating profit after tax attributable to shareholders of AIA and higher allocated equity as the AIA Group retained earnings in local operations in order to provide capital to support further growth. During FY 2009 capital allocated to the Other Markets segment increased US\$18 million, primarily reflecting a US\$75 million increase in the Philippines as a result of sales of former subsidiaries less a dividend of US\$25 million to ALICO and increases in capital allocated to the AIA Group's operations in Australia, Vietnam and its ongoing operations in Indonesia, which more than offset a decrease of US\$62 million resulting from the sale of PT Asuransi AIA Indonesia.

*Year ended 30 November 2008 compared with year ended 30 November 2007*

Despite the regional economic slowdown, most of the AIA Group's operating units in Other Markets experienced TWPI growth in FY 2008. Overall, the AIA Group's operations in Other Markets saw TWPI grow 15.5% to US\$1,366 million in FY 2008 from US\$1,184 million in FY 2007. On a constant exchange rate basis, the increase was 12.7%.

The AIA Group's Australian operations were the largest contributor to TWPI among the Other Markets segment, representing 30.6% on a TWPI basis in FY 2008. In Australia, TWPI increased across all product lines and premium types with an overall increase of 33.2%, primarily as a result of a significant increase in group and standalone health and protection insurance premiums. The AIA Group's group insurance business in Australia acquired a number of large corporate customers, while growth in standalone health and protection insurance business was driven primarily by higher sales achieved through greater focus on the IFA channel throughout FY 2008. Most of the AIA Group's other operating units within the Other Markets segment experienced growth in investment-linked and group product premiums. Its operations in Vietnam saw first year premiums grow at 19.6% in FY 2008, which was mainly due to increased sales of universal life products.

Investment income (excluding investment income from AIA investment-linked contracts) increased 12.8% to US\$397 million in FY 2008 from US\$352 million in FY 2007.

Operating expenses increased 10.2% to US\$173 million in FY 2008 from US\$157 million in FY 2007. This increase was primarily driven by strategic initiatives undertaken in operating units in Indonesia, Australia and Vietnam, such as distribution channel expansion and systems improvements, and local currency appreciation against the US dollar in FY 2008. The expense ratio decreased marginally to 12.7% in FY 2008 from 13.3% in FY 2007.

Operating profit increased 10.6% to US\$188 million in FY 2008 from US\$170 million in FY 2007. Operating profit increased in most of its operating units in Other Markets due to higher sales and higher investment income. Operating profit also includes the effect of equity accounting for the AIA Group's share of losses from associates and joint ventures of US\$29 million in FY 2008 and US\$8 million in FY 2007. The AIA operating margin decreased to 13.8% in FY 2008 from 14.4% in FY 2007, mainly as a result of TWPI increasing at a greater rate than operating profit before tax.

Operating return on allocated equity increased to 12.5% in FY 2008 from 10.0% in FY 2007, reflecting the increase in operating profit after tax attributable to shareholders of AIA and the effects of capital allocations by the AIA Group to support continued expansion in Australia of US\$18 million (in the form of subordinated debt), in Vietnam of US\$23 million, in Taiwan of US\$9 million, as well as US\$50 million (in the form of subordinated debt) in Indonesia to support local solvency requirements in FY 2008. In addition, the AIA Group invested US\$44 million in its joint venture in India in FY 2008.

## 7.8 Corporate and Other

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
Investment income <sup>(1)</sup>	72	45	(10)
Operating expenses <sup>(2)</sup>	148	104	82
Operating loss	(99)	(81)	(88)
Operating loss after tax attributable to shareholders of AIA	(146)	(87)	(106)
Allocated segment equity <sup>(3)</sup>	985	689	909
Net capital in/(out) flow <sup>(4)</sup>	285	(377)	383

(1) Excludes investment income related to AIA investment-linked contracts.

(2) Excludes non-operating actuarial gains and losses arising from defined benefit schemes as detailed in Part XV, note 5.

(3) Allocated segment equity includes capital allocations in the form of subordinated into company debt.

(4) Capital outflows consist of dividends/profit distributions to the Corporate and Other segment and capital inflows consist of capital injections by the Corporate and Other segment.

### *Year ended 30 November 2009 compared with year ended 30 November 2008*

The activities of the Corporate and Other segment consist of the AIA Group's corporate functions, shared services and eliminations of intragroup transactions. The Corporate and Other segment holds the majority of the AIA Group's investment in AIG shares.

Investment income (excluding investment income from AIA investment-linked contracts) decreased to a net loss of US\$10 million in FY 2009 from a net gain of US\$45 million in FY 2008 reflecting lower interest income.

Operating expenses for this segment are stated net of fees for intra-group corporate services which are charged to the reporting segments. Operating expenses decreased to US\$82 million in FY 2009 from US\$104 million in FY 2008 as the AIA Group further refined its corporate service fee charging policy and rationalised headcount in certain central support functions, reducing head office personnel by some 200 individuals. Taking all of the above, together with a substantial reduction in investment management and finance costs, the operating loss grew to US\$88 million in FY 2009 compared with US\$81 million in FY 2008.

The allocated segment equity increased in FY 2009 reflecting capital contribution from AIG, less net redeployment of capital to other segments and payment of dividends to AIG.

### *Year ended 30 November 2008 compared with year ended 30 November 2007*

Investment income (excluding investment income from AIA investment-linked contracts) decreased 37.5% to US\$45 million in FY 2008 from US\$72 million in FY 2007 as capital from the Corporate and Other segment was redeployed to support continued expansion of the AIA Group's business and capital requirements of other segments, thereby decreasing funds available for investment in this reporting segment.

Operating expenses are stated net of fees for intra-group corporate services which are charged to the reporting segments. Operating expenses decreased 29.7% to US\$104 million in FY 2008 from US\$148 million in FY 2007, reflecting refinement in the basis of charging expenses, within the AIA Group. The operating loss decreased 18.2% to US\$81 million in FY 2008 from US\$99 million in FY 2007 mainly as a result of the reduction in investment income, partially offset by the reduction in operating expenses.

Operating loss after tax attributable to shareholders of AIA reduced to US\$87 million in FY 2008 from US\$146 million in FY 2007, representing a greater reduction than in the operating loss, primarily due to a reversal of deferred tax liabilities during FY 2008.

Allocated segment equity decreased in FY 2008 reflecting redeployment of capital to other segments to support business expansion and capital requirements as well as payment of dividends to the AIG Group.

## 8. Liquidity and capital resources

The AIA Group manages its liquidity and capital resources on a group-wide basis, as well as at the level of its subsidiaries and branches. Its principal cash inflows come from insurance premiums, deposits, policy fees, management fees for its AIA investment-linked products and annuity sales. In the case of AIA, as discussed below at section 11 of this Part XIII, its principal capital inflows will be dividends from AIA Co and its principal capital outflows will be dividends to shareholders.

The principal sources of funds generated by the AIA Group's insurance operations are generally affected by fluctuations in the level of policy surrenders, withdrawals, maturities, benefits and claims and guarantees to policyholders. The AIA Group's operating units may face liquidity pressure in the form of unexpected cash demands that could arise from an increase in the level of policyholders terminating policies. The AIA Group closely monitors and manages the level of surrenders in order to minimise such liquidity risk. AIA is a holding company and depends upon dividends and other distributions and payments from AIA Co for its cash flow, and AIA Co depends upon dividends and other distributions and payments from the AIA Group's operating subsidiaries and branches for substantially all of its cash flow. The payment of dividends and other distributions and payments by the AIA Group's subsidiaries and branches are regulated by applicable insurance, foreign exchange and tax laws, rules and regulations. The amount and timing of certain dividends, distributions and other payments by the AIA Group's insurance subsidiaries or branches require regulatory approval. In particular, the payment of dividends, distributions and other payments to AIA by AIA Co is subject to the oversight of the OCI. As a holding company, the ability of AIA to pay dividends and meet other obligations depends on dividends and other payments from its operating subsidiaries and branches, which are subject to contractual, regulatory and other limitations.

Liquidity is also available from the AIA Group's portfolio of investment assets. Its investments generally comprise highly liquid and marketable securities, which generally could be liquidated to meet cash needs. As of 30 November 2009, its cash and cash equivalents were US\$3,405 million. The AIA Group seeks to augment its liquidity by employing various liability management techniques, including staggering of maturities of term deposits and investing in marketable short-term securities. As of 30 November 2009, its investments in fixed maturity securities had a fair value of US\$52,201 million. In some of the markets in which it invests, the AIA Group is subject to market liquidity risk due to the significant size of its local currency denominated investments. In some of the markets in which it invests, its ability to sell investments in a sizeable volume without affecting the markets may be limited.

The AIA Group's cash inflows and existing cash balances are used to pay liabilities under various life insurance, annuity and health and protection insurance products, and to purchase investment assets. The AIA Group also uses its funds to pay operating expenses, income taxes and dividends that may be declared and payable to its shareholders.

Foreign exchange rate risk arises from the AIA Group's capital being held in multiple currencies in the Asia Pacific region. The AIA Group's primary concern is potential gains and losses to the group-level solvency position that could result from translation of local currencies into the US dollar. The US dollar is the functional currency for solvency margin reporting to the Hong Kong Office of the Commissioner of Insurance. Foreign exchange rate risk can also arise from gains or losses that result from the conversion of profits distributed to AIA Co that are denominated in local currencies to the US dollar. The AIA Group actively monitors the exposure of its capital position to such foreign exchange rate risks and undertakes appropriate hedging strategies to mitigate such risks, to the extent they are inconsistent with the AIA Group's risk appetite.

### *Cash flows*

	<b>Year ended 30 November</b>		
	<b>2007</b>	<b>2008</b>	<b>2009</b>
	(in US\$ millions)		
<b>Profit before tax</b> . . . . .	<b>2,798</b>	<b>42</b>	<b>2,580</b>
Net cash (used in)/provided by operating activities . . . . .	1,634	2,287	(1,101)
Net cash (used in)/provided by investing activities . . . . .	(72)	(168)	(98)
Net cash (used in)/provided by financing activities . . . . .	(62)	(414)	348
<b>Net increase in cash and cash equivalents</b> . . . . .	<b>1,500</b>	<b>1,705</b>	<b>(851)</b>
Cash and cash equivalents at the beginning of the financial year . . . . .	1,035	2,583	4,164
Effect of exchange rate changes on the balance of cash held in foreign currencies at the beginning of the financial year . . . . .	48	(124)	92
<b>Cash and cash equivalents at end of the financial year</b> . . . . .	<b>2,583</b>	<b>4,164</b>	<b>3,405</b>

### *Operating activities*

Net cash used in operating activities was US\$1,101 million in FY 2009 compared with net cash provided by operating activities of US\$2,287 million in FY 2008, primarily reflecting the repositioning of the AIA Group's investment portfolio during the third and fourth quarters of FY 2009. During FY 2007 and FY 2008, the AIA Group de-risked its balance sheet and maintained a high cash balance in response to the AIG Events and to meet potential obligations as it wound down and largely withdrew from securities lending. The AIA Group increased its investment activities significantly in the second half of FY 2009 as debt and equity markets recovered and the

economic and trading outlook became more positive, funded mainly by cash generated from operating activities. The impact of the AIA Group's portfolio re-risking as it re-entered the market at the end of FY 2009 was muted because of the substantial cash balances that it had built up.

Net cash provided by operating activities was US\$2,287 million in FY 2008, an increase from US\$1,634 million in FY 2007. The increase in cash provided by operating activities over this period was primarily due to realisation of financial investments, and due to changes in the AIA Group's investment strategy in the latter half of FY 2008 which resulted in an increase in the proportion of net cash inflows from its insurance business held as cash and cash equivalents, rather than invested in financial investments.

Of cash and cash equivalents at 30 November 2009, US\$764 million was held to back investment-linked contracts, as compared with US\$1,116 million at 30 November 2008. The AIA Group held a balance of cash and cash equivalents of US\$160 million as at 30 November 2008 in respect of securities lending as compared with nil as at 30 November 2009 as it largely withdrew from securities lending during the year.

As at 28 February 2010 cash and cash equivalents of the AIA Group were US\$3,887 million (30 November 2009 US\$3,405 million).

#### *Investing activities*

Investing activities consist of acquisitions and divestitures of subsidiaries and associates and acquisitions and disposals of investment property and intangible assets. Net cash used in investing activities was US\$98 million in FY 2009, a decrease from US\$168 million in FY 2008. The decrease in cash used in investing activities over this period was primarily due to a reduction in purchases of investment property, plant and equipment.

Net cash used in investing activities was US\$168 million in FY 2008, an increase from US\$72 million in FY 2007. The increase in cash used in investing activities over this period was primarily due to investment activities in investment property, plant and equipment.

#### *Financing activities*

Net cash provided by financing activities was US\$348 million in FY 2009 compared with net cash used in financing activities of US\$414 million in FY 2008. This increase reflected the repayment of a substantial portion of loans from fellow subsidiaries of AIG in FY 2008 and the capital contribution the AIA Group received from AIG during FY 2009 of US\$401 million, primarily in relation to separation activities including the withdrawal from securities lending, reimbursement of separation costs, the sale of the AIA Group's investment management operations to AIG and the disposal of other entities to third parties.

Net cash used in financing activities was US\$414 million in FY 2008, an increase from US\$62 million in FY 2007. The increase in cash used in financing activities over this period was primarily due to repayment of borrowings from subsidiaries of AIG and an increase in dividend payments to AIA's parent. These amounts offset the cash inflow from a capital contribution by AIA's parent.

#### *Insurance solvency margin*

The AIA Group is in compliance with the solvency and capital adequacy requirements of its regulators. Its primary insurance regulator at the group level is the OCI, which requires that AIA meet the solvency margin requirements of the ICO. AIA defines "Total Available Capital" as the amount of assets in excess of liabilities measured in accordance with ICO and "Required Capital" as the minimum required margin of solvency calculated in accordance with ICO. The ICO (among other matters) sets minimum solvency margin requirements that an insurer must meet in order to be authorised to carry on insurance business in or from Hong Kong. The "Solvency Margin Ratio" is the ratio of Total Available Capital to Required Capital. The ICO requires Hong Kong regulated insurance entities within the AIA Group to maintain Total Available Capital that is not less than 100% of the required minimum solvency margin, such that Total Available Capital exceeds Required Capital.

#### *Capital and Regulatory Orders Specific to the AIA Group*

The AIA Group is subject to regulatory orders designed to protect the AIA Group's assets in several of its geographical markets. The orders imposed by the following regulators are summarised below.

## Hong Kong Office of the Commissioner of Insurance

Letters dated 17 September 2008 were issued from the OCI to each of AIA Co and AIA-B (“Section 35 Orders”) requiring each of AIA Co or AIA-B, including all of their branches, as appropriate:

- 1) to ensure that all insurance business and all transactions with any “specified person” (which includes but is not limited to its branches, directors, controllers, shareholders and associates or group companies) is on normal commercial terms;
- 2) to ensure that AIA Co or AIA-B not place any deposit with or transfer assets (except for normal insurance transactions) or provide financial assistance to any specified person without first obtaining written consent from the OCI; and
- 3) to inform the OCI as soon as practicable of any circumstances which may put the interest of policyholders or potential policyholders at risk.

Among other consequences, the Section 35 Orders place restrictions on the ability of AIA Co and AIA-B to engage in capital related transactions with specified persons. Accordingly, the Section 35 Orders restrict the ability of AIA Co and AIA-B to pay dividends to their parent companies, and limit their ability to engage in intercompany transactions with specified persons, such as payment of intercompany service fees without first obtaining written consent from the OCI.

By further letters dated 18 September 2008 to AIA Co and AIA-B, the OCI required that AIA Co or AIA-B as appropriate not acquire a new controller without first obtaining written consent from the OCI.

By letters to AIA Co and AIA-B dated 15 March 2010, the OCI confirmed that the requirements contained in its letters dated 17 and 18 September 2008 remain in force.

## Monetary Authority of Singapore

Since October 2008, the Monetary Authority of Singapore (“MAS”) has issued certain directions to AIA Singapore specifying that it comply with increased capital adequacy requirements. In addition, the directions provide that prior MAS consent be sought in respect of certain transactions including transfers or disposals of certain assets (including land or buildings) and financing and guarantee arrangements. The directions also impose certain additional reporting requirements on AIA Singapore.

## Bermuda Monetary Authority

By a Letter of Undertaking dated 18 December 2008, American International Company Limited (“AICO”), in its capacity as the licensed Insurance Manager of AIA-B, made certain undertakings to the Bermuda Monetary Authority (“BMA”).

In the Letter of Undertaking, AICO:

- 1) undertakes to ensure that AIA-B would seek prior approval from the BMA before entering into transactions outside the normal course of business; and
- 2) undertakes to submit a daily basis report to the BMA on: (i) transfers of more than US\$1,000,000 per transaction or an aggregate amount of greater than US\$1,000,000 per day from AIA-B to another jurisdiction other than where the fund originated; (ii) transactions of greater than US\$15,000,000 whether incoming or outgoing; (iii) all material issues having an impact threshold of equal to or greater than 10% of AIA-B’s total statutory capital and surplus.

## China Insurance Regulatory Commission

Notices issued by the China Insurance Regulatory Commission (“CIRC”) ordered AIA Shanghai Branch, Guangdong Branch, Jiangsu Branch, Beijing Branch, Shenzhen Branch, Suzhou Central Sub-Branch, Dongguan Sub-Branch and Jiangmen Sub-Branch to:

- 1) maintain sufficient funds to cope with possible cancellations and to prevent liquidity risks and monitor the liquidity daily; and
- 2) enhance capital fund safety by: (a) not entering into any mortgage, guarantee, letter of credit or incurring debt other than in the normal course of business; (b) not transferring any assets or funds outside of the PRC; and (c) obtaining approval from the CIRC on any affiliated transaction with AIG including reinsurance transactions (so as to prevent capital and assets from flowing outside of the PRC).

## Bank Negara Malaysia

Under a letter dated 16 September 2008, Bank Negara Malaysia (“BNM”) requested AIA Malaysia to obtain prior written approval of BNM in relation to the following:

- 1) payment of dividends (interim and/or final) to its shareholders (being in addition to the general requirement to obtain a no objection from BNM prior to declaring a dividend exceeding a prescribed statutory amount);
- 2) extension of credit facilities to related-parties within the AIG Group;
- 3) guarantees or undertakings given to/on behalf of related-parties within the AIG Group; and
- 4) any other related-party transactions, excluding any transaction in the ordinary course of AIA Malaysia business relating to insurance policies, reinsurance cessions and claims.

## Other Orders

Correspondence has also been issued to the AIA Group by the Mandatory Provident Fund Schemes Authority in Hong Kong and the regulators in Taiwan, Brunei and Vietnam. Pursuant to this correspondence, regular updates are to be provided to the regulators, and certain regulators must provide their consent before assets are transferred or transactions are entered into with connected parties.

A number of transactions undertaken in FY 2008 and FY 2009 enhanced the company solvency position of the AIA Group. Effective 28 February 2009, AIA-B and AIA Australia, among others, became subsidiaries of AIA Co. On 3 November 2009, beneficial ownership of Philamlife was transferred to AIA Group. In particular, the integration of AIA-B as a wholly-owned subsidiary of AIA Co substantially strengthened solvency and capital position. The information below illustrates AIA Co and AIA-B’s Total Available Capital, Required Capital and Required Solvency Margin Ratio under the ICO at the end of FY 2007, FY 2008 and FY 2009.

## AIA Co

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
<b>Total Available Capital</b> . . . . .	2,551	2,751	4,811
Required Capital . . . . .	1,357	1,316	1,547
Solvency Margin Ratio . . . . .	188%	209%	311%

## AIA-B

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
<b>Total Available Capital</b> . . . . .	2,519	1,469	2,742
Required Capital . . . . .	648	684	911
Solvency Margin Ratio . . . . .	389%	215%	301%

Combined with the capital contributions of AIA Australia and Philamlife into AIA Co, the Total Available Capital, Required Capital and Solvency Margin Ratio as of 30 November 2009 of AIA Co under the ICO was approximately US\$4,811 million, US\$1,547 million and 311%, respectively.

The AIA Group’s individual branches and subsidiaries are also subject to the supervision of government regulators in the jurisdictions in which those branches and subsidiaries are domiciled. AIA-B, although domiciled in Bermuda, is also required to comply with the solvency margin requirements under the ICO because of its substantial insurance business carried on in Hong Kong. The various regulators overseeing the AIA Group actively monitor its solvency margin position. AIA Co and AIA-B submit annual filings to the OCI setting forth their solvency margin ratios based on their annual audited accounts, and the AIA Group’s operating units make similar annual filings with their respective local regulators. The AIA Group’s operating units were in compliance with the solvency margin requirements of their respective local regulators at 30 November 2007, 2008 and 2009.

## 9. Indebtedness

### *Borrowings and obligations under securities lending and repurchase agreements*

As of 30 November 2009, the AIA Group had borrowings of US\$688 million outstanding. Of these borrowings, US\$549 million were in the form of bank loans, US\$85 million in the form of bank overdrafts, US\$50 million in the form of loans from fellow subsidiaries of AIG and US\$4 million in the form of other loans.

The most material financing transaction that the AIA Group is a party to is a five-year variable rate term loan facility dated 23 November 2007 relating to a refinancing of a loan facility for AIA Central. The available facility and amount outstanding as of 30 November 2009 was US\$542 million. The loan facility for AIA Central is on standard commercial terms and on a non-recourse basis, principally secured against assets of the AIA Group's subsidiary company, Bayshore Development Group Limited ("Bayshore"), a 90% owned subsidiary of the AIA Group which owns AIA Central in Hong Kong, and shares held by Grand Design Development Limited, a wholly-owned subsidiary company, and the immediate parent of Bayshore, in Bayshore.

The remaining bank loan relates to a three-year fixed rate term loan facility commencing 31 August 2007, held by the AIA Group's Thai operations. The available facility and amount outstanding as of 30 November 2009 was US\$7 million. The loan facility, which is on standard commercial terms and on a non-recourse basis, is secured against a piece of land held by the AIA Group's Thai operations and is subject to AIA maintaining a certain minimum solvency ratio in respect of its regulated life insurance business in Thailand.

As of 30 November 2009, the AIA Group had no material bank loans other than as described immediately above.

### *Changes to liquidity and indebtedness subsequent to 30 November 2009*

As of 28 February 2010, cash and cash equivalents were US\$3,887 million (30 November 2009 US\$3,405 million). As of 28 February 2010, the AIA Group borrowings had decreased to US\$628 million outstanding (30 November 2009 US\$688 million) principally reflecting a fall in bank loan balances.

The net cash position is defined as cash and cash equivalents less borrowings. At 28 February 2010 the net cash position was US\$3,259 million. Since this date net cash has decreased as a result of normal investing and trading activity. There has been no significant change in the borrowings of the AIA Group or in the long term banking facilities available to the AIA Group.

### *Operational borrowings*

The following operational borrowing as a ratio of total equity attributable to shareholders of AIA is presented on a consistent basis as of 30 November 2007, 2008 and 2009. For the purpose of this analysis, operational borrowings include short-term loans from fellow subsidiaries of AIG arising from an intra-group corporate reorganisation and borrowings and obligations under repurchase agreements. It excludes obligations under agreements related to securities lending since the AIA Group largely withdrew from all securities lending in November 2009.

- As of 30 November 2007, the AIA Group's operational borrowing as a percentage of total equity attributable to shareholders of AIA was 22.3%. Excluding loans from fellow subsidiaries of AIG, the ratio of operational borrowing to total equity attributable to shareholders of AIA was 16.4%
- As of 30 November 2008, the AIA Group's operational borrowing as a percentage of total equity attributable to shareholders of AIA decreased to 15.4% despite a 32.6% decrease in equity attributable to shareholders of AIA to US\$9,176 million from US\$13,616 million in the previous year. The decrease in equity was principally driven by negative fair value and foreign currency translation reserves; while the decrease in operational borrowings reflects a substantial reduction in obligations under repurchase agreements (which decreased to US\$755 million) and repayment of a substantial portion of related party borrowings (which decreased the related party borrowings to US\$20 million).
- As of 30 November 2009, the AIA Group's ratio of operational borrowing as a percentage of total equity attributable to shareholders of AIA decreased further to 6.4% largely due to a reduction in obligations under repurchase agreements, which decreased 62.4% to US\$284 million as of 30 November 2009 from US\$755 million in the previous year, combined with a significant increase in equity attributable to shareholders of AIA to US\$15,252 million as of 30 November 2009 compared with US\$9,176 million in the previous year. The latter was largely driven by a recovery in market values of financial investments towards the end of FY 2009.

## Contractual obligations

### Commitments under operating leases

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
<b>Properties and others</b>			
Not later than one year . . . . .	64	69	76
Later than one and not later than five years . . . . .	121	136	102
Later than five years . . . . .	<u>117</u>	<u>101</u>	<u>94</u>
<b>Total</b> . . . . .	<u><b>302</b></u>	<u><b>306</b></u>	<u><b>272</b></u>

The AIA Group is the lessee of a number of properties and items of office equipment held under operating leases. The leases typically run for an initial period of one to seven years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually reviewed at the end of the lease term to reflect market rates. None of the leases include contingent rentals.

### Investment commitments

	Year ended 30 November		
	2007	2008	2009
	(in US\$ millions)		
<b>Investment commitments</b>			
Not later than one year . . . . .	—	107	90
Later than one and not later than five years . . . . .	143	51	36
Later than five years . . . . .	<u>—</u>	<u>131</u>	<u>138</u>
<b>Total</b> . . . . .	<u><b>143</b></u>	<u><b>289</b></u>	<u><b>264</b></u>

Investment commitments consist of commitments to invest in private equity partnerships.

## Contingencies

The AIA Group is subject to regulation in each of the geographical markets in which it operates by insurance, securities, capital markets, pension, data privacy and other regulators and it is exposed to the risk of regulatory actions in response to perceived or actual non-compliance with regulations relating to suitability, sales or underwriting practices, claims payments and procedures, product design, disclosure, administration, denial or delay of benefits and breaches of fiduciary or other duties.

The AIA Group is exposed to legal proceedings, complaints and other actions from its activities including those arising from commercial activities, sales practices, suitability of products, policies and claims.

The AIA Group is the reinsurer in a residential mortgage credit reinsurance agreement covering residential mortgages in Australia. Due to a change in law, further cessions under this contract ended in July 2008. This reinsurance is fully retroceded to a subsidiary of AIG. The AIA Group is exposed to the risk of losses in the event of the failure of the counterparty retrocessionaire to honour its obligations. The principal balance outstanding on mortgage loans to which the reinsurance agreement relates was approximately US\$3,588 million at 30 November 2009 (US\$3,147 million at 30 November 2008 and US\$4,507 million at 30 November 2007). The liabilities and related reinsurance assets, which totalled US\$24 million at 30 November 2009 (US\$32 million at 30 November 2008 and US\$31 million at 30 November 2007) respectively arising from these agreements are reflected and presented on a gross basis in accordance with the AIA Group's accounting policies. The AIA Group expects to fully recover amounts outstanding at 30 November 2009 under the terms of this agreement from the retrocessionaire. In the event of a change in control, either party has the right to terminate the retrocession cover with the AIA Group electing whether the termination is on a run-off basis or clean cut basis.

The AIA Group provided reinsurance and retrocession of general insurance business which was primarily underwritten in the 1970s and 1980s. In the absence of any claim notifications in the three years ended 30 November 2009, the AIA Group does not expect any further material liabilities to arise. At the time AIA-B was transferred to the AIA Group, AIRCO, the former owner of AIA-B, provided AIA Co with an uncapped indemnification for losses with respect to claims made before 1 November 2010, arising from underwriting activities of the Bermuda office of AIA-B prior to 28 February 2009.

The AIA Group has issued capital guarantees and minimum guaranteed rates of return ranging from 0% to 5% to holders of units of pension funds that have an accumulation value of approximately US\$1,260 million at 30 November 2009 (US\$1,232 million at 30 November 2008 and US\$1,272 million at 30 November 2007). It has the ability to reduce the guaranteed rates of return, subject to obtaining approvals of applicable regulators.

The status of the licences of the AIA Group is reviewed from time to time by the AIA Group's regulators in light of a number of factors including the legal structure of the AIA Group.

#### **10. Off-balance sheet arrangements**

Except as described above in "Contractual Obligations – Commitments under Operating Leases" and the discussion of capital guarantees and minimum guaranteed rates of return the AIA Group has issued to certain holders of units of pension funds in "Contingencies" in this section, the AIA Group has no other material off-balance sheet arrangements.

#### **11. Distributable reserves**

The principal source of income of AIA is dividends from AIA Co, while the principal capital outflows of AIA will be dividends to shareholders. AIA serves principally as a holding company and will incur certain corporate expenses.

#### **12. Other non-recurring items**

In FY 2009, material non-recurring items comprised restructuring and separation costs of US\$89 million.

In FY 2008, material non-recurring items comprised: (i) a US\$447 million gain arising on final settlement of the reinsurance recapture; (ii) the release of a withholding tax provision of US\$275 million resulting from the clarification of a tax treaty; and (iii) US\$10 million of restructuring and separation costs incurred in order to enhance future operational efficiency of corporate operating expenses.

#### **13. Quantitative and qualitative analysis of market risk**

Market risk is the exposure created by potential changes in market prices and rates. The AIA Group is exposed to market risk arising principally from its holding of financial investments. Some of the significant market risks it faces include interest rate risk, foreign exchange risk and equity market price risks.

##### ***Interest rate risk***

The AIA Group's exposure to interest rate risk predominantly arises from its investments in long-term fixed income debt securities, which are exposed to fluctuations in interest rates.

Interest rate risk also arises from the AIA Group's insurance and investment contracts with guaranteed and fixed terms, or settlement options available on maturity which carry the risk that interest income and capital redemptions from the financial assets backing the liabilities are insufficient to fund the guaranteed benefits payable as interest rates rise and fall. For other products, including those with participation or investment-linked features, interest rate risk is significantly reduced due to the non-guaranteed nature of additional policyholder benefits.

The AIA Group manages its interest rate risk by generally investing in fixed income assets in the same currencies as those of its liabilities, as well as investing in financial instruments with tenors that broadly match the duration of its liabilities.

The AIA Group also considers the effect of interest rate risk in its overall product strategy. Certain products, such as investment-linked, universal life and participating business contracts, inherently have lower interest rate risk as their design provides flexibility as to crediting rates and policyholder dividend scales.

The table below sets forth the sensitivity of profit and total equity to changes in interest rates. In calculating the sensitivity of debt instruments to changes in interest rates the AIA Group has made assumptions about the corresponding impact on liabilities to policyholders. Assets held to support AIA investment-linked contracts have been excluded on the basis that changes in fair value are wholly borne by policyholders. Sensitivity analysis for assets held in participating funds has been calculated after allocation of returns to policyholders using the applicable minimum policyholders' participation ratios. For the purpose of this illustration the impact of possible impairments of financial investments classified as available for sale which may arise in times of economic stress have been ignored, since default events reflect the characteristics of individual issuers. Because the AIA Group's accounting policies lock in interest rate assumptions on policy inception and its assumptions incorporate a provision for adverse

deviations, the level of movement illustrated in this sensitivity analysis does not result in loss recognition and so there is no corresponding effect on liabilities.

	30 November 2007		30 November 2008		30 November 2009	
	Impact on profit before tax	Impact on total equity (before the effects of taxation)	Impact on profit before tax	Impact on total equity (before the effects of taxation)	Impact on profit before tax	Impact on total equity (before the effects of taxation)
	(in US\$ millions)					
+50 basis points shift in yield curves . . . . .	(45)	(1,130)	(53)	(1,096)	(64)	(1,492)
–50 basis points shift in yield curves . . . . .	45	1,130	53	1,096	64	1,492

**Foreign exchange rate risk**

Foreign exchange rate risk arises from the AIA Group’s operations in multiple jurisdictions in the Asia Pacific region. Foreign exchange rate risk associated with assets and liabilities denominated in non-functional currencies results in gains and losses being recognised in the income statement. Foreign exchange rate risk associated with the retranslation of the net assets of operations with non-US dollar functional currencies results in gains or losses being recorded directly in total equity.

The AIA Group generally invests in assets denominated in currencies that match its liabilities to avoid currency mismatches. However, for yield enhancement and risk diversification purposes, the AIA Group’s business units also invest, in some instances, in instruments in currencies that are different from the originating liabilities. These activities expose the AIA Group to gains and losses arising from foreign exchange rate movements. The AIA Group’s business units monitor foreign currency exposures and where these are not consistent with its risk appetite, positions may be closed or hedging instruments may be purchased.

The table below sets forth the sensitivity of the AIA Group’s total equity to changes in foreign exchange rates applied to net foreign currency exposures after taking into account the effect of economic hedges of currency risk. While providing economic hedges that reduce net exposure to foreign exchange rate risk, hedge accounting is not applied. Currencies for which net exposure is not significant are excluded from the analysis below. In compiling the table below, the impact of a 5% strengthening of original currency is stated relative to the functional currency of the relevant operation of the AIA Group. The impact of a 5% strengthening of the US dollar is also stated relative to functional currency. Currency exposure reflects the net notional amount of currency derivative positions as well as net equity by currency.

	United States Dollar	Hong Kong Dollar	Thai Baht	Singapore Dollar	Malaysian Ringgit	China Renminbi	Korean Won
	(in US\$ millions)						
<b>30 November 2009</b>							
Equity analysed by original currency . . . .	11,824	(410)	2,448	(1,922)	563	704	924
Net notional amounts of currency							
derivative positions . . . . .	(3,845)	—	1,256	3,031	—	—	100
Currency exposure . . . . .	<u>7,979</u>	<u>(410)</u>	<u>3,704</u>	<u>1,109</u>	<u>563</u>	<u>704</u>	<u>1,024</u>
<b>5% strengthening of original currency</b>							
Impact on profit before tax . . . . .	<u>103</u>	<u>(63)</u>	<u>1</u>	<u>11</u>	<u>1</u>	<u>9</u>	<u>2</u>
<b>5% strengthening of the US dollar</b>							
Impact on total equity . . . . .	<u>(103)</u>	<u>(9)</u>	<u>(184)</u>	<u>(54)</u>	<u>(28)</u>	<u>(30)</u>	<u>(50)</u>
<b>30 November 2008</b>							
Equity analysed by original currency . . . .	7,085	(502)	2,113	(1,887)	482	628	598
Net notional amounts of currency							
derivative positions . . . . .	(3,316)	—	1,039	2,776	—	—	(96)
Currency exposure . . . . .	<u>3,769</u>	<u>(502)</u>	<u>3,152</u>	<u>889</u>	<u>482</u>	<u>628</u>	<u>502</u>
<b>5% strengthening of original currency</b>							
Impact on profit before tax . . . . .	<u>31</u>	<u>(66)</u>	<u>1</u>	<u>6</u>	<u>—</u>	<u>7</u>	<u>1</u>
<b>5% strengthening of the US dollar</b>							
Impact on total equity . . . . .	<u>(31)</u>	<u>(5)</u>	<u>(156)</u>	<u>(42)</u>	<u>(24)</u>	<u>(28)</u>	<u>(25)</u>
<b>30 November 2007</b>							
Equity analysed by original currency . . . .	11,387	(15)	2,141	(2,370)	318	355	831
Net notional amounts of currency							
derivative positions . . . . .	(2,818)	—	686	2,728	—	—	—
Currency exposure . . . . .	<u>8,569</u>	<u>(15)</u>	<u>2,827</u>	<u>358</u>	<u>318</u>	<u>355</u>	<u>831</u>
<b>5% strengthening of original currency</b>							
Impact on profit before tax . . . . .	<u>128</u>	<u>(41)</u>	<u>(14)</u>	<u>8</u>	<u>2</u>	<u>8</u>	<u>8</u>
<b>5% strengthening of the US dollar</b>							
Impact on total equity . . . . .	<u>(128)</u>	<u>(9)</u>	<u>(141)</u>	<u>(16)</u>	<u>(15)</u>	<u>(14)</u>	<u>(35)</u>

**Equity market price risk**

Equity market price risk arises from changes in the market value of equity securities and equity funds. With the exception of the AIA Group's holding of shares in AIG, a significant proportion of its equity instruments are either held to back AIA investment-linked contracts, the investment risk in respect of which is wholly borne by policyholders, or in respect of participating business, where investment risks are shared between the AIA Group and its policyholders. Equity securities form a relatively small portion of the AIA Group's overall non-linked investment portfolio (including participating funds).

For the purpose of illustrating the sensitivity of profit and total equity to changes in equity prices, the impact of possible impairments of financial investments classified as available for sale which may arise in times of economic stress has been ignored and certain assumptions were made about the corresponding impact of asset valuations on liabilities to policyholders. Assets held to support AIA investment-linked contracts have also been excluded on the basis that changes in fair value are wholly borne by policyholders.

	30 November 2007		30 November 2008		30 November 2009	
	Impact on profit for the year before tax	Impact on total equity (before the effects of taxation)	Impact on profit for the year before tax	Impact on total equity (before the effects of taxation)	Impact on profit for the year before tax	Impact on total equity (before the effects of taxation)
	(in US\$ millions)					
10% increase in equity prices . . . . .	464	716	204	214	308	314
10% decrease in equity prices . . . . .	(464)	(716)	(204)	(214)	(308)	(314)

## 14. First quarter 2010 results for the AIA Group

The following information was prepared by Prudential on a basis consistent with Prudential's reporting basis for the comparable periods based on unaudited financial data extracted from AIA's management accounts.

<u>Sales — APE</u>	<u>3 months to 28 February 2010</u>	<u>3 months to 28 February 2009</u>	<u>% change</u>
	US\$m	US\$m	
Hong Kong . . . . .	96	85	13
Singapore and Brunei . . . . .	31	21	48
Thailand . . . . .	97	69	41
Korea . . . . .	76	68	12
China . . . . .	44	37	19
Malaysia . . . . .	28	23	22
Other markets . . . . .	<u>83</u>	<u>90</u>	<u>(8)</u>
<b>Group total . . . . .</b>	<b><u>455</u></b>	<b><u>393</u></b>	<b><u>16</u></b>

<u>New business profit</u>	<u>3 months to 28 February 2010</u>	<u>3 months to 28 February 2009</u>	<u>% change</u>
	US\$m	US\$m	
<b>Group total — pre tax . . . . .</b>	<b>198</b>	150	32
— post tax . . . . .	<b>141</b>	107	32

<u>Margin — APE %</u>	<u>3 months to 28 February 2010</u>	<u>3 months to 28 February 2009</u>	<u>+/- % pts</u>
<b>Group total — pre tax . . . . .</b>	<b>44</b>	38	+6pts
— post tax . . . . .	<b>31</b>	27	+4pts

In the first quarter of 2010 new business APE sales grew by 16% over the first quarter of 2009 at actual exchange rates.

The first quarter 2010 growth was driven by strong single premium sales due to the improvement in investor sentiment as stock markets recovered. This growth was particularly strong in Singapore and Thailand where new business APE sales increased in the first quarter of 2010 by 48% and 41% respectively.

Other markets new business APE sales in the first quarter of 2010 decreased by 8%. The main contributing factor for this was a 33% decrease in APE in Australia, where the first quarter 2009 included new business in respect of two large new group schemes.

The increase in the first quarter 2010 pre tax new business margin to 44% from 38% reflects improvements in pricing and product mix over those sold during the financial year ended 30 November 2009.

### EEV New Business Methodology and Assumptions

#### Valuation of new business

The contribution from new business has been prepared in accordance with the EEV principles and guidance issued in May 2004 by the European Insurers' CFO Forum except for certain disclosure points (described in the Consulting Actuaries' Report set out in Part XV of this document, such that they relate to the new business contribution for the 12 months to 30 November 2009).

The new business contribution represents the profits determined by applying the same operating and economic assumptions as those used for the 30 November 2009 value of in-force business. The only exception to this is for Hong Kong and Thailand where the long term returns were used for the whole projection period as opposed to grading to market yields. The impact of this difference is immaterial.

In determining the cost of required capital, the more onerous (at 30 November 2009) of the local entity reserving and regulatory capital basis and the Hong Kong basis (at 150% of regulatory capital) for branches of AIA and AIA-B has been assumed.

The new business contribution for 2010 does not allow for any excess of acquisition expenses over the unit cost assumptions. This assumption is consistent with the preparation of the new business contribution for the 12 months to 30 November 2009 as set out in the Consulting Actuaries' Report in Part XV of this document.

### Principal economic assumptions

- The same economic assumptions have been used to determine the new business contribution for the 3 months ending 28 February 2010 and the 3 months ending 28 February 2009. This is appropriate as, given the fact that the new business is largely regular premium business, the key economic assumptions impacting the new business contribution are the long-term assumptions. These assumptions are not expected to vary significantly between 2009 and 2010.
- Initial returns on fixed income assets have been based on current market yields, adjusted for the risk of default.
- Long term returns for fixed income assets reflect expected returns having regard to historical returns, estimates of long term forward rates from yields available on Government bonds and current bond yields.
- Where initial returns on fixed interest assets differ markedly from long term returns, returns are assumed to grade to the long term returns linearly over the estimated mean term of the existing fixed interest assets.
- Equity returns have been determined by reference to the projected long term yield on 10-year government bonds plus an equity risk premium which varies by territory with a maximum risk premium of 600 basis points.
- Risk discount rates are set equal to risk-free rates plus a risk margin. The risk margin reflects any non-diversifiable risk associated with the emergence of distributable earnings that is not allowed for elsewhere in the valuation.

The tables below summarise the principal financial assumptions at 28 February 2010 and 28 February 2009:

	Australia %	China %	Hong Kong %	Indonesia (USD denominated) %	Indonesia (Rupiah denominated) %	Korea %
New business risk discount rate . . . . .	9.0	10.0	8.0	12.5	17.0	10.0
Government bond yield . . . . .	5.75	3.7	3.8	6.9	11.0	5.2

	Malaysia %	New Zealand %	Philippines %	Singapore & Brunei %	Taiwan %	Thailand %	Vietnam %
New business risk discount rate . . . . .	9.0	9.0	14.0	7.5	8.0	10.0	16.0
Government bond yield . . . . .	4.5	6.3	7.5	2.9	1.7	4.2	9.25

	AIA Group Total	
	28 February 2010 %	28 February 2009 %
New business weighted risk discount rate (note) . . . . .	9.5	9.3

**Note:**

The weighted risk discount rates shown for the AIA Group above have been determined by weighting each country's risk discount rates by reference to the EEV basis new business result.

### Approach to estimate the new business contribution for the 3 months ended 28 February 2009

The new business contribution for the 3 months ended 28 February 2009 has been estimated assuming that new business margins (as a percentage of APE) for each product group within each territory are the same as for the 12 months ended 30 November 2009. It has therefore been implicitly assumed that the mix of business within each product group has remained unchanged during the 12 months ended 30 November 2009. Should this product mix have changed during this period, the new business contribution for the 3 months ended 28 February 2009 could be materially different to that shown.

## Foreign exchange rates

Foreign currency profits have been translated at average exchange rates for the period. The principal exchange rates are as follows:

<u>Local currency: USD \$</u>	<u>Average for 3 months to 28 February 2010</u>	<u>Average for 3 months to 28 February 2009</u>
China . . . . .	6.83	6.85
Hong Kong . . . . .	7.75	7.75
Korea . . . . .	1,154.30	1,384.60
Malaysia . . . . .	3.40	3.59
Singapore . . . . .	1.40	1.49
Thailand . . . . .	33.14	35.09

## Other Information

In addition, AIG provided to Prudential the following unaudited information on AIA's results for the fiscal quarters ended 28 February 2010 and 2009, prepared for inclusion as a discontinued operation in AIG's unaudited consolidated financial statements prepared in accordance with US generally accepted accounting principles (US GAAP) for the three months ended 31 March 2010 as follows:

<u>(US\$ in millions) (unaudited)</u>	<u>Q1 2010</u>	<u>Q1 2009</u>
Total Revenues: . . . . .	3,175	2,787
Pre-tax Income: . . . . .	658	390

The information on Total Revenues and Pre-tax Income shown above is not necessarily indicative of how AIA's results may have been presented if separate stand-alone financial statements had been prepared on either a US GAAP or an IFRS basis (as used by Prudential).

## 15. List of explanations

Part VIII (*Information about the AIA Group*) and Part XIII (*Operating and Financial Review of the AIA Group*) are to be read in conjunction with the following list setting out the explanations of certain terms. These terms and their meanings may not always correspond to standard industry meaning or usage of these terms.

<b>“AIA discretionary participation features” or “AIA DPF”</b>	<p>a contractual right to receive, as a supplement to guaranteed benefits, additional benefits:</p> <ul style="list-style-type: none"> <li>• that are likely to be a significant portion of the total contractual benefits;</li> <li>• whose amount or timing is contractually at the discretion of the issuer; and</li> <li>• that are contractually based on the performance of any of the following: a specified pool of contracts or a specified type of a contract; a specified pool of assets; or the company, fund or other equity that issues the contract as discussed in IFRS 4;</li> </ul>
<b>“AIA investment experience”</b>	realised and unrealised investment gains and losses recognised in the consolidated income statement;
<b>“AIA investment-linked products” or “AIA investment-linked contracts”</b>	AIA investment-linked products are insurance products where the surrender value of the policy is linked to the value of underlying investments (such as collective investment schemes, internal investment pools or other property) or fluctuations in the value of underlying investment or indices. Investment risk associated with the product is usually borne by the policyholder. Insurance coverage, investment and administration services are provided for which the charges are deducted from the investment fund assets. Benefits payable will depend on the price of the units prevailing at the time of surrender, death or the maturity of the policy, subject to surrender charges. AIA investment-linked products are presented together with pension products for purposes of disclosure of financial information. These are also referred to as unit linked products or unit linked contracts;

<b>“AIA operating margin”</b>	AIA operating margin measures the operating profitability of business relative to the volume of the business generated by the AIA Group; AIA operating margin is calculated as operating profit as a percentage of TWPI;
<b>“AIA total investment portfolio”</b>	the AIA Group’s investment portfolio composed of cash and cash equivalents, investment property and financial investments but excluding receivables (consisting of amounts due from insurance and investment contract holders, amounts due from agents, brokers and intermediaries as well as insurance and intercompany receivables, receivables from sales of investments and other receivables);
<b>“AIA persistency”</b>	the percentage of insurance policies remaining in force from year to year, as measured by premiums. AIA persistency data discussed in this prospectus excludes Philamlife which only joined AIA in November 2009;
<b>“Asia Pacific”</b>	consists of Australia, Brunei, China, Hong Kong, India, Indonesia, Korea, Macau, Malaysia, New Zealand, the Philippines, Singapore, Taiwan, Thailand and Vietnam. <b>For the avoidance of doubt, the phrase “Asia Pacific” excludes Japan;</b>
<b>“equity securities and alternative investments”</b>	equity securities (comprising private and public equities, securities held by consolidated mutual funds managed by AIG, interests in investment funds and AIA’s holding of shares in AIG) and investment property;
<b>“expense ratio”</b>	operating expenses expressed as a percentage of TWPI;
<b>“financial investments”</b>	equity and fixed income securities plus receivables and derivative financial instruments classified as assets, excluding cash and cash equivalents;
<b>“fixed income securities”</b>	debt securities (consisting of government and government agency bonds, corporate bonds and structured securities) as well as policy loans, mortgage loans on residential and commercial real estate, inter-company loans to fellow subsidiaries of AIG and other loans (less any allowance for loan losses) plus term deposits and cash and cash equivalents;
<b>“investment income”</b>	investment income comprises interest income, dividends and rental income;
<b>“investments”</b>	fixed income securities plus equity securities and alternative investments. This may be further defined as financial investments excluding receivables, plus investment property and cash and cash equivalents;
<b>“lapse risk”</b>	the risk that, having purchased an insurance policy from the AIA Group, customers either surrender the policy or cease paying premiums on it and so the expected stream of future premiums ceases. Lapse risk is taken into account in building projections of future premium revenues, for example when testing for liability adequacy and the recoverability of deferred acquisition costs;
<b>“net insurance and investment contract benefits”</b>	life insurance investment contract benefits, claims and movements in contract liabilities net of amounts ceded to third party reinsurers, excluding corresponding changes in insurance and investment contract liabilities from AIA investment experience for AIA investment-linked contracts and participating funds, and investment income related to AIA investment-linked contracts;
<b>“net profit”</b>	profit for the year after tax attributable to shareholders of AIA;

<b>“net return on allocated equity”</b>	net profit expressed as a percentage of the simple average of opening and closing allocated equity;
<b>“net return on equity”</b>	net return on equity measures AIA’s ability to generate returns for AIA’s shareholders. Net return on equity is calculated as net profit attributable to shareholders of AIA, as a percentage of average total equity attributable to shareholders of AIA, which is a simple average of the opening and closing balances;
<b>“new business premiums”</b>	first year premiums plus 10% of single premiums on new business written during the period;
<b>“operating expenses”</b>	the expenses of operations excluding restructuring and separation costs;
<b>“operating profit”</b>	profit before tax excluding AIA investment experience and investment income related to AIA investment-linked contracts; changes in insurance and investment contract benefits in respect of AIA investment-linked contracts and the AIA investment experience of participating funds; changes in third party interests in consolidated funds, and other significant items of non-operating income and expenditure;
<b>“Operating Profit After Tax” or “OPAT”</b>	<p>profit after tax attributable to shareholders of AIA, excluding the following non-operating items:</p> <ul style="list-style-type: none"> <li>• AIA investment experience (consisting of realised gains and losses, foreign exchange gains and losses, impairments and unrealised gains and losses on investments held at fair value through profit and loss);</li> <li>• investment income related to AIA investment-linked contracts (consisting of dividends, interest income and rental income);</li> <li>• investment management expenses related to AIA investment-linked contracts;</li> <li>• corresponding changes in insurance and investment contract liabilities in respect of AIA investment-linked contracts and participating funds and changes in third party interests in consolidated investment funds; and</li> <li>• other significant items management consider to be non-operating income and expenses;</li> </ul>
<b>“operating return on allocated equity”</b>	measures the efficiency of use of capital in AIA’s operations. Operating return on allocated equity is calculated as operating profit after tax attributable to shareholders of AIA, expressed as a simple average of opening and closing total equity attributable to shareholders of AIA, less the fair value and foreign currency translation reserves, and adjusted for subordinated intercompany debt;
<b>“policyholder and shareholder investments”</b>	investments other than those held to back AIA investment-linked contracts;
<b>“restructuring and separation costs”</b>	restructuring costs represent costs related to restructuring programmes and are primarily comprised of redundancy and contract termination. Separation costs are those significant and identifiable costs related to the AIA Group’s separation from AIG. Restructuring and separation costs do not form part of operating expenses;
<b>“securities lending”</b>	securities lending consists of the loan of certain of the AIA Group’s financial investments in third parties securities on a short term basis. AIG established a global securities lending programme in the late 1990s, in which AIA-B, AIA and AIA-B’s Hong Kong branches and AIA’s Brunei branch participated to enhance portfolio return. AIG

Global Securities Lending (Ireland) Ltd acted as an agent for AIG subsidiaries in this programme. The operating units that participated in the programme lent AIA assets in exchange for cash as collateral from the borrowers of the assets. The cash collateral was then used to reinvest generally in securities which were rated as investment grade at the date of purchase. Due to the deterioration of market conditions and liquidity issues in the securities lending programme at AIG, the AIA Group began to restructure and wind down its participation in this programme, which was largely completed by 30 November 2009. References to the effects of securities lending in Parts VIII and Parts XIII relate to the investment income, investment management expenses and finance costs and non-operating investment return directly arising from this programme of securities lending and their consequent impact pre tax on operating profit and net profit attributable to shareholders of AIA;

**“solvency”**

the ability of an insurance company to satisfy its policyholder benefits and claims obligations; and

**“strategic initiative expenses”**

strategic initiative expenses are those operating expenses controlled by AIA Group’s Strategic Initiatives Office, mainly comprising investment in distribution channel development and operational efficiency.

## PART XIV

### HISTORICAL FINANCIAL INFORMATION FOR PRUDENTIAL GROUP

#### A. Accountants' Report

*The following is the text of a report received from Prudential's reporting accountant, KPMG Audit Plc, Chartered Accountants, for the purpose of incorporation in this prospectus.*



**KPMG Audit Plc**  
Chartered Accountants  
8 Salisbury Square  
London  
EC4Y 8BB  
United Kingdom

The Directors  
Prudential plc  
Laurence Pountney Hill  
London, EC4R 0HH

**17 May 2010**

Dear Sirs

#### **Prudential plc (the "Company")**

We report on the financial information relating to the Company and its subsidiaries (hereinafter collectively referred to as the "Prudential Group") comprising the consolidated income statements, consolidated statements of comprehensive income, the consolidated statements of changes in equity and the consolidated cash flow statements of the Prudential Group, for each of the years ended 31 December 2007, 31 December 2008 and 31 December 2009, and the consolidated statements of financial position of the Prudential Group and statements of financial position of the Company as at 31 December 2007, 31 December 2008 and 31 December 2009, together with the notes thereto (the "Financial Information") as set out in the prospectus of the Company dated 17 May 2010 (the "Prospectus").

This financial information has been prepared for inclusion in the prospectus dated 17 May 2010 of Prudential plc on the basis of the accounting policies set out in note A of the Financial Information (section B of this Part XIV). This report is required by paragraph 20.1 of Annex I of the Prospectus Directive Regulation and is given for the purpose of complying with that paragraph and for no other purpose.

#### **Responsibilities**

The Directors of the Company are responsible for preparing the financial information on the basis of preparation set out in note A2 of the Financial Information and in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU").

It is our responsibility to form an opinion on the Financial Information and to report our opinion to you. Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 23.1 of Annex I of the Prospectus Directive Regulation, consenting to its inclusion in the prospectus.

#### **Basis of opinion**

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the Financial Information. It also included an assessment of the significant estimates and judgments made by those responsible for the preparation of the Financial Information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Financial Information is free from material misstatement whether caused by fraud or other irregularity or error.

### **Opinion**

In our opinion, the Financial Information gives, for the purposes of the prospectus dated 17 May 2010, a true and fair view of the state of affairs of the Prudential Group and the Company as at the dates stated and of the Prudential Group's consolidated results, cash flows, comprehensive income and changes in equity for the periods then ended in accordance with the basis of preparation set out and described in note A2 of the Financial Information and in accordance with IFRS as adopted by the EU.

### **Declaration**

For the purposes of Prospectus Rule 5.5.3R (2)(f) we are responsible for this report as part of the prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the prospectus in compliance with paragraph 1.2 of Annex I of the Prospectus Directive Regulation.

### **Yours faithfully**

KPMG Audit Plc London, United Kingdom

**B. Consolidated financial information for the years ended 31 December 2007, 31 December 2008 and 31 December 2009**

**CONSOLIDATED INCOME STATEMENT**

	Note	Year ended 31 December		
		2007	2008	2009
		£m	£m	£m
Gross premiums earned . . . . .		18,359	18,993	20,299
Outward reinsurance premiums . . . . .		(171)	(204)	(323)
Earned premiums, net of reinsurance . . . . .	F2	18,188	18,789	19,976
Investment return . . . . .	F2	12,225	(30,202)	26,889
Other income . . . . .	F2	2,457	1,146	1,234
Total revenue, net of reinsurance . . . . .	F1,F2	32,870	(10,267)	48,099
Benefits and claims . . . . .		(26,224)	4,620	(39,901)
Outward reinsurers' share of benefits and claims . . . . .		(20)	389	265
Movement in unallocated surplus of with-profits funds . . . . .	H12	(541)	5,815	(1,559)
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance . . . . .		(26,785)	10,824	(41,195)
Acquisition costs and other operating expenditure . . . . .	F3	(4,859)	(2,459)	(4,572)
Finance costs: interest on core structural borrowings of shareholder-financed operations . . . . .	F4	(168)	(172)	(209)
Loss on sale of Taiwan agency business . . . . .	I1	—	—	(559)
Total charges, net of reinsurance . . . . .	F1	(31,812)	8,193	(46,535)
Profit (loss) before tax ( <i>being tax attributable to shareholders' and policyholders' returns</i> ) <sup>(note 1)</sup> . . . . .		1,058	(2,074)	1,564
Tax credit attributable to policyholders' returns . . . . .		5	1,624	(818)
Profit (loss) before tax attributable to shareholders . . . . .	B1	1,063	(450)	746
Tax credit (charge) . . . . .	F5	(349)	1,683	(873)
Less: tax credit attributable to policyholders' returns . . . . .		(5)	(1,624)	818
Tax credit (charge) attributable to shareholders' returns . . . . .	F5	(354)	59	(55)
<b>Profit (loss) from continuing operations after tax</b> . . . . .		709	(391)	691
Discontinued operations (net of tax) . . . . .	I9	241	—	(14)
Profit (loss) for the year . . . . .		950	(391)	677
Attributable to:				
Equity holders of Prudential . . . . .		947	(396)	676
Minority interests . . . . .		3	5	1
<b>Profit (loss) for the year</b> . . . . .		950	(391)	677
<b>Earnings per share (in pence)</b>				
Basic:				
Based on profit (loss) from continuing operations attributable to the equity holders of Prudential . . . . .	B2	28.8p	(16.0)p	27.6p
Based on profit (loss) from discontinued operations attributable to the equity holders of Prudential . . . . .	B2	9.9p	—	(0.6)p
		38.7p	(16.0)p	27.0p
Diluted:				
Based on profit (loss) from continuing operations attributable to the equity holders of Prudential . . . . .	B2	28.8p	(16.0)p	27.6p
Based on profit (loss) from discontinued operations attributable to the equity holders of Prudential . . . . .	B2	9.8p	—	(0.6)p
		38.6p	(16.0)p	27.0p

**Notes**

1) This measure is the formal profit (loss) before tax measure under IFRS but is not the result attributable to shareholders.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Note	Year ended 31 December		
		2007	2008	2009
		£m	£m	£m
<b>Profit (loss) for the year</b> .....		950	(391)	677
<b>Other comprehensive income (loss):</b>				
Exchange movements on foreign operations and net investment hedges:				
Exchange movements arising during the year .....	B4	11	391	(206)
Related tax .....		2	119	11
		<u>13</u>	<u>510</u>	<u>(195)</u>
Movement in cash flow hedges .....		(3)	—	—
Related tax .....		1	—	—
		<u>(2)</u>	<u>—</u>	<u>—</u>
Available-for-sale securities:				
Unrealised valuation movements on securities classified as available-for-sale of banking operations .....		(2)	—	—
Unrealised valuation movements on securities of US insurance operations classified as available-for-sale: .....	D3(a)			
Unrealised holding gains (losses) arising during the year .....		(231)	(2,482)	2,249
Add back net losses included in the income statement on disposal and impairment .....		(13)	378	420
Total .....		<u>(246)</u>	<u>(2,104)</u>	<u>2,669</u>
Related change in amortisation of deferred income and acquisition costs ...	H1	88	831	(1,069)
Related tax .....		53	442	(557)
		<u>(105)</u>	<u>(831)</u>	<u>1,043</u>
<b>Other comprehensive income (loss) for the year, net of related tax</b> .....		<u>(94)</u>	<u>(321)</u>	<u>848</u>
<b>Total comprehensive income (loss) for the year</b> .....		<u>856</u>	<u>(712)</u>	<u>1,525</u>
Attributable to:				
Equity holders of Prudential Group .....		853	(717)	1,524
Minority interests .....		3	5	1
<b>Total comprehensive income (loss) for the year</b> .....		<u>856</u>	<u>(712)</u>	<u>1,525</u>

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2007

	Note	Share capital	Share premium	Retained earnings	Translation reserve	Available- for-sale securities reserve	Hedging reserve	Share- holders' equity	Minority interests	Total equity £m
<b>Reserves</b>										
Profit for the year . . . . .		—	—	947	—	—	—	947	3	950
Other comprehensive income (loss):										
Exchange movements on foreign operations and net investment hedges, net of related tax . . . . .		—	—	—	13	—	—	13	—	13
Movement on cash flow hedges, net of related tax . . . . .		—	—	—	—	—	(2)	(2)	—	(2)
Unrealised valuation movements, net of related change in amortisation of deferred income and acquisition costs and related tax . . .		—	—	—	—	(105)	—	(105)	—	(105)
Total other comprehensive income (loss) . . . . .		—	—	—	13	(105)	(2)	(94)	—	(94)
Total comprehensive income (loss) for the year . . . . .		—	—	947	13	(105)	(2)	853	3	856
Dividends . . . . .	B3	—	—	(426)	—	—	—	(426)	(5)	(431)
Reserve movements in respect of share-based payments . . . . .		—	—	18	—	—	—	18	—	18
Change in minority interests arising principally from purchase and sale of property partnerships of the PAC with-profits fund and of other consolidated investment funds . . . . .		—	—	—	—	—	—	—	(28)	(28)
<b>Share capital and share premium</b>										
New share capital subscribed . . . . .	H11	1	181	—	—	—	—	182	—	182
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . .	H11	—	(175)	175	—	—	—	—	—	—
<b>Treasury shares</b>										
Movement in the value of own shares held in respect of share-based payment plans . . . . .		—	—	7	—	—	—	7	—	7
Movement in the value of Prudential plc shares purchased by unit trusts consolidated under IFRS . . . . .		—	—	4	—	—	—	4	—	4
Net increase (decrease) in equity . . . . .		1	6	725	13	(105)	(2)	638	(30)	608
At beginning of year . . . . .		<u>122</u>	<u>1,822</u>	<u>3,576</u>	<u>(125)</u>	<u>27</u>	<u>2</u>	<u>5,424</u>	<u>132</u>	<u>5,556</u>
<b>At end of year . . . . .</b>	H11	<u><u>123</u></u>	<u><u>1,828</u></u>	<u><u>4,301</u></u>	<u><u>(112)</u></u>	<u><u>(78)</u></u>	<u><u>—</u></u>	<u><u>6,062</u></u>	<u><u>102</u></u>	<u><u>6,164</u></u>

	<u>Note</u>	<u>Share capital</u>	<u>Share premium</u>	<u>Retained earnings</u>	<u>Translation reserve</u>	<u>Available-for-sale securities reserve</u>	<u>Hedging reserve</u>	<u>Shareholders' equity</u>	<u>Minority interests</u>	<u>Total equity</u> £m
<b>Reserves</b>										
Loss for the year . . . . .		—	—	(396)	—	—	—	(396)	5	(391)
Other comprehensive income (loss):										
Exchange movements on foreign operations and net investment hedges, net of related tax . . . . .		—	—	—	510	—	—	510	—	510
Unrealised valuation movements, net of related change in amortisation of deferred income and acquisition costs and related tax . . . . .		<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(831)</u>	<u>—</u>	<u>(831)</u>	<u>—</u>	<u>(831)</u>
Total other comprehensive income (loss) . . . . .		<u>—</u>	<u>—</u>	<u>—</u>	<u>510</u>	<u>(831)</u>	<u>—</u>	<u>(321)</u>	<u>—</u>	<u>(321)</u>
Total comprehensive income (loss) for the year . . . . .		—	—	(396)	510	(831)	—	(717)	5	(712)
Dividends . . . . .	B3			(453)	—	—	—	(453)	(2)	(455)
Reserve movements in respect of share-based payments . . . . .		—	—	18	—	—	—	18	—	18
Change in minority interests arising principally from purchase and sale of property partnerships of the PAC with-profits fund and of other consolidated investment funds . . . . .		—	—	—	—	—	—	—	(50)	(50)
<b>Share capital and share premium</b>										
New share capital subscribed . . . . .	H11	2	168	—	—	—	—	170	—	170
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	H11	—	(156)	156	—	—	—	—	—	—
<b>Treasury shares</b>										
Movement in own shares held in respect of share-based payment plans . . . . .		—	—	3	—	—	—	3	—	3
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS . . . . .		<u>—</u>	<u>—</u>	<u>(25)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(25)</u>	<u>—</u>	<u>(25)</u>
Net increase (decrease) in equity . . . . .		2	12	(697)	510	(831)	—	(1,004)	(47)	(1,051)
At beginning of year . . . . .		<u>123</u>	<u>1,828</u>	<u>4,301</u>	<u>(112)</u>	<u>(78)</u>	<u>—</u>	<u>6,062</u>	<u>102</u>	<u>6,164</u>
<b>At end of year . . . . .</b>	H11	<u>125</u>	<u>1,840</u>	<u>3,604</u>	<u>398</u>	<u>(909)</u>	<u>—</u>	<u>5,058</u>	<u>55</u>	<u>5,113</u>

		Share	Share	Retained	Translation	Available- for-sale	Hedging	Share- holders'	Minority	Total
	Note	capital	premium	earnings	reserve	securities reserve	reserve	equity	interests	equity
										£m
<b>Reserves</b>										
Profit for the year . . . . .		—	—	676	—	—	—	676	1	677
Other comprehensive income (loss):										
Exchange movements on foreign operations and net investment hedges, net of related tax . . . . .		—	—	—	(195)	—	—	(195)	—	(195)
Unrealised valuation movements, net of related change in amortisation of deferred income and acquisition costs and related tax . . . . .		—	—	—	—	1,043	—	1,043	—	1,043
Total other comprehensive income (loss) . . . . .		—	—	—	(195)	1,043	—	848	—	848
Total comprehensive income (loss) for the year . . . . .		—	—	676	(195)	1,043	—	1,524	1	1,525
Dividends . . . . .	B3	—	—	(481)	—	—	—	(481)	—	(481)
Reserve movements in respect of share-based payments . . . . .		—	—	29	—	—	—	29	—	29
Change in minority interests arising principally from purchase and sale of property partnerships of the PAC with-profits fund and of other consolidated investment funds . . . . .		—	—	—	—	—	—	—	(24)	(24)
<b>Share capital and share premium</b>										
New share capital subscribed . . . . .	H11	2	139	—	—	—	—	141	—	141
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . .	H11	—	(136)	136	—	—	—	—	—	—
<b>Treasury shares</b>										
Movement in own shares held in respect of share- based payment plans . . . .		—	—	3	—	—	—	3	—	3
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS . . . . .		—	—	(3)	—	—	—	(3)	—	(3)
Net increase (decrease) in equity . . . . .		2	3	360	(195)	1,043	—	1,213	(23)	1,190
At beginning of year . . . . .		125	1,840	3,604	398	(909)	—	5,058	55	5,113
<b>At end of year . . . . .</b>	H11	<u>127</u>	<u>1,843</u>	<u>3,964</u>	<u>203</u>	<u>134</u>	<u>—</u>	<u>6,271</u>	<u>32</u>	<u>6,303</u>

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Note	31 December		
		2007	2008	2009
		£m	£m	£m
<b>ASSETS</b>				
Intangible assets attributable to shareholders:				
Goodwill . . . . .	H1(a)	1,341	1,341	1,310
Deferred acquisition costs and other intangible assets . . . . .	H1(b)	2,836	5,349	4,049
Total . . . . .		<u>4,177</u>	<u>6,690</u>	<u>5,359</u>
Intangible assets attributable to with-profits funds:				
In respect of acquired subsidiaries for venture fund and other investment purposes . . . . .	H2(a)	192	174	124
Deferred acquisition costs and other intangible assets . . . . .	H2(b)	19	126	106
Total . . . . .		<u>211</u>	<u>300</u>	<u>230</u>
Total . . . . .		<u>4,388</u>	<u>6,990</u>	<u>5,589</u>
Other non-investment and non-cash assets:				
Property, plant and equipment . . . . .	H6	1,012	635	367
Reinsurers' share of insurance contract liabilities . . . . .	H3	783	1,240	1,187
Deferred tax assets . . . . .	H4	951	2,886	2,708
Current tax recoverable . . . . .	H4	285	657	636
Accrued investment income . . . . .	G1,H5	2,023	2,513	2,473
Other debtors . . . . .	G1,H5	909	1,232	762
Total . . . . .		<u>5,963</u>	<u>9,163</u>	<u>8,133</u>
Investments of long-term business and other operations:				
Investment properties . . . . .	H7	13,688	11,992	10,905
Investments accounted for using the equity method . . . . .	H8	12	10	6
Financial investments: . . . . .	G1			
Loans . . . . .		7,924	10,491	8,754
Equity securities and portfolio holdings in unit trusts . . . . .		86,157	62,122	69,354
Debt securities . . . . .		83,984	95,224	101,751
Other investments . . . . .		4,396	6,301	5,132
Deposits . . . . .		<u>7,889</u>	<u>7,294</u>	<u>12,820</u>
Total . . . . .		<u>204,050</u>	<u>193,434</u>	<u>208,722</u>
Properties held for sale . . . . .	H9	30	—	3
Cash and cash equivalents . . . . .	G1,H10	<u>4,951</u>	<u>5,955</u>	<u>5,307</u>
<b>Total assets</b> . . . . .	B6	<u><u>219,382</u></u>	<u><u>215,542</u></u>	<u><u>227,754</u></u>

	Note	31 December		
		2007	2008	2009
		£m	£m	£m
<b>EQUITY AND LIABILITIES</b>				
<b>Equity</b>				
Shareholders' equity . . . . .	H11	6,062	5,058	6,271
Minority interests . . . . .		102	55	32
<b>Total equity</b> . . . . .		<u>6,164</u>	<u>5,113</u>	<u>6,303</u>
<b>Liabilities</b>				
Policyholder liabilities and unallocated surplus of with-profits funds:				
Insurance contract liabilities . . . . .	H12	132,776	136,030	145,713
Investment contract liabilities with discretionary participation features . . . . .	G1	29,550	23,446	24,880
Investment contract liabilities without discretionary participation features . . . . .	G1	14,032	14,501	15,805
Unallocated surplus of with-profits funds . . . . .	H12	<u>13,959</u>	<u>8,414</u>	<u>10,019</u>
Total . . . . .		<u>190,317</u>	<u>182,391</u>	<u>196,417</u>
Core structural borrowings of shareholder-financed operations:				
Subordinated debt . . . . .	H13	1,570	1,987	2,691
Other . . . . .	H13	<u>922</u>	<u>971</u>	<u>703</u>
Total . . . . .	G1,H13	<u>2,492</u>	<u>2,958</u>	<u>3,394</u>
Other borrowings:				
Operational borrowings attributable to shareholder-financed operations . . . . .	G1,H13	3,081	1,977	2,751
Borrowings attributable to with-profits funds . . . . .	G1,H13	987	1,308	1,284
Other non-insurance liabilities:				
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	G1	4,081	5,572	3,482
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	G1	3,556	3,843	3,809
Deferred tax liabilities . . . . .	H4	3,402	3,229	3,872
Current tax liabilities . . . . .	H4	1,237	842	1,215
Accruals and deferred income . . . . .		599	630	594
Other creditors . . . . .	G1	1,020	1,496	1,612
Provisions . . . . .	H14	575	461	643
Derivative liabilities . . . . .	G1,G3	1,080	4,832	1,501
Other liabilities . . . . .	G1,H15	<u>791</u>	<u>890</u>	<u>877</u>
Total . . . . .		<u>16,341</u>	<u>21,795</u>	<u>17,605</u>
<b>Total liabilities</b> . . . . .	B6	<u>213,218</u>	<u>210,429</u>	<u>221,451</u>
<b>Total equity and liabilities</b> . . . . .		<u>219,382</u>	<u>215,542</u>	<u>227,754</u>

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Note	Year Ended 31 December		
		2007	2008	2009
		£m	£m	£m
<b>Cash flows from operating activities</b>				
Profit (loss) before tax from continuing operations ( <i>being tax attributable to shareholders' and policyholders' returns</i> )(†) . . . . .		1,058	(2,074)	1,564
Profit (loss) before tax from discontinued operations . . . . .	I9	222	—	(14)
Total profit (loss) before tax . . . . .		1,280	(2,074)	1,550
Changes in operating assets and liabilities:				
Investments . . . . .		(11,818)	32,424	(26,388)
Other non-investment and non-cash assets . . . . .		(378)	(828)	(384)
Policyholder liabilities (including unallocated surplus) . . . . .		11,845	(26,987)	24,932
Other liabilities (including operational borrowings) . . . . .		902	(631)	(299)
Interest income and expense and dividend income included in profit before tax . . . . .		(8,301)	(7,927)	(7,267)
Other non-cash items (including £559 million in 2009 for the loss on disposal of Taiwan agency business) . . . . .		(141)	(74)	650
Operating cash items:				
Interest receipts . . . . .		5,641	5,875	5,734
Dividend receipts . . . . .		2,732	2,019	1,780
Tax paid . . . . .		(624)	(653)	(200)
<b>Net cash flows from operating activities</b> . . . . .		<b>1,138</b>	<b>1,144</b>	<b>108</b>
<b>Cash flows from investing activities</b>				
Purchases of property, plant and equipment . . . . .	H6	(231)	(240)	(91)
Proceeds from disposal of property, plant and equipment . . . . .		61	11	54
Disposal of Taiwan agency business . . . . .	I1	—	—	(497)
Completion adjustment for previously disposed business . . . . .	I9	—	—	(20)
Acquisition of subsidiaries, net of cash balances . . . . .	I7(iii)	(77)	—	—
Disposal of Egg, net of cash balances . . . . .	I9	(538)	—	—
Disposal of other subsidiaries, net of cash balances . . . . .	I7(iii)	157	—	—
Deconsolidation of investment subsidiaries . . . . .	I7(iii)	(91)	—	—
Net cash flows from investing activities . . . . .		(719)	(229)	(554)
<b>Cash flows from financing activities</b>				
Structural borrowings of the Prudential Group: . . . . .	I10			
Shareholder-financed operations:				
Issue of subordinated debt, net of costs . . . . .		—	—	822
Redemption of senior debt . . . . .		(150)	—	(249)
Interest paid . . . . .		(171)	(167)	(207)
With-profits operations:				
Interest paid . . . . .		(9)	(9)	(9)
Equity capital:*				
Issues of ordinary share capital . . . . .	H11	6	12	3
Dividends paid . . . . .	B3	(255)	(297)	(344)
Net cash flows from financing activities . . . . .		(579)	(461)	16
Net increase (decrease) in cash and cash equivalents . . . . .		(160)	454	(430)
Cash and cash equivalents at beginning of year . . . . .		5,071	4,951	5,955
Effect of exchange rate changes on cash and cash equivalents . . . . .		40	550	(218)
<b>Cash and cash equivalents at end of year</b> . . . . .	H10	<b>4,951</b>	<b>5,955</b>	<b>5,307</b>

† This measure is the formal (loss) profit before tax measure under IFRS but it is not the result attributable to shareholders.

\* Cash movements in respect of equity capital exclude scrip dividends.

STATEMENT OF FINANCIAL POSITION OF THE PARENT COMPANY

	31 December		
	2007 £m	2008 £m	2009 £m
<b>ASSETS</b>			
<b>Non-current assets</b>			
Investments:			
Shares in subsidiary undertakings . . . . .	7,170	7,193	10,071
Loans to subsidiary undertakings . . . . .	2,809	3,212	899
	<u>9,979</u>	<u>10,405</u>	<u>10,970</u>
<b>Current assets</b>			
Debtors:			
Amounts owed by subsidiary undertakings . . . . .	3,291	1,986	2,760
Deferred tax . . . . .	9	117	186
Other debtors . . . . .	25	11	7
Derivative assets . . . . .	10	267	151
Cash and cash equivalents . . . . .	178	102	360
	<u>3,513</u>	<u>2,483</u>	<u>3,464</u>
<b>Total assets</b> . . . . .	<u>13,492</u>	<u>12,888</u>	<u>14,434</u>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Subordinated liabilities . . . . .	1,566	1,983	2,687
Debenture loans . . . . .	797	549	549
Other borrowings . . . . .	7	9	—
Amounts owed to subsidiary undertakings . . . . .	2,643	1,464	3,326
Pension liabilities . . . . .	31	20	22
	<u>5,044</u>	<u>4,025</u>	<u>6,584</u>
<b>Current liabilities</b>			
Debenture loans . . . . .	—	249	—
Commercial paper . . . . .	2,422	1,269	2,031
Other borrowings . . . . .	48	200	207
Derivative liabilities . . . . .	144	235	136
Amounts owed to subsidiary undertakings . . . . .	2,455	3,341	1,279
Tax payable . . . . .	332	311	379
Sundry creditors . . . . .	6	19	4
Accruals and deferred income . . . . .	44	44	41
	<u>5,451</u>	<u>5,668</u>	<u>4,077</u>
Total liabilities . . . . .	<u>10,495</u>	<u>9,693</u>	<u>10,661</u>
<b>Equity</b>			
Share capital . . . . .	123	125	127
Share premium . . . . .	1,828	1,840	1,843
Retained earnings . . . . .	1,046	1,230	1,803
Total equity . . . . .	<u>2,997</u>	<u>3,195</u>	<u>3,773</u>
<b>Total equity and liabilities</b> . . . . .	<u>13,492</u>	<u>12,888</u>	<u>14,434</u>

## NOTES ON THE PRUDENTIAL GROUP FINANCIAL INFORMATION

### A: BACKGROUND AND ACCOUNTING POLICIES

#### A1: *Nature of operations*

Prudential together with its subsidiaries (collectively, the Prudential Group) is an international financial services group with its principal operations in the UK, the US and Asia. The Prudential Group operates in the UK through its subsidiaries, primarily The Prudential Assurance Company Limited (PAC), Prudential Annuities Limited (PAL), Prudential Retirement Income Limited (PRIL) and M&G Investment Management Limited.

In the US, the Prudential Group's principal subsidiary is Jackson National Life Insurance Company (Jackson). The Prudential Group also has operations in Hong Kong, Malaysia, Singapore, Indonesia and other Asian countries.

Prudential Group offers a wide range of retail financial products and services and asset management services throughout these territories. The retail financial products and services principally include life insurance, pensions and annuities as well as collective investment schemes.

Long-term business products written in the UK and Asia are principally with-profits deposit administration, other conventional and unitised with-profits policies and non-participating pension annuities in the course of payment. Long-term business also includes linked business written in the UK and Asia. The principal products written by Jackson are interest-sensitive deferred annuities and whole-life policies, variable annuities, guaranteed investment contracts, fixed index deferred annuities and term life insurance.

Prudential business was incorporated in England on 30 May 1848 as The Prudential Mutual Assurance Investment and Loan Association under relevant UK legislation. At the current time Prudential is a limited liability company subject to the Companies' Act. Prudential has been the holding company of the companies comprising the Prudential Group, details of which are set out in note I7, throughout the Relevant Period.

Substantially all companies comprising the Prudential Group have adopted 31 December as their financial year end date. Details of the principal companies comprising the Prudential Group that are subject to audit during the Relevant Period and the names of the respective auditors are set out in note I7. The statutory financial information of these companies was converted in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union (EU) for the purposes of the group accounts. Prudential is a public limited company incorporated and registered in England and Wales. The registered office is:

Laurence Pountney Hill  
London  
EC4R 0HH  
Registered number: 1397169

#### A2: *Basis of preparation*

The consolidated financial information consolidates the Prudential Group and the Prudential Group's interest in associates and jointly-controlled entities.

The consolidated financial information of Prudential and the parent company financial information has been prepared and approved by the directors in accordance with International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board ("IASB") and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2009, there were no unendorsed standards effective for the three years ended 31 December 2009 affecting the consolidated or the parent company financial information, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to Prudential. Accordingly, Prudential's financial information for the three years ended 31 December 2009 is prepared in accordance with IFRSs as issued by the IASB.

The Prudential Group has applied IFRS standards and interpretations adopted by the EU that are effective for financial years commencing on or before 1 January 2009. All accounting pronouncements adopted at 31 December 2009 have been applied consistently across the three year track record period unless the relevant standard permits an alternative approach upon transition. The only such transitional arrangements which the Prudential Group has taken advantage of during the track record period are as follows:

i) Amendments to IFRS 7 'Improving Disclosures about financial instruments' - this standard enhances the disclosures around financial instruments. Comparatives are not required for these disclosures and the Prudential

Group has taken advantage of this exemption. As a disclosure standard this has no impact on the primary financial statements of the Prudential Group.

ii) Amendments to IAS 40 - 'Investment Property' - although full retrospective application is permitted, the Prudential Group has taken advantage of the ability to apply this prospectively from 1 January 2009 on the basis that full retrospective application would not have had a significant impact on the Prudential Group's financial results and position in 2007 and 2008. Further details on the application of new accounting pronouncements are provided in note A5.

For the purposes of the Prudential Group's annual report and accounts, the parent company prepares its own financial statements in accordance with applicable accounting standards under UK Generally Accepted Accounting Practice (UK GAAP). For the purpose of this document, the parent company financial information has been prepared in accordance with IFRS, applying accounting policies which are consistent with those applied for the Prudential Group consolidated financial information. In addition, investments in subsidiary undertakings are shown at cost, net of impairments.

### **A3: Critical accounting policies, estimates and judgements**

#### *a Critical accounting policies*

Prudential's discussion and analysis of its financial condition and results of operation are based upon Prudential's consolidated financial information, which have been prepared in accordance with IFRS adopted for use in the EU. Were the Prudential Group to apply IFRS as published by the IASB, as opposed to the EU-adopted IFRS, no additional measurement adjustments or disclosures would be required. It is the Prudential Group's policy to adopt mandatory requirements of new or altered EU-adopted IFRS standards where required, with earlier adoption applied where permitted and appropriate in the circumstances.

The preparation of this financial information requires Prudential to make estimates and judgements that affect the reported amounts of assets, liabilities, and revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Prudential evaluates its estimates, including those related to long-term business provisioning, the fair value of assets and the declaration of bonus rates. Prudential bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgements and uncertainties, and potentially give rise to different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to those described below.

The critical accounting policies in respect of the items discussed below are critical for the Prudential Group's results insofar as they relate to the Prudential Group's shareholder-financed business. In particular this applies for Jackson which is the largest shareholder-backed business in the Prudential Group. The policies are not critical in respect of the Prudential Group's with-profits business. This distinction reflects the basis of recognition of profits and accounting treatment of unallocated surplus of with-profits funds. Additional explanation is provided later in this note and cross-referenced notes as to why the distinction between with-profits business and shareholder-backed business is relevant.

The items discussed below and in cross-referenced notes explain the effect of changes in estimates and the effect of reasonably likely changes in the key assumptions underlying these estimates as of the latest statements of financial position date so as to provide analysis that recognises the different accounting effects on profit and loss or equity. In order to provide relevant analysis that is appropriate to the circumstances applicable to the Prudential Group's businesses, the explanations refer to types of business, fund structure, the relationship between asset and policyholder liability measurement, and the differences in the method of accounting permitted under IFRS 4 for accounting for insurance contract assets, policyholder liabilities and unallocated surplus of the Prudential Group's with-profits funds.

#### **Insurance contract accounting**

With the exception of certain contracts described in note D1, the contracts issued by the Prudential Group's life assurance business are classified as insurance contracts and investment contracts with discretionary participating features. As permitted by IFRS 4, assets and liabilities of these contracts are accounted for under previously applied GAAP. In limited circumstances the Prudential Group has chosen to apply a more relevant or reliable measure. The

following paragraphs explain how the current Prudential Group applies this policy. Except as described below in respect of UK regulated with-profits funds where the basis applied has been improved to a more relevant or reliable measure (also as permitted under IFRS 4), the modified statutory basis (MSB) of reporting as set out in the revised Statement of Recommended Practice (SORP) issued by the Association of British Insurers (ABI) has been applied to the Prudential Group's UK and overseas operations.

In 2005 the Prudential Group chose to improve its IFRS accounting for UK regulated with-profits funds by the voluntary application of the UK accounting standard FRS 27, 'Life Assurance'. Under this standard, the main accounting changes that were required for UK with-profits funds were:

- Derecognition of deferred acquisition costs and related deferred tax; and
- replacement of MSB liabilities with adjusted realistic basis liabilities.

The results included in the IFRS financial information reflect this basis.

Unallocated surplus represents the excess of assets over policyholder liabilities for the Prudential Group's with-profits funds that have yet to be appropriated between policyholders and shareholders. The Prudential Group has opted to account for unallocated surplus wholly as a liability with no allocation to equity. This treatment reflects the fact that shareholders' participation in the cost of bonuses arises only on distribution. Shareholder profits on with-profits business reflect one-ninth of the cost of declared bonus.

For the Prudential Group's current overseas operations, the application of the MSB (which permits the use of local GAAP in some circumstances) varies depending upon the basis of accounting applied prior to IFRS adoption or acquisition by the Prudential Group, and whether adjustments to the basis or a more appropriate method should be applied. For Jackson, applying the MSB as applicable to overseas operations, which permits the application of local GAAP in some circumstances, the assets and liabilities of insurance contracts are accounted for under insurance accounting prescribed by US GAAP. For the assets and liabilities of insurance contracts of the Prudential Group's current Asian operations, the local GAAP is applied with adjustments, where necessary, to comply with UK GAAP. For the operations in Taiwan, Vietnam and Japan, countries where local GAAP is not appropriate in the context of the previously applied MSB, accounting for insurance contracts is based on US GAAP. For participating business the liabilities include provisions for the policyholders' interest in realised investment gains and other surpluses that, where appropriate, and in particular for Vietnam, have yet to be declared as bonuses.

The usage of these bases of accounting has varying effects on the way in which product options and guarantees are measured. For UK regulated with-profits funds, options and guarantees are valued on a market consistent basis. The basis is described in note D2(f)(ii). For other operations a market consistent basis is not applied under the accounting basis described in note A4. Details of the guarantees, basis of setting assumptions, and sensitivity to altered assumptions are described in notes D3 and D4.

### **Valuation and accounting presentation of fair value movements of derivatives and debt securities of Jackson**

Under IAS 39, derivatives are required to be carried at fair value. Unless net investment hedge accounting is applied, value movements on derivatives are recognised in the income statement. With the exception of value movements on derivatives held for variable annuities and other equity related hedging activities, the value movements on derivatives held by Jackson are separately identified within the short-term fluctuations in investment returns identified as part of the Prudential Group's segment results described below and in note B1. Derivative value movements in respect of equity risk within variable annuity business and other equity related hedging activities are included within the operating profit based on longer-term investment returns.

For derivative instruments of Jackson, the Prudential Group has considered whether it is appropriate to undertake the necessary operational changes to qualify for hedge accounting so as to achieve matching of value movements in hedging instruments and hedged items in the performance statements. In reaching the decision a number of factors were particularly relevant. These were:

- IAS 39 hedging criteria have been designed primarily in the context of hedging and hedging instruments that are assessable as financial instruments that are either stand-alone or separable from host contracts, rather than, for example, duration characteristics of insurance contracts;
- the high hurdle levels under IAS 39 of ensuring hedge effectiveness at the level of individual hedge transactions;
- the difficulties in applying the macro hedge provisions under IAS 39 (which are more suited to banking arrangements) to Jackson's derivative book;

- the complexity of asset and liability matching of US life insurers such as those with Jackson's product range; and finally
- whether it is possible or desirable, without an unacceptable level of costs and constraint on commercial activity, to achieve the accounting hedge effectiveness required under IAS 39.

Taking account of these considerations the Prudential Group has decided that, except for certain minor categories of derivatives, it is not appropriate to seek to achieve hedge accounting under IAS 39. As a result of this decision the total income statement results are more volatile as the movements in the value of Jackson's derivatives are reflected within it.

Under IAS 39, unless carried at amortised cost (subject to impairment provisions where appropriate) under the held-to-maturity category, debt securities are also carried at fair value. The Prudential Group has chosen not to classify any financial assets as held-to-maturity. Debt securities of Jackson are designated as available-for-sale with value movements, unless impaired, being recorded as movements within other comprehensive income. Impairments are recorded in the income statement.

### **Presentation of results before tax**

The total tax charge for the Prudential Group reflects tax that in addition to relating to shareholders' profits is also attributable to policyholders and unallocated surplus of with-profits funds and unit-linked policies. This is explained in more detail in note F5. However, pre-tax profits are determined after transfers to or from unallocated surplus of with-profits funds. These transfers are in turn determined after taking account of tax borne by with-profits funds. Consequently reported profit before the total tax charge is not representative of pre-tax profits attributable to shareholders. In order to provide a measure of pre-tax profits attributable to shareholders the Prudential Group has chosen to adopt an income statement presentation of the tax charge and pre-tax results that distinguishes between policyholder and shareholder components.

### **Segmental analysis of results and earnings attributable to shareholders**

The Prudential Group uses operating profit based on longer-term investment returns as the segmental measure of its results. The basis of calculation is disclosed in note A4(d).

For shareholder-backed business, with the exception of debt securities held by Jackson and assets classified as loans and receivables, all financial investments and investment property are designated as assets at fair value through profit and loss. Short-term fluctuations in investment returns on such assets held by with-profits funds, do not affect directly reported shareholder results. This is because (i) the unallocated surplus of with-profits funds is accounted for as liabilities and (ii) excess or deficits of income and expenditure of the funds over the required surplus for distribution are transferred to or from unallocated surplus. However, for shareholder-backed businesses the short-term fluctuations affect the result for the year and the Prudential Group provides additional analysis of results to provide information on results before and after short-term fluctuations in investment returns.

#### *b Critical accounting estimates and judgements*

##### ***Investments***

Determining the fair value of financial investments when the markets are not active

The Prudential Group holds certain financial investments for which the markets are not active. These can include financial investments which are not quoted on active markets and financial investments for which markets are no longer active as a result of market conditions e.g. market illiquidity. When the markets are not active, there is generally no or limited observable market data to account for financial investments at fair value. The determination of whether an active market exists for a financial investment requires management's judgement.

If the market for a financial investment of the Prudential Group is not active, the fair value is determined by using valuation techniques. The Prudential Group establishes fair value for these financial investments by using quotations from independent third-parties, such as brokers or pricing services or by using internally developed pricing models. Priority is given to publicly available prices from independent sources, when available but overall, the source of pricing and/or the valuation technique is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date. The valuation techniques include the use of 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 and may include a number of assumptions relating to variables such as credit risk

and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these financial investments.

The financial investments measured at fair value are classified (from 1 January 2009) into the following three level hierarchy on the basis of the lowest level of inputs that is significant to the fair value measurement of the financial investment concerned:

*Level 1:* Quoted prices (unadjusted) in active markets for identical assets and liabilities

*Level 2:* Inputs other than quoted prices included within level 1 that are observable either directly or indirectly (i.e. derived from prices).

*Level 3:* Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs).

At 31 December 2009, £5,557 million of the financial investments (net of derivative liabilities) valued at fair value were classified as level 3. Of these £1,684 million are held to back shareholder non-linked business and so changes to these valuations will directly impact shareholders' equity. Prudential has applied the amendments to IFRS 7 described in note A5 for periods beginning on 1 January 2009. Additional supplementary 2008 disclosures have been prepared in certain instances. Further details of the classification of financial instruments are given in note G1.

Determining impairments relating to financial assets

#### **Available-for-sale securities**

Under IAS 39, the Prudential Group has the option on purchase to account for individual financial instruments as available-for-sale. Currently, the only financial investments carried on an available-for-sale basis by the Prudential Group are represented by Jackson's debt securities portfolio. The consideration of evidence of impairment requires management's judgement. In making this determination the factors considered include, for example,

- Whether the decline of the financial investment's fair value is substantial

A substantial decline in fair value might be indicative of a credit loss event that would lead to a measurable decrease in the estimated future cash flows.

- The impact of the duration of the security on the calculation of the revised estimated cash flows.

The duration of a security for maturity helps to inform whether assessments of estimated future cash flows that are higher than market value are reasonable.

- The duration and extent to which the amortised cost exceeds fair value

This factor provides an indication of how the contractual cash flows and effective interest rate of a financial asset compares with the implicit market estimate of cash flows and the risk attaching to a 'fair value' measurement. The length of time for which that level of difference has been in place may also provide further evidence as to whether the market assessment implies an impairment loss has arisen.

- The financial condition and prospects of the issuer or other observable conditions that indicate the investment may be impaired.

If a loss event that will have a detrimental effect on cash flows is identified an impairment loss in the income statement is recognised. The loss recognised is determined as the difference between the book cost and the fair value of the relevant impaired securities. This loss comprises the effect of the expected loss of contractual cash flows and any additional market price driven temporary reductions in values.

For Jackson's residential mortgage-backed and other asset-backed securities, all of which are classified as available-for-sale, the model used to analyse cash flows, begins with the current delinquency experience of the underlying collateral pool for the structure, by applying assumptions about how much of the currently delinquent loans will eventually default, and multiplying this by an assumed loss severity. Additional factors are applied to anticipate ageing effect. After applying a cash flow simulation an indication is obtained as to whether or not the security has suffered, or is anticipated to suffer, contractual principal or interest payment shortfall. If a shortfall applies an impairment charge is recorded.

The difference between the fair value and book cost for unimpaired securities accounted for as available-for-sale falls to be accounted for as unrealised gains or losses, with the movements in the accounting period being accounted for in other comprehensive income.

The Prudential Group's review of fair value involves several criteria, including economic conditions, credit loss experience, other issuer-specific developments and future cash flows. These assessments are based on the best available information at the time. Factors such as market liquidity, the widening of bid/ask spreads and a change in cash flow assumptions can contribute to future price volatility. If actual experience differs negatively from the assumptions and other considerations used in the consolidated financial information, unrealised losses currently in equity may be recognised in the income statement in future periods. The preceding note in this section provides explanation on how fair value is determined when the markets for the financial investments are not active. Further, additional details on the impairments of the available-for-sale securities of Jackson are described in notes D3 and G5.

### **Assets held at amortised cost**

Financial assets classified as loans and receivables under IAS 39 are initially recognised at fair value plus transaction costs. Subsequently they are carried at amortised cost using the effective interest rate method. The loans and receivables include loans collateralised by mortgages, deposits and loans to policyholders. In estimating future cash flows, the Prudential Group looks at the expected cash flows of the assets and applies historical loss experience of assets with similar credit risks that has been adjusted for conditions in the historical loss experience which no longer exist or for conditions that are expected to arise. The estimated future cash flows are discounted using the financial asset's original or variable effective interest rate and exclude credit losses that have not yet been incurred.

The risks inherent in reviewing the impairment of any investment include the risk that market results may differ from expectations; facts and circumstances may change in the future and differ from estimates and assumptions; or the Prudential Group may later decide to sell the asset as a result of changed circumstances.

### **Insurance contracts**

#### *Product classification*

IFRS 4 requires contracts written by insurers to be classified as either 'insurance contracts' or 'investment contracts' depending on the level of insurance risk transferred. Insurance risk is a pre-existing risk, other than financial risk, transferred from the contract holder to the contract issuer. If significant insurance risk is transferred by the contract then it is classified as an insurance contract. Contracts that transfer financial risk but not significant insurance risk are termed investment contracts. Furthermore, some contracts, both insurance and investment, contain discretionary participating features representing the contractual right to receive additional benefits as a supplement to guaranteed benefits:

- a that are likely to be a significant portion of the total contract benefits;
- b whose amount or timing is contractually at the discretion of the insurer; and
- c that are contractually based on asset or fund performance, as discussed in IFRS 4.

Accordingly, insurers must perform a product classification exercise across their portfolio of contracts issued to determine the allocation to these various categories. IFRS 4 permits the continued usage of previously applied GAAP for insurance contracts and investment contracts with discretionary participating features. Except for UK regulated with-profits funds, as described subsequently, this basis has been applied by the Prudential Group.

For investment contracts that do not contain discretionary participating features, IAS 39 and, where the contract includes an investment management element, IAS 18, apply measurement principles to assets and liabilities attaching to the contract.

#### *Valuation assumptions*

##### **i Contracts of with-profits funds**

The Prudential Group's insurance contracts and investment contracts with discretionary participating features are primarily with-profits and other protection type policies. For UK regulated with-profits funds, the contract liabilities are valued by reference to the UK Financial Services Authority's (FSA) realistic basis. In aggregate, this basis has the effect of placing a value on the liabilities of UK with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances.

The basis of determining liabilities for the Prudential Group's with-profits business has little or no effect on the results attributable to shareholders. This is because movements on liabilities of the with-profits funds are absorbed by the unallocated surplus. Except through indirect effects, or in remote circumstances as described below, changes

to liability assumptions are therefore reflected in the carrying value of the unallocated surplus, which is accounted for as a liability rather than shareholders' equity.

A detailed explanation of the basis of liability measurement is contained in note D2(f)(ii).

The Prudential Group's other with-profits contracts are written in with-profits funds that operate in some of the Prudential Group's Asian operations. The liabilities for these contracts and those of Prudential Annuities Limited, which is a subsidiary company of the PAC with-profits funds, are determined differently. For these other with-profits contracts applicable to the Prudential Group's activities in 2007, 2008 and 2009 the liabilities are estimated using actuarial methods based on assumptions relating to premiums, interest rates, investment returns, expenses, mortality and surrenders. The assumptions to which the estimation of these reserves is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders.

For liabilities determined using the basis described above for UK regulated with-profits funds, and the other liabilities described in the preceding paragraph, changes in estimates arising from the likely range of possible changes in underlying key assumptions have no direct impact on the reported profit.

This lack of sensitivity reflects the with-profits fund structure, basis of distribution, and the application of previous GAAP to the unallocated surplus of with-profits funds as permitted by IFRS 4. Changes in liabilities of these contracts that are caused by altered estimates are absorbed by the unallocated surplus of the with-profits funds with no direct effect on shareholders' equity. The Prudential Group's obligations and more detail on such circumstances are described in note H14.

## **ii Other contracts**

Contracts, other than those of with-profits funds, are written in shareholder-backed operations of the Prudential Group. The significant shareholder-backed product groupings and the factors that may significantly affect IFRS results due to experience against assumptions or changes of assumptions vary significantly between business units. For some types of business the effect of changes in assumptions may be significant, whilst for others, due to the nature of the product, assumption setting may be of less significance. The nature of the products and the significance of assumptions are discussed in notes D2, D3 and D4. From the perspective of shareholder results the key sensitivity relates to the assumption for allowance for credit risk for UK annuity business. Prior to its disposal of the Taiwan agency business in the first half of 2009, the Prudential Group's financial results were also sensitive to the assumed future investment returns for that business.

## **Jackson**

Jackson offers individual fixed annuities, fixed index annuities, immediate annuities, variable annuities, individual and variable life insurance and institutional products. With the exception of institutional products and an incidental amount of business for annuity, certain contracts which are accounted for as investment contracts under IAS 39, all of Jackson's contracts are accounted for under IFRS 4 as insurance contracts by applying US GAAP, the previous GAAP used before IFRS adoption. Under US GAAP the requirements of SFAS 60 'Accounting and Reporting for Insurance Enterprises' and SFAS 97 'Accounting and Reporting by Insurance Enterprises for certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments' apply to these contracts. The accounting requirements under these standards and the effect of changes in valuation assumptions are considered below for fixed annuity, variable annuity and traditional life insurance contracts.

Fixed annuity contracts, which are investment contracts under US GAAP terminology, are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts, namely deferred income, any amounts previously assessed against policyholders that are refundable on termination of the contract, and any premium deficiency, i.e., any probable future loss on the contract. These types of contract contain considerable interest rate guarantee features. Notwithstanding the accompanying market risk exposure, except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of Jackson's fixed annuity products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement.

Variable annuity contracts written by Jackson may provide for guaranteed minimum death, income, or withdrawal benefit features. In general terms, liabilities for these benefits are accounted for under US GAAP by using estimates of future benefits and fees under best estimate assumptions. For variable annuity business the key assumption is the expected long-term level of equity market returns, which for 2007, 2008 and 2009 was 8.4% per annum (gross of fund management fees) determined using a mean reversion methodology. Under the mean reversion methodology,

projected returns over the next five years are flexed (subject to capping) so that, combined with the actual rates of return for the current and the previous two years the 8.4% rate is maintained. The projected rates of return are capped at no more than 15% for each of the next five years. Further details are explained in note D3(h).

These returns affect the level of future expected profits through their effects on the fee income with consequential impact on the amortisation of deferred acquisition costs as described below and the required level of provision for guaranteed minimum death benefit claims.

For traditional life insurance contracts, provisions for future policy benefits are determined using the net level premium method and assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviation.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and the guaranteed minimum death benefit reserves, the profits of Jackson are relatively insensitive to changes in insurance risk. This reflects the principally spread and fee-based nature of Jackson's business.

### **Asian operations**

The insurance products written in the Prudential Group's Asian operations principally cover with-profits business, unit-linked business, and other non-participating business. The results of with-profits business are relatively insensitive to changes in estimates and assumptions that affect the measurement of policyholder liabilities. As for the UK business, this feature arises because unallocated surplus is accounted for by the Prudential Group as a liability. The results of Asian unit-linked business are also relatively insensitive to changes in estimates or assumptions.

Prior to its disposal in the first half of 2009, the principal non-participating business in the Prudential Group's Asian operations, for which changes in estimates and assumptions was important from year to year, was the traditional whole-life business written in Taiwan. Premium rates were set to give a guaranteed minimum sum assured on death and a guaranteed surrender value on early surrender based on prevailing interest rates at the time of policy issue. Premium rates also included an allowance for mortality and expenses. This business was therefore especially sensitive to falling interest rates. This exposure has been removed following the disposal of the Taiwan agency business. The remaining non-participating business in Asia remains sensitive to interest rates but this sensitivity is of a much lower order. Further details are provided in D4(i).

### ***Deferred acquisition costs***

Significant costs are incurred in connection with acquiring new insurance business. Except for acquisition costs of with-profits contracts of the UK regulated with-profits funds, which are accounted for under the realistic FSA regime as described in note A4, these costs, which vary with, and are primarily related to, the production of new business, are capitalised and amortised against margins in future revenues on the related insurance policies. The recoverability of the asset is measured and the asset is deemed impaired if the projected future margins are less than the carrying value of the asset. To the extent that the future margins differ from those anticipated, then an adjustment to the carrying value of the deferred acquisition cost asset will be necessary.

The deferral and amortisation of acquisition costs is of most relevance to the Prudential Group's results for shareholder-financed long-term business of Jackson and Asian operations. The majority of the UK shareholder-backed business is for individual and group annuity business where the incidence of acquisition costs is negligible.

### **Jackson**

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the long-term spread between the earned rate and the rate credited to policyholders, which is based on the annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges), all of which are based on a combination of Jackson's actual industry experience and future expectations. A detailed analysis of actual experience is measured by internally developed mortality studies.

For variable annuity business, the key assumption is the expected long-term level of equity market returns as described above.

The level of acquisition costs carried in the statement of financial position is also sensitive to unrealised valuation movements on debt securities held to back the liabilities and solvency capital. Further details are explained in notes D3(h) and H1.

## **Asian operations**

In 2008, a number of changes were made to the basis of estimating the level of deferred acquisition costs, as described in note D4(h)(c).

## ***Pensions***

The Prudential Group applies the requirements of IAS 19, 'Employee benefits' and associated interpretations including IFRIC 14 'IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', to its defined benefit pension schemes. The principal defined benefit pension scheme is the Prudential Staff Pension Scheme (PSPS). For PSPS the terms of the trust deed restrict shareholders' access to any underlying surplus. Accordingly, applying the interpretation of IFRIC 14, any underlying IAS 19 basis surplus is not recognised for IFRS reporting. The financial position for PSPS recorded in the IFRS financial statements reflects the higher of any underlying IAS 19 deficit and any obligation for deficit funding.

The economic participation in the surplus or deficits attaching to PSPS and the smaller Scottish Amicable Pensions Scheme (SAPS) are shared between the PAC with-profits sub-fund (WPSF) and shareholder operations. The economic interest reflects the source of contributions over the scheme life, which in turn reflects the activity of the members during their employment.

In the case of PSPS, movements in the apportionment of the financial position for PSPS between the WPSF and shareholders' funds in 2009 reflect the 70/30 ratio applied to the base deficit position as at 31 December 2005 but with service cost and contributions for ongoing service apportioned by reference to the cost allocation for activity of current employees. For SAPS the ratio is estimated to be 50/50 between the WPSF and shareholders' funds.

Due to the inclusion of actuarial gains and losses in the income statement rather than being recognised in other comprehensive income, the results of the Prudential Group are affected by changes in interest rates for corporate bonds that affect the rate applied to discount projected pension payments, changes in mortality assumptions and changes in inflation assumptions.

## ***Deferred tax***

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 the available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which the losses can be relieved. The taxation regimes applicable across the Prudential Group apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets. The judgements made, and uncertainties considered, in arriving at deferred tax balances in the financial information are discussed in note H4.

## ***Goodwill***

Goodwill impairment testing requires the exercise of judgement by management as to prospective future cash flows. Further information is disclosed in note H1.

### ***A4: Significant accounting policies***

#### ***a Financial instruments other than financial instruments classified as long-term business contracts***

##### **Investment classification**

Under IAS 39, subject to specific criteria, financial instruments should be accounted for under one of the following categories; financial investments at fair value through profit and loss, financial investments held on an available-for-sale basis, financial investments held-to-maturity or loans and receivables. Upon initial recognition, financial investments are measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. These IAS 39 classifications have been changed by IFRS 9 "Financial Investments: Classification and Measurement" which is not required to be adopted until 2013 and is still subject to EU endorsement. This standard has not been adopted by the Prudential Group in 2009. The Prudential Group holds financial investments on the following bases:

- i Financial assets and liabilities at fair value through profit and loss — this comprises assets and liabilities designated by management as fair value through profit and loss on inception and derivatives that are held for trading. These investments are measured at fair value with all changes thereon being recognised in investment income.

- ii Financial investments on an available-for-sale basis — this comprises assets that are designated by management and/or do not fall into any of the other categories. Available-for-sale financial assets are initially recognised at fair value plus attributable transaction costs. For available-for-sale debt securities, the difference between their cost and par value is amortised to the income statement using the effective interest rate. Available-for-sale financial assets are subsequently measured at fair value. Interest income is recognised on an effective interest basis in the income statement. Except for foreign exchange gains and losses on debt securities, not in functional currency, which are included in the income statement, unrealised gains and losses are recognised in other comprehensive income (i.e. outside of the income statement). Upon disposal or impairment, accumulated unrealised gains and losses are transferred from other comprehensive income to the income statement as realised gains or losses.
- iii Loans and receivables — this comprises non-quoted investments that have fixed or determinable payments and are not designated as fair value through profit and loss or available-for-sale. These investments include loans collateralised by mortgages, deposits, loans to policyholders and other unsecured loans and receivables. These investments are initially recognised at fair value plus transaction costs. Subsequently they are carried at amortised cost using the effective interest method.

As permitted under IAS 39, the Prudential Group has designated certain financial assets as fair value through profit and loss as these assets are managed and their performance is evaluated on a fair value basis. Currently, these assets represent all of the Prudential Group's financial assets except all loans and receivables and debt securities held by Jackson. Debt securities held by Jackson are accounted for on an available-for-sale basis. The use of the fair value option is consistent with the Prudential Group's risk management and investment strategies.

The Prudential Group uses the trade date method to account for regular purchases and sales of financial assets.

#### Use of fair values

The Prudential Group uses current bid prices to value its investments with quoted prices. Actively traded investments without quoted prices are valued using prices provided by third parties. If there is no active established market for an investment, the Prudential Group applies an appropriate valuation technique such as a discounted cash flow technique. Additional details are provided in note G1.

#### Impairments

The Prudential Group assesses at each statement of financial position date whether there is objective evidence that a financial asset or group of financial assets not held at fair value through profit and loss is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a loss event) and that a loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of financial assets is impaired includes observable data that comes to the attention of the Prudential Group. For assets designated as available-for-sale, the initial impairment is the cumulative loss which is removed from the available-for-sale reserve within equity and recognised in the income statement. Any subsequent impairment loss is measured as the cumulative loss, less any impairment loss previously recognised.

For loans and receivables carried at amortised cost, the impairment amount is the difference between carrying value and the present value of the expected cash flows discounted at the original effective interest rate.

If, in subsequent periods, an impaired debt security held on an available-for-sale basis or an impaired loan or receivable recovers in value (in part or in full), and this recovery can be objectively related to an event occurring after the impairment, then the previously recognised impairment loss is reversed through the income statement (in part or in full).

#### Derivatives and hedge accounting

Derivative financial instruments are used to reduce or manage investment, interest rate and currency exposures, to facilitate efficient portfolio management and for investment purposes.

The Prudential Group may designate certain derivatives as hedges. This includes fair value hedges, cash flow hedges and hedges of net investments in foreign operations. If the criteria for hedge accounting are met then the following accounting treatments are applied from the date at which the designation is made and the accompanying requisite documentation is in place:

- i Hedges of net investments in foreign operations — the effective portion of any change in fair value of derivatives or other financial instruments designated as net investment hedges are recognised in other comprehensive income (i.e. outside of the income statement). The ineffective portion of changes in the fair

value of the hedging instrument is recorded in the income statement. The gain or loss on the hedging instrument recognised directly in the Statement of comprehensive income is recognised in the income statement on disposal of the foreign operation.

- ii Fair value hedges — movements in the fair value of the hedged item attributable to the hedged risk are recognised in the income statement.
- iii Cash flow hedges — the effective portion of changes in the fair value of derivatives designated as cash flow hedges is recognised in other comprehensive income (i.e. outside of the income statement). Movements in fair value relating to the ineffective portion are booked in the income statement. Amounts recognised in other comprehensive income are recorded in the income statement in the periods in which the hedged item affects profit or loss.

All derivatives that do not meet the relevant hedging criteria are carried at fair value with movements in fair value being recorded in the income statement.

The primary areas of the Prudential Group's continuing operations where derivative instruments are held are the UK with-profits funds and annuity business, and Jackson.

For the Prudential Group's continuing operations, hedge accounting under IAS 39 is not usually applied. The exceptions, where hedge accounting has been applied in 2007, 2008 and 2009, are summarised in note G3.

For UK with-profits funds the derivative programme is undertaken as part of the efficient management of the portfolio as a whole. As noted in section D2 value movements on the with-profits funds investments are reflected in changes in asset-share liabilities to policyholders or the liability for unallocated surplus. Shareholders' profit and equity are not affected directly by value movements on the derivatives held.

For UK annuity business the derivatives are held to contribute to the matching, as far as practical, of asset returns and duration with those of liabilities to policyholders. The carrying value of these liabilities is sensitive to the return on the matching financial assets including derivatives held. Except for the extent of minor mismatching, value movements on derivatives held for this purpose do not affect shareholders' profit or equity.

For Jackson an extensive derivative programme is maintained. Value movements on the derivatives held can be very significant in their effect on shareholder results. The Prudential Group has chosen generally not to seek to construct the Jackson derivative programme so as to facilitate hedge accounting where theoretically possible, under IAS 39. Further details on this aspect of the Prudential Group's financial reporting are described in note A3.

#### Embedded derivatives

Embedded derivatives are present in host contracts issued by various Prudential Group companies, in particular for Jackson. They are embedded within other non-derivative host financial instruments and insurance contracts to create hybrid instruments. Where economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value with the changes in fair value recognised in the income statement, the embedded derivative is bifurcated and carried at fair value as a derivative in accordance with IAS 39. In addition, the Prudential Group applies the requirement of IFRS 4 to not separate and fair value surrender options embedded in host contracts and with-profit investment contracts whose strike price is either a fixed amount or a fixed amount plus interest.

Further details on the valuation basis for embedded derivatives attaching to Jackson's life assurance contracts are provided in note D3 (f).

#### Securities lending including repurchase agreements

The Prudential Group is party to various securities lending agreements under which securities are loaned to third-parties on a short-term basis. The loaned securities are not derecognised; rather, they continue to be recognised within the appropriate investment classification. An operational policy of the Prudential Group is that collateral in excess of 100% of the fair value of securities loaned is required from all securities borrowers and typically consists of cash, debt securities, equity securities or letters of credit.

In cases where the Prudential Group takes possession of the collateral under its securities lending programme, the collateral, and corresponding obligation to return such collateral, are recognised in the consolidated statement of financial position.

#### Derecognition of financial assets and liabilities

The Prudential Group's policy is to derecognise financial assets when it is deemed that substantially all the risks and rewards of ownership have been transferred. The Prudential Group also derecognises a financial asset when the

contractual rights to the cash flows from the financial asset expire. Where the Prudential Group neither transfers nor retains substantially all the risks and rewards of ownership, the Prudential Group will derecognise the financial asset where it is deemed that the Prudential Group has not retained control of the financial asset.

Where the transfer does not result in the Prudential Group transferring the right to receive the cash flows of the financial assets, but does result in the Prudential Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised providing all of the following conditions are met:

- the Prudential Group has no obligation to pay amounts to the eventual recipients unless it collects the equivalent amounts from the original asset;
- the Prudential Group is prohibited by the terms of the transfer contract from selling or pledging the original asset; and
- the Prudential Group has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay.

The Prudential Group derecognises financial liabilities only when the obligation specified in the contract is discharged, cancelled or has expired.

#### Borrowings

Although initially recognised at fair value, net of transaction costs, borrowings, excluding liabilities of consolidated collateralised debt obligations, are subsequently accounted for on an amortised cost basis using the effective interest method. Under the effective interest method, the difference between the redemption value of the borrowing and the initial proceeds (net of related issue costs) is amortised through the income statement to the date of maturity or, for hybrid debt, over the expected life of the instrument.

#### Financial liabilities designated at fair value through profit and loss

Consistent with the Prudential Group's risk management and investment strategy and the nature of the products concerned, the Prudential Group has designated under IAS 39 classification certain financial liabilities at fair value through profit and loss as these instruments are managed and their performance evaluated on a fair value basis. These instruments include liabilities related to consolidated collateralised debt obligations and net assets attributable to unit holders of consolidated unit trusts and similar funds.

### **b Long-term business contracts**

#### ***Income statement treatment***

##### Premiums and claims

As noted previously, subject to certain conditions, IFRS 4 permits the continued usage of previously applied GAAP for measurements of assets and liabilities of insurance contracts and investment contracts with discretionary participating features. This permission also applies to the basis of presentation of premiums and benefits and claims. It is therefore possible under this "grandfathering" for diverse treatments of these items to apply in the income statement. This diversity can include a treatment whereby all premiums, benefits and claims are recorded in the income statement. Alternatively, for life assurance products with investment features, but with sufficient risk to be accounted for as insurance contracts under IFRS 4, premiums and claims may be accounted for as movements on deposits within the liability to policyholders in the statement of financial position. Prudential's current policy is to "grandfather" the treatment previously applied before conversion to IFRS or acquisition of an operation.

Premium and annuity considerations for conventional with-profits policies and other protection type insurance policies are recognised as revenue when due. Premiums and annuity considerations for linked policies, unitised with-profits and other investment type policies are recognised as revenue when received or, in the case of unitised or unit-linked policies, when units are issued. These amounts exclude UK premium taxes and similar duties where Prudential collects and settles taxes borne by the customer.

Policy fees charged on linked and unitised with-profits policies for mortality, asset management and policy administration are recognised as revenue when related services are provided.

Claims paid include maturities, annuities, surrenders and deaths. Maturity claims are recorded as charges on the policy maturity date. Annuity claims are recorded as charges when each annuity instalment becomes due for payment. Surrenders are charged to the income statement when paid and death claims are recorded when notified.

For investment contracts which do not contain discretionary participating features, the accounting is done under IAS 39 to reflect the deposit nature of the arrangement, with premiums and claims reflected as deposits and withdrawals and taken directly to the statement of financial position as movements in the financial liability balance.

#### Acquisition costs

With the exception of costs incurred in respect of with-profit contracts valued on a realistic basis, costs of acquiring new insurance business, principally commissions, marketing and advertising costs and certain other costs associated with policy issuance and underwriting that are not reimbursed by policy charges, are specifically identified and capitalised as part of deferred acquisition costs (DAC), which are included as an asset in the statement of financial position. The DAC asset in respect of insurance contracts is amortised against margins in future revenues on the related insurance policies, to the extent that the amounts are recoverable out of the margins. Recoverability of the unamortised DAC asset is assessed at the time of policy issue and reviewed if profit margins have declined.

Under IFRS, investment contracts (excluding those with discretionary participation features) accounted for as financial liabilities in accordance with IAS 39 which also offers investment management services, require the application of IAS 18 for the revenue attached to these services. The Prudential Group's investment contracts primarily comprise certain unit-linked savings contracts in the UK and Asia and contracts with fixed and guaranteed terms in the US (such as guaranteed investment contracts and annuity-certain) all of which offer an investment service.

Incremental, directly attributable acquisition costs relating to the investment management element of these contracts are capitalised and amortised in line with the related revenue. If the contracts involve up-front charges, this income is also deferred and amortised through the income statement in line with contractual service provision.

#### *UK regulated with-profits funds*

Prudential's long-term business written in the UK comprises predominantly life insurance policies with discretionary participating features under which the policyholders are entitled to participate in the returns of the funds supporting these policies. Business similar to this type is also written in certain of the Prudential Group's Asian operations subject to local market and regulatory conditions. Such policies are called with-profits policies. Prudential maintains with-profits funds within the Prudential Group's long-term business funds, which segregate the assets and liabilities and accumulate the returns related to that with-profits business. The amounts accumulated in these with-profits funds are available to provide for future policyholder benefit provisions and for bonuses to be distributed to with-profits policyholders. The bonuses, both annual and final, reflect the right of the with-profits policyholders to participate in the financial performance of the with-profits funds. Shareholders' profits with respect to bonuses declared on with-profits business correspond to the shareholders' share of the cost of bonuses as declared by the board of directors. The shareholders' share currently represents one-ninth of the cost of bonuses declared for with-profits policies.

Annual bonuses are declared and credited each year to with-profits policies. The annual bonuses increase policy benefits and, once credited, become guaranteed. Annual bonuses are charged to the profit and loss account in the year declared. Final bonuses are declared each year and accrued for all policies scheduled to mature and for death benefits expected to be paid during the next financial year. Final bonuses are not guaranteed and are only paid on policies that result from claims through the death of the policyholder or maturity of the policy within the period of declaration or by concession on surrender. No policyholder benefit provisions are recorded for future annual or final bonus declarations.

The policyholders' liabilities of the UK regulated with-profits funds are accounted for under FRS 27.

Under FRS 27 for the UK regulated with-profits funds:

- no deferred acquisition costs and related deferred tax are recognised; and
- adjusted realistic basis liabilities instead of MSB liabilities are recognised.

FRS 27 realistic liabilities are underpinned by the FSA's Peak 2 basis of reporting. This Peak 2 basis requires the value of liabilities to be calculated as:

- a with-profits benefits reserve (WPBR); plus
- future policy related liabilities (FPRL); plus
- the realistic current liabilities of the fund.

The WPBR is primarily based on the retrospective calculation of accumulated asset shares but is adjusted to reflect future policyholder benefits and other outgoings.

The FPRL must include a market consistent valuation of costs of guarantees, options and smoothing, less any related charges, and this amount is determined using either a stochastic approach, hedging costs or a series of deterministic projections with attributed probabilities.

The assumptions used in the stochastic models are calibrated to produce risk-free returns on each asset class. Volatilities of, and correlations between, investment returns from different asset classes are as determined by the Prudential Group's Portfolio Management Group on a market consistent basis.

The cost of guarantees, options and smoothing is very sensitive to the bonus, market value reduction (MVR) and investment policies the Prudential Group employs and therefore the stochastic modelling incorporates a range of management actions that would help to protect the fund in adverse scenarios. Substantial flexibility has been included in the modelled management actions in order to reflect the discretion that the Prudential Group retains in adverse investment conditions, thereby avoiding the creation of unreasonable minimum capital requirements. The management actions assumed are consistent with management's policy for with-profits funds and the disclosures made in the publicly available Principles and Practices of Financial Management.

The realistic basis liabilities representing the Peak 2 basis realistic liabilities for with-profits business included in Form 19 of the FSA regulatory returns, exclude the element for the shareholders' share of the future bonuses. For accounting under FRS 27 this latter item is reversed because, consistent with the current basis of financial reporting, shareholder transfers are recognised only on declaration.

#### Unallocated surplus

The unallocated surplus represents the excess of assets over policyholder liabilities for the Prudential Group's with-profits funds. As allowed under IFRS 4, the Prudential Group has opted to continue to record unallocated surplus of with-profits funds wholly as a liability. The annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders, is transferred to (from) the unallocated surplus each year through a charge (credit) to the income statement. The balance retained in the unallocated surplus represents cumulative income arising on the with-profits business that has not been allocated to policyholders or shareholders. The balance of the unallocated surplus is determined after full provision for deferred tax on unrealised appreciation on investments.

#### ***Other insurance contracts (i.e. contracts which contain significant insurance risk as defined under IFRS 4)***

For these contracts UK GAAP has been applied, which reflects the MSB. Under this basis the following approach applies:

##### Other UK insurance contracts

Other UK insurance contracts that contain significant insurance risk include unit-linked, annuity and other non-profit business. For the purposes of local regulations, segregated accounts are established for linked business for which policyholder benefits are wholly or partly determined by reference to specific investments or to an investment-related index. The interest rates used in establishing policyholder benefit provisions for pension annuities in the course of payment are adjusted each year. Mortality rates used in establishing policyholder benefit provisions were based on published mortality tables adjusted to reflect actual experience.

##### Overseas subsidiaries

For the Prudential Group's overseas operations, the application of the MSB (which permits the application of local GAAP in some circumstances) varies depending upon the basis of accounting applied prior to IFRS adoption or acquisition by the Prudential Group, and whether adjustments to the basis or a more appropriate method should be applied.

##### Jackson

The future policyholder benefit provisions for Jackson's conventional protection-type policies are determined using the net level premium method under US GAAP principles and assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviations. For non-conventional protection-type policies, the policyholder benefit provision included within policyholder liabilities in the consolidated statement of financial position is the policyholder account balance.

For the business of Jackson, the determination of the expected emergence of margins, against which the amortisation profile of the DAC asset is established, is dependent on certain key assumptions. For single premium

deferred annuity business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders. For variable annuity business, the key assumption is the expected long-term level of equity market returns which, for 2007, 2008 and 2009, was 8.4% per annum implemented using a mean reversion methodology. These returns affect the level of future expected profits through their effects on fee income and the required level of provision for guaranteed minimum death benefit claims.

Jackson accounts for the majority of its investment portfolio on an available-for-sale basis (see investment policies above) whereby unrealised gains and losses are recognised in other comprehensive income. As permitted by IFRS 4, Jackson has used shadow accounting. Under shadow accounting, to the extent that recognition of unrealised gains or losses on available-for-sale securities causes adjustments to the carrying value and amortisation patterns of DAC and deferred income, these adjustments are recognised in other comprehensive income to be consistent with the treatment of the gains or losses on the securities.

#### Asian operations

Consistent with the overarching provisions of IFRS 4 which, as described in note A3(a), permits the accounting for assets and liabilities of insurance contracts and investment contracts with discretionary participating features under previously applied GAAP except for the Prudential Group's current operations in Taiwan, Vietnam and Japan, the future policyholder benefit provisions for the Prudential Group's current Asian businesses in 2007, 2008 and 2009 are determined in accordance with methods prescribed by local GAAP adjusted to comply, where necessary, with UK GAAP. For the Hong Kong business, which is a branch of the PAC, and the Singapore and Malaysian operations the valuation principles and sensitivities to changes of assumptions of conventional with-profits and other protection-type policies are similar to those described above for equivalent products written by the UK operations. Refinements to the local reserving methodology are generally treated as change in estimates, dependent on the nature of the change. Such a refinement arose in 2009 in respect of Malaysia as explained in note D4(h)

For the operations in Taiwan, Vietnam and Japan, countries where local GAAP is not appropriate in the context of the previously applied MSB, accounting for insurance contracts is based on US GAAP. For these three operations the business written is primarily non-participating and linked business. The future policyholder benefit provisions for non-linked business are determined using the net level premium method, with an allowance for surrenders, maintenance and claim expenses. Rates of interest used in establishing the policyholder benefit provisions vary by operation depending on the circumstances attaching to each block of business. Where appropriate, liabilities for participating business for these three operations include provisions for the policyholders' interest in realised investment gains and other surpluses that have yet to be declared as bonuses.

Although the basis of valuation of the Prudential Group's overseas operations is in accordance with the requirements of the Companies Act 2006 and ABI SORP, the valuation of policyholder benefit provisions for these businesses may differ from that determined on a UK MSB for UK operations with the same features. These differences are permitted under IFRS 4.

#### Liability adequacy

The Prudential Group performs liability adequacy testing on its insurance provisions to ensure that the carrying amounts of provisions (less related DAC and present value of in-force business — see policy on business acquisitions and disposals) is sufficient to cover current estimates of future cash flows. When performing the liability adequacy test, the Prudential Group discounts all contractual cash flows and compares this amount to the carrying value of the liability. Any deficiency is immediately charged to the income statement.

#### Reinsurance

In the normal course of business, the Prudential Group seeks to reduce loss exposure by reinsuring certain levels of risk in various areas of exposure with other insurance companies or reinsurers. An asset or liability is recognised in the consolidated statement of financial position representing premiums due to or payments due from reinsurers and the share of benefits and claims recoverable from reinsurers. The measurement of reinsurance assets is consistent with the measurement of the underlying direct insurance contracts.

The only material purchases of reinsurance contracts in the periods of the results in the financial information arise in Jackson. Gains arising on the purchase of reinsurance contracts by Jackson are deferred and amortised over the contract duration.

Any loss is recognised in the income statement immediately.

***Investment contracts (contracts which do not contain significant insurance risk as defined under IFRS 4)***

For investment contracts with discretionary participation features, the accounting basis is consistent with the accounting for similar with-profits insurance contracts. Other investment contracts are accounted for on a basis that reflects the hybrid nature of the arrangements whereby part is accounted for as a financial instrument under IAS 39 and the investment management service component is accounted for under IAS 18. The method used to measure the liability for these investment contracts depends upon the terms of the contracts and will therefore vary by the type of product.

For certain investment contracts with fixed and guaranteed terms, the Prudential Group uses the amortised cost model to measure the liability. On contract inception, the liability is measured at fair value less incremental, directly attributable acquisition costs. Remeasurement at future reporting dates is on an amortised cost basis utilising an effective interest rate methodology whereby the interest rate utilised discounts to the net carrying amount of the financial liability.

Those investment contracts without fixed and guaranteed terms are designated at fair value through profit and loss, because the resulting liabilities are managed and their performance is evaluated on a fair value basis. Fair value is based upon the fair value of the underlying assets of the fund. Where the contract includes a surrender option its carrying value is subject to a minimum carrying value equal to its surrender value.

**c Other assets, liabilities, income and expenditure**

**Basis of consolidation**

The Prudential Group consolidates those entities it is deemed to control. The degree of control is determined by the ability of the Prudential Group to govern the financial and operating policies of an entity in order to obtain benefits. Consideration is given to other factors such as potential voting rights.

The Prudential Group has consolidated special purpose entities (SPEs), such as funds holding collateralised debt obligations (CDOs), where evaluation of the substance of the relationship between the SPE and the Prudential Group indicates that the Prudential Group is deemed to control the SPE under IFRS.

The Prudential Group holds investments in internally and externally managed open-ended investment companies (OEICs) and unit trusts. These are consolidated where the Prudential Group's ownership level is 50% or greater. The Prudential Group's percentage ownership levels in these entities can fluctuate from day to day according to changes in the Prudential Group's and third-party participation in the funds. In instances where the Prudential Group's ownership of internally managed funds declines marginally below 50% and, based on historical analysis and future expectations the decline in ownership is expected to be temporary, the funds continue to be consolidated as subsidiaries under IAS 27.

Where the Prudential Group exercises significant influence or has the power to exercise significant influence over an entity, generally through ownership of 20% or more of the entity's voting rights, but does not control the entity, then this is considered to be an investment in an associate. With the exception of those referred to below, the Prudential Group's investments in associates are recorded at the Prudential Group's share of the associates' net assets. The carrying value of investments in associates is adjusted each year for the Prudential Group's share of the entities' profit or loss. This does not apply to investments in associates held by the Prudential Group's insurance or investment funds including the venture capital business or mutual funds and unit trusts, which, as permitted by IAS 28, are carried at fair value through profit and loss.

The Prudential Group's investments in joint ventures are recognised using proportional consolidation whereby the Prudential Group's share of an entity's individual balances are combined line-by-line with similar items into the Prudential Group financial information.

Other interests in entities, where significant influence is not exercised, are carried as investments at fair value through profit and loss.

The consolidated financial information of the Prudential Group includes the assets, liabilities and results of Prudential and subsidiary undertakings in which Prudential has a controlling interest, using accounts drawn up to 31 December 2007, 31 December 2008 and 31 December 2009 respectively, except where entities have non-coterminous year ends. In such cases, the information consolidated is based on the accounting period of these entities and is adjusted for material changes up to 31 December. Accordingly, the information consolidated is deemed to cover the same period for all entities throughout the Prudential Group. The results of subsidiaries are included in the financial information from the date control commences to the date control ceases. All inter-company

transactions are eliminated on consolidation. Results of asset management activities include those for managing internal funds.

#### Investment properties

Investments in leasehold and freehold properties not for occupation by the Prudential Group including from 2009 (See note A5 for further details) properties under development for future use as investment properties, are carried at fair value, with changes in fair value included in the income statement. Properties are valued annually either by the Prudential Group's qualified surveyors or by taking into consideration the advice of professional external valuers. In the UK the valuations are undertaken using the guidelines of the Royal Institution of Chartered Surveyors (RICS). The RICS guidelines apply separate assumptions to the value of the land, buildings and tenancy associated with each property. Each property is externally valued at least once every three years. For overseas operations investment property valuations are obtained from qualified valuers. The cost of additions and renovations is capitalised and considered when estimating fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific property. If this information is not available, the Prudential Group uses alternative valuation methods such as discounted cash flow projections or recent prices in less active markets.

Leases of investment property where the Prudential Group has substantially all the risks and rewards of ownership are classified as finance leases (leasehold property). Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. Where a lease has a contingent rent element, the rent is calculated in accordance with individual lease terms and charged as an expense as incurred.

#### Pension schemes

The Prudential Group operates a number of pension schemes around the world. The largest of these schemes is the PSPS, a defined benefit scheme. The Prudential Group also operates defined contribution schemes. Defined contribution schemes are schemes where the Prudential Group pays contributions into a fund and the Prudential Group has no legal or constructive obligation to pay further contributions should the assets of that fund be insufficient to pay the employee benefits relating to employee service in both current and prior periods. Defined benefit schemes are post-employment benefit plans that are not defined contribution schemes.

For the Prudential Group's defined benefit schemes, if the present value of the defined benefit obligation exceeds the fair value of the scheme assets, then a liability is recorded in the Prudential Group's statement of financial position. By contrast, if the fair value of the assets exceeds the present value of the defined benefit obligation then the surplus will only be recognised if the nature of the arrangements under the Trust deed, and funding arrangements between the Trustee and Prudential support the availability of refunds or recoverability through agreed reductions in future contributions. In addition, if there is a constructive obligation for the Prudential Group to pay deficit funding, this is also recognised.

The Prudential Group utilises the projected unit credit method to calculate the defined benefit obligation. Estimated future cash flows are then discounted at a high-quality corporate bond rate, adjusted to allow for the difference in duration between the bond index and the pension liabilities where appropriate, to determine its present value. These calculations are performed by independent actuaries.

The plan assets of the Prudential Group's pension schemes exclude several insurance contracts that have been issued by the Prudential Group. These assets are excluded from plan assets in determining the pension obligation recognised in the consolidated statement of financial position.

The aggregate of the actuarially determined service costs of the currently employed personnel and the unwind of discount on liabilities at the start of the period, less the expected investment return on scheme assets at the start of the period, is charged to the income statement. Actuarial gains and losses as a result of changes in assumptions or experience variances are also charged or credited to the income statement.

Contributions to the Prudential Group's defined contribution schemes are expensed when due. Once paid, the Prudential Group has no further payment obligations. Any prepayments are reflected as an asset on the statement of financial position.

#### Share-based payments

The Prudential Group offers share award and option plans for certain key employees and a Save As You Earn (SAYE) plan for all UK and certain overseas employees. The arrangements for distribution to employees of shares held in trust relating to share award plans and for entitlement to dividends depend upon the particular terms of each plan. Shares held in trust relating to these plans are conditionally gifted to employees.

The compensation expense charged to the income statement is primarily based upon the fair value of the options granted, the vesting period and the vesting conditions. Vesting conditions exclude the ability of an employee to voluntarily exit a scheme and such exits are treated as an acceleration of vesting and hence a shortening of the period over which the expense is charged. The Prudential Group revises its estimate of the number of options likely to be exercised at each statement of financial position date and adjusts the charge to the income statement accordingly. Where the share-based payment depends upon vesting outcomes attaching to market-based performance conditions, additional modelling is performed to estimate the fair value of the awards. No subsequent adjustment is then made to the fair value charge for awards that do not vest on account of these performance conditions not being met.

Prudential has established trusts to facilitate the delivery of Prudential Shares under employee incentive plans and savings-related share option schemes. None of the trusts that hold shares for employee incentive and savings plans continue to hold these shares once they are issued to employees. The cost to Prudential of acquiring these treasury shares held in trusts is shown as a deduction from shareholders' equity.

## Tax

The Prudential Group's UK subsidiaries each file separate tax returns. Jackson and other foreign subsidiaries, where permitted, file consolidated income tax returns. In accordance with UK tax legislation, where one domestic UK company is a 75% owned subsidiary of another UK company or both are 75% owned subsidiaries of a common parent, the companies are considered to be within the same UK tax group. For companies within the same tax group, trading profits and losses arising in the same accounting period may be offset for purposes of determining current and deferred taxes.

Current tax expense is charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year. To the extent that losses of an individual UK company are not offset in any one year, they can be carried back for one year or carried forward indefinitely to be offset against profits arising from the same company.

Deferred taxes are provided under the liability method for all relevant temporary differences, being the difference between the carrying amount of an asset or liability in the statement of financial position and its value for tax purposes. IAS 12, 'Income Taxes' does not require all temporary differences to be provided for, in particular, the Prudential Group does not provide for deferred tax on undistributed earnings of subsidiaries where the Prudential Group is able to control the timing of the distribution and the temporary difference created is not expected to reverse in the foreseeable future. The tax effects of losses available for carry forward are recognised as an asset. Deferred tax assets are only recognised when it is more likely than not that future taxable profits will be available against which these losses can be utilised. Deferred tax related to charges or credits taken directly to equity is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

The tax charge for long-term business includes tax expense on with-profits funds attributable to both the policyholders and the shareholders. Different tax rules apply under UK law depending upon whether the business is life insurance or pension business. Tax on the life insurance business is based on investment returns less expenses attributable to that business. Tax on the pension business is based on the shareholders' profits or losses attributable to that business. The shareholders' portion of the long-term business is taxed at the shareholders' rate with the remaining portion taxed at rates applicable to the policyholders.

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 tax rates (and laws) that have been enacted or are substantively entailed at the end of the reporting period.

## **Basis of presentation of tax charges**

Tax charges in the income statement reflect the aggregate of the shareholder tax on the long-term business result and on the Prudential Group's other results.

Under UK Listing Authority rules, profit before tax is required to be presented. This requirement, coupled with the fact that IFRS does not contemplate tax charges which are attributable to policyholders and unallocated surplus of with-profits funds and unit-linked policies, necessitates the reporting of total tax charges within the presented results. The result before all taxes (i.e. 'profit before tax' as shown in the income statement) represents income net of post-tax transfers to unallocated surplus of with-profits funds, before tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders. Separately within the income statement, 'profit before tax attributable to shareholders' is shown after deduction of taxes attributable to

policyholders and unallocated surplus of with-profits funds and unit-linked policies. Tax charges on this measure of profit reflect the tax charges attributable to shareholders. In determining the tax charges attributable to shareholders, the Prudential Group has applied a methodology consistent with that previously applied under UK GAAP reflecting the broad principles underlying the tax legislation of life assurance companies.

#### Property, plant and equipment

All property, plant and equipment such as owner occupied property, computer equipment and furniture and fixtures, are carried at depreciated cost. Costs including expenditure directly attributable to the acquisition of the assets are capitalised. Depreciation is calculated and charged on a straight-line basis over an asset's estimated useful life. The residual values and useful lives are reviewed at each statement of financial position date. If the carrying amount of an asset is greater than its recoverable amount then its carrying value is written down to that recoverable amount.

Leasehold improvements to owner occupied property are depreciated over the shorter of the economic life and the life of the lease. Assets held under finance leases are capitalised at their fair value.

#### Business acquisitions and disposals

Business acquisitions are accounted for by applying the purchase method of accounting, which adjusts the net assets of the acquired company to fair value at the date of purchase. The excess of the costs of acquisition over the fair value of the assets and liabilities of the acquired entity is recorded as goodwill. Should the fair value of the identifiable assets and liabilities of the entity exceed the cost of acquisition then this amount is recognised immediately in the income statement. Income and expenses of acquired entities are included in the income statement from the date of acquisition. Income and expenses of entities sold during the period are included in the income statement up to the date of disposal. The gain or loss on disposal is calculated as the difference between sale proceeds, net of selling costs, less the net assets of the entity at the date of disposal.

For life insurance company acquisitions, the adjusted net assets include an identifiable intangible asset for the present value of in-force business which represents the profits that are expected to emerge from the acquired insurance business. The present value of in-force business is calculated using best estimate actuarial assumptions for interest, mortality, persistency and expenses and is amortised over the anticipated lives of the related contracts in the portfolio. The net carrying amount of insurance liabilities acquired less the value of in-force business, represents the fair value of the insurance liabilities acquired. An intangible asset may also be recognised in respect of acquired investment management contracts representing the fair value of contractual rights acquired under these contracts.

Prudential uses the economic entity method to purchase minority interests. Under the economic entity method any difference between consideration and the share of net assets acquired is recorded directly in equity.

#### Goodwill

Goodwill arising on acquisitions of subsidiaries and businesses is capitalised and carried on the Prudential Group statement of financial position as an intangible asset at initial value less any accumulated impairment losses. Goodwill impairment testing is conducted annually and when there is an indication of impairment. For the purposes of impairment testing, goodwill is allocated to cash generating units. These cash generating units reflect the smallest group of assets that includes the goodwill and generates cash flows that are largely independent of the cash inflows from other groups of assets. If the carrying amount of the cash generating unit exceeds its recoverable amount then the goodwill is considered impaired. Impairment losses are recognised immediately in the income statement and may not be reversed in future periods.

#### Acquired intangible assets

Intangible assets acquired on the purchase of a subsidiary or portfolio of contracts are valued at acquisition and carried at cost less amortisation and any accumulated impairment losses. Amortisation is charged over the estimated useful life of the assets on a basis reflecting the pattern in which the assets' future economic benefits are expected to be consumed. The residual values and useful lives are reviewed at each statement of financial position date.

#### Cash and cash equivalents

Cash and cash equivalents consist of cash at bank and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 days maturity from the date of acquisition.

#### Rights of offset

Assets and liabilities in the consolidated financial information are only reported on a net basis when there is a legally enforceable right to offset and there is an intention to settle on a net basis.

## Segments

Under IFRS 8, adopted in 2009 the Prudential Group determines and presents operating segments based on the information that internally is provided to the Group Executive Committee (“GEC”), which is the Prudential Group’s chief operating decision maker.

An operating segment is a component of the Prudential Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Prudential Group’s other components. An operating segment’s operating results are reviewed regularly by the GEC to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

The operating segments identified by the Prudential Group reflect the Prudential Group’s organisational structure, which is by both geography (Asia, US and UK) and by product line (insurance operations and asset management). Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type.

Insurance operations comprise principally of products that contain both significant and insignificant elements of insurance risk. The products are managed together and there is no distinction between these two categories other than for accounting purposes. This segment also includes the commission earned on general insurance business and investment subsidiaries held for supporting the Prudential Group’s insurance operations

Asset management comprises both internal and third party asset management services, inclusive of portfolio and mutual fund management, where the Prudential Group acts as an advisor, and broker-dealer activities. The nature of the products and the managing of the business differ from the risks inherent in the insurance operations segments, and the regulatory environment of the asset management industry differs from that of the insurance operations segments.

The Prudential Group’s operating segments as determined under IFRS 8 are:

### ***Insurance operations***

- Asia
- US (Jackson)
- UK

### ***Asset management operations***

- M&G
- Asian asset management
- US broker-dealer and asset management (including Curian Capital LLC)

Prudential Capital has been incorporated into the M&G operating segment for the purposes of segment reporting.

The performance measure of operating segments utilised by Prudential is IFRS operating profit attributable to shareholders based on longer-term investment returns. This measure excludes the recurrent items of short-term fluctuations in investment returns and the shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes. In addition, for 2009 this measure excludes the non-recurrent cost of hedging the Prudential Group IGD capital surplus included within short-term fluctuations in investment returns (see note B1). In 2009 the Company sold its Taiwan agency business. In order to facilitate comparisons on a like for like basis, the loss on sale and the results of the Taiwan agency business during the period of ownership (including those for the 2007 and 2008 comparatives) are shown separately within the supplementary analysis of profit. Further details on the determination of the performance measure of “operating profit based on longer-term investment returns” is provided below in note A4 (d).

Segment results that are reported to the GEC include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items are mainly in relation to the Group Head Office and Asia Regional Head Office.

### Shareholders’ dividends

Dividends to shareholders are recognised as a liability in the period in which they are declared. Where scrip dividends are issued, the value of such shares, measured as the amount of the cash dividend alternative, is credited to

reserves and the amount in excess of the nominal value of the shares issued is transferred from the share premium account to retained earnings.

#### Share capital

Where there is no obligation to transfer assets, shares are classified as equity. The difference between the proceeds received on issue of the shares, net of share issue costs, and the nominal value of the shares issued, is credited to share premium. Where the Prudential Group purchases shares for the purposes of employee incentive plans, the consideration paid, net of issue costs, is deducted from retained earnings. Upon issue or sale any consideration received is credited to retained earnings net of related costs.

#### Foreign exchange

The Prudential Group's consolidated financial information is currently presented in the parent company's functional currency. Accordingly, the results and financial position of foreign subsidiaries must be translated into the presentation currency of the Prudential Group from their functional currencies, i.e. the currency of the primary economic environment in which the entity operates. All assets and liabilities of foreign subsidiaries are converted at year end exchange rates whilst all income and expenses are converted at average exchange rates where this is a reasonable approximation of the rates prevailing on transaction dates. The impact of these currency translations is recorded as a separate component in the statement of comprehensive income.

Foreign currency borrowings that have been used to provide a hedge against Prudential Group equity investments in overseas subsidiaries are translated at year end exchange rates and movements recognised in other comprehensive income. Other foreign currency monetary items are translated at year end exchange rates with changes recognised in the income statement.

Foreign currency transactions are translated at the spot rate prevailing at the time.

### **d Operating profit based on longer-term investment returns**

Consistent with the Prudential Group's segmental reporting for its current businesses, the Prudential Group provides supplementary analysis of profit before tax attributable to shareholders that distinguishes operating profit based on longer-term investment returns from other constituent elements of the total profit.

In determining its segmental results, the Prudential Group uses operating profit based on longer-term investment returns to measure the performance of its operational segments. For the purposes of measuring operating profit, investment returns on shareholder-financed business (including the shareholders' share of participating business other than UK style with-profits funds) are based on the expected longer-term rates of return. This reflects the particular features of long-term insurance business where assets and liabilities are held for the long term and for which the accounting basis for insurance liabilities under current IFRS is not generally conducive to demonstrating trends in underlying performance for life businesses exclusive of changes in market conditions. In determining profit on this basis the following key elements are applied to the segment operating results of the Prudential Group's shareholder-financed operations.

#### **i Debt and equity securities**

Longer-term investment returns comprise income and longer-term capital returns. For debt securities the longer-term capital returns comprise two elements. These are a risk margin reserve (RMR) based charge for expected defaults, which is determined by reference to the credit quality of the portfolio, and amortisation of interest-related realised gains and losses to operating results based on longer-term investment returns to the date when sold bonds would have otherwise matured. The shareholder-backed operation for which the risk margin reserve charge is most significant is Jackson National Life. The RMR charge for Jackson is based on long-term average default and recovery data as published by Moody's. During 2009, refinements were made to the RMR process following the National Association of Insurance Commissioners ("NAIC") issuing RBC valuation data for more than 20,000 RMBS securities. Longer-term equity returns comprise aggregate long-term income and capital returns.

#### **ii Derivative value movements**

Value movements for Jackson's equity-based derivatives and variable annuity product embedded derivatives are included in operating profits based on longer-term investment returns. The inclusion of these movements is so as to broadly match with the results on the Jackson variable annuity book that pertain to equity market movements, subject to some limitations for GMDB products where US GAAP does not fully reflect the economic features being hedged. These accounting mis-matches are magnified in periods of significant market movements.

Other derivative value movements are excluded from operating results based on longer-term investment returns. These derivatives are primarily held by Jackson as part of a broadly-based hedging programme for features of Jackson's bond portfolio (for which value movements are booked in the statement of comprehensive income rather than income statement) and product liabilities (for which US GAAP accounting does not reflect the economic features being hedged).

These key elements are of most importance in determining the operating results based on longer-term investment returns of Jackson.

There are two exceptions to the basis described above for determining operating results based on longer-term investment returns. These are for:

- Unit-linked and US variable annuity business.

For such business the policyholder liabilities are directly reflective of the asset value movements. Accordingly, all asset value movements are recorded in the operating results based on longer-term investment returns.

- Assets covering non-participating business liabilities that are interest rate sensitive.

For UK annuity business policyholder liabilities are determined by reference to current interest rates. The value movements of the assets covering liabilities are closely correlated with the related change in liabilities. Accordingly, asset value movements are recorded within the operating results based on longer-term investment returns. Policyholder liabilities include a margin for credit risk as explained in note D2(f)(iii). Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.

### iii Liabilities to policyholders and embedded derivatives for product guarantees

Under IFRS, the degree to which the carrying values of liabilities to policyholders are sensitive to current market conditions varies between territories depending upon the nature of the 'grandfathered' measurement basis. In general, in those instances where the liabilities are particularly sensitive to routine changes in market conditions, the accounting basis is such that the impact of market movements on the assets and liabilities are broadly equivalent in the income statement, and operating profit based on longer-term investment returns is not distorted. In these circumstances there is no need for the movement in the liability to be bifurcated between the element that relates to longer-term market conditions and short-term effects.

However, some types of business movements in liabilities do require bifurcation to ensure that at the net level (i.e. after allocated investment returns and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

#### a Asia

##### *Vietnamese participating business*

For the participating business in Vietnam the liabilities include policyholders' interest in investment appreciation and other surplus. Bonuses paid in a reporting period and accrued policyholder interest in investment appreciation and other surpluses primarily reflect the level of realised investment gains above contract specific hurdle levels. For this business operating profit based on longer-term investment returns includes the aggregate of longer-term returns on the relevant investments, a credit or charge equal to movements on the liability for the policyholders' interest in realised investment gains (net of any recovery of prior deficits on the participating pool), less amortisation over five years of current and prior movements on such credits or charges.

The overall purpose of these adjustments is to ensure that investment returns included in operating results equal longer-term returns but that in any one reporting period movements on liabilities to policyholders caused by investment returns are substantially matched in the presentation of the segmental analysis of profit before tax attributable to policyholders.

##### *Non-participating business*

Liabilities are bifurcated so that the movement in the carrying value of liabilities is split between that which is included in operating results based on longer-term investment returns, and the residual element for the effect of using year end rates is included in short-term fluctuations and in the income statement.

### ***Guaranteed Minimum Death Benefit (GMDB) product features***

For unhedged GMDB liabilities accounted for under IFRS using 'grandfathered' US GAAP, such as in the Japanese business, the change in carrying value is determined under SOP 03-01, which partially reflects changes in market conditions. Under the company's segmental basis of reporting the operating profit reflects the change in liability based on longer-term market conditions with the difference between the charge to the operating result and the movement reflected in the total result included in short-term fluctuations in investment returns.

#### **b US operations — embedded derivatives for variable annuity guarantee features**

Under IFRS, the Guaranteed Minimum Withdrawal Benefit (GMWB) and Guaranteed Minimum Income Benefit (GMIB) reinsurance are required to be fair valued as embedded derivatives. The movements in carrying values are affected by changes in the level of observed implied equity volatility and changes to the discount rate applied from year to year. For these embedded derivatives, as described in note D3(i), the discount rate applied reflects AA corporate bond curve rates. For the purposes of determining operating profit based on longer-term investment returns the charge for these features is determined using historical longer-term equity volatility levels and long-term average AA corporate bond rate curves.

#### **c UK shareholder-backed annuity business**

With one exception, the operating result based on longer-term investment returns reflects the impact of all value movements on policyholder liabilities for annuity business in PRIL and the PAC non-profit sub-fund.

The exception is for the impact on credit risk provisioning of actual downgrades during the year. As this feature arises due to short-term market conditions the effect of downgrades, if any, in a particular period, on the overall provisions for credit risks is included in the category of short-term fluctuations in investment returns.

The effects of other changes to credit risk provisioning are included in the operating result, as is the net effect of changes to the valuation rate of interest applied to portfolio rebalancing to align more closely with management benchmark.

#### **iv Fund management and other non-insurance businesses**

For these businesses, the particular features applicable for life insurance noted above do not apply. For these businesses, it is inappropriate to include returns in the operating result on the basis described above. Instead it is appropriate to generally include realised gains and losses (including impairments) in the operating result with unrealised gains and losses being included in short-term fluctuations. For this purpose impairments are calculated as the credit loss determined by comparing the projected cash flows discounted at the original effective interest rate to the carrying value. In some instances it may also be appropriate to amortise realised gains and losses on derivatives and other financial instruments to operating results over a time period that reflects the underlying substance of the arrangements.

### ***A5: New accounting pronouncements***

The following standards, interpretations and amendments have either been effective and adopted in 2009 or have been issued but are not yet effective in 2009 including those which have not yet been adopted by the EU. This is not intended to be a complete list as only those standards, interpretations and amendments that are anticipated to have an impact upon the Prudential Group's financial information has been discussed.

#### **Accounting pronouncements adopted in 2009**

##### ***IFRS 8, 'Operating Segments'***

IFRS 8 superseded IAS 14 'Segment Reporting' for accounting periods beginning on or after 1 January 2009 and requires the Prudential Group to adopt the 'management approach' to reporting the financial performance of its operating segments.

In accordance with IFRS 8, the Prudential Group determines and presents operating segments based on the information that internally is provided to the Group Executive Committee, which is the Prudential Group's chief operating decision maker. Further details on the operating segments and their related performance measure are provided in note A4(c) in "Segments".

The adoption of IFRS 8 has resulted in presentational and disclosure changes in the Prudential Group's financial information. This standard has no impact on the results or financial position of the Prudential Group.

### ***Amendments to IAS 1, 'Presentation of Financial information: A Revised Presentation'***

The revised version of IAS 1, which includes non-mandatory changes to the titles of some of the financial information, has resulted in a number of changes in presentation and disclosure.

As a result of the adoption of this revised IAS 1, the Prudential Group has changed the titles of its “consolidated balance sheet” to “consolidated statement of financial position” and its “consolidated cash flow statement” to “consolidated statement of cash flows”.

The Prudential Group has also introduced a consolidated statement of comprehensive income in accordance with the revised IAS 1. Components of comprehensive income recognised outside of the income statement, for example exchange movements and the unrealised valuation movement of Jackson’s available-for-sale debt securities, are now presented separately from changes in equity and are disclosed in the statement of comprehensive income. Consequent to this presentational change, the Prudential Group has altered the exchange translation method of the unrealised valuation movement of Jackson’s available-for-sale debt securities from the previous application of closing exchange rate to the average exchange rate, consistent with the translation method of foreign subsidiaries’ income statement items. There is no impact on shareholders’ equity or the income statement from this change.

### ***Improvements to IFRSs***

The improvements issued by the IASB in May 2008 include amendments to a number of standards. The only amendment that has impacted the financial information is the amendment to IAS 40, 'Investment property' (and consequential amendments to IAS 16, 'Property, Plant and Equipment') which now states that property that is under construction or development for future use as investment property is within the scope of IAS 40 and so should be measured at fair value where this is reliably measurable. Previously, these properties were within the scope of IAS 16 and were measured at cost.

As a result of this amendment, the Prudential Group has reclassified its properties under development for future use as investment properties from Property, plant and equipment to Investment properties. This amendment is effective on a prospective application basis from 1 January 2009 and whilst IAS 40 permits retrospective application provided that the fair values of investment properties under construction were determined at those dates, Prudential has not sought to adjust 2007 and 2008 comparatives due to the relative immateriality of any such adjustments. At 1 January 2009, properties under development with a cost of £131 million were reclassified to Investment properties and revalued to a fair value of £152 million. The fair value adjustment of a gain of £21 million was recorded in the income statement but as the relevant properties were held by the PAC with-profits fund, the gain was absorbed by the liability for unallocated surplus and has no direct effect on the profit or loss attributable to shareholders or shareholders’ equity. There was no deferred tax impact on this fair value adjustment.

### ***Amendments to IFRS 7, 'Improving Disclosures about Financial Instruments'***

In March 2009, the IASB issued amendments to IFRS 7 which requires enhanced disclosures about fair value measurements and liquidity risk. The amendments include the introduction of a three-level hierarchy for fair value measurement disclosures and require additional disclosures about the relative reliability of fair value measurements. This has been included in note G1. Prudential has applied the amendments to IFRS 7 for periods beginning on 1 January 2009. Additional supplementary 2008 disclosures have been prepared in certain instances.

In addition, the Prudential Group has also adopted the following accounting pronouncements in 2009 but their adoption has had no material impact on results and financial position of the Prudential Group:

- *Amendment to IFRS 2, 'Share-based Payment: Vesting Conditions and Cancellations'*
- *Amendment to IAS 23 'Borrowing costs'*
- *Amendments to IAS 32 and IAS 1, 'Puttable Financial Instruments and Obligations Arising on Liquidation'*
- *IFRIC 16, 'Hedges of a Net Investment in A Foreign Operation'*

### ***Accounting pronouncement endorsed by the EU but not yet effective***

The following accounting pronouncements potentially relevant to the Prudential Group have been issued and endorsed for use in the EU but are not mandatory for adoption for 31 December 2009 year ends.

*Revised IFRS 3, 'Business Combinations' and Amendments to IAS 27, 'Consolidated and Separate Financial Information'*

The revised IFRS 3 and amended IAS 27 are the outcomes of the second phase of the IASB's and the US Financial Accounting Standards Board's (FASB) joint business combination project. The more significant changes from the revised IFRS 3 include:

- The immediate expensing of acquisition-related costs rather than inclusion in goodwill; and
- recognition and measurement at fair value of contingent consideration at acquisition date with subsequent changes to income.

The amendments to IAS 27 reflect changes to the accounting for non-controlling (minority) interests.

The revised IFRS 3 and amended IAS 27 are effective for business combinations occurring in the accounting period beginning on or after 1 July 2009.

*Amendment to IAS 39, 'Financial Instruments: Recognition and Measurement' — Eligible Hedged Items*

This amendment to IAS 39 clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. This amendment is effective for EU compliant financial information for accounting periods beginning on or after 1 July 2009. The Prudential Group is currently assessing the impact of this amendment but it is not expected to have a material impact on the financial information of the Prudential Group.

***Accounting pronouncements not yet endorsed by the EU***

The following accounting pronouncements potentially relevant to the Prudential Group have been issued but not yet endorsed for use in the EU.

*Improvements to IFRSs (2009)*

In April 2009, the IASB published amendments to a number of standards as part of its annual improvements projects. These amendments are effective for Prudential's 2010 financial information. The Prudential Group is currently assessing the impact of these improvements to its financial information.

*Amendment to IFRS 2 — Group Cash-Settled Share-based Payment Transactions*

In June 2009 the IASB issued further amendments to IFRS 2 which sets out the accounting requirements for share-based payments. These amendments clarified existing guidance, in particular by specifying that an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction and no matter whether the transaction is settled in shares or cash. Prudential is still assessing the impact of the standard but it is not expected to have a material impact on the Prudential Group's financial information.

*IFRIC 19 Extinguishing financial liabilities with equity instruments*

In November 2009 the IFRIC issued guidance on how to account for the extinguishment of a financial liability by the issue of equity instruments. This standard is likely to be effective for EU compliant financial information for accounting periods beginning on or after 1 July 2010. This interpretation is not considered to have a material effect on the Prudential Group's financial information.

*IFRS 9 Financial Instruments: Classification and Measurement*

In November 2009 the IASB issued a new standard which altered the classification and measurement of financial instruments. Under the new standard only two possible classifications arise, rather than the four existing classifications currently available under IAS 39, and will result in all financial assets being valued at amortised cost or fair value through profit and loss. Financial liabilities are excluded from the scope of the standard.

The standard is not mandatory before 2013 year-ends and is yet to be endorsed by the EU. The Prudential Group is still assessing the full impact of this standard.

## B: SUMMARY OF RESULTS

### B1: Segment disclosure — income statement

The determination of the operating segments and performance measure of the operating segments of the Prudential Group are as detailed in note A4.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<u>Asian operations</u>			
Insurance operations:(note ii)			
Underlying results before exceptional credit . . . . .	140	257	353
Exceptional credit for Malaysia operations(note D4(h)) . . . . .	—	—	63
Total Asian insurance operations . . . . .	<u>140</u>	<u>257</u>	<u>416</u>
Development expenses . . . . .	(15)	(26)	(6)
<b>Total Asian insurance operations after development expenses</b> . . . . .	<u>125</u>	<u>231</u>	<u>410</u>
<b>Asian asset management</b> . . . . .	<u>72</u>	<u>52</u>	<u>55</u>
Total Asian operations . . . . .	<u>197</u>	<u>283</u>	<u>465</u>
<u>US operations</u>			
<b>Jackson (US insurance operations)(notes ii,iv)</b> . . . . .	444	406	459
<b>Broker-dealer and asset management(note iv)</b> . . . . .	8	7	4
Total US operations . . . . .	<u>452</u>	<u>413</u>	<u>463</u>
<u>UK operations</u>			
UK insurance operations:(note ii)			
Long-term business . . . . .	524	545	606
General insurance commission(note v) . . . . .	4	44	51
<b>Total UK insurance operations</b> . . . . .	<u>528</u>	<u>589</u>	<u>657</u>
<b>M&amp;G</b> . . . . .	<u>254</u>	<u>286</u>	<u>238</u>
Total UK operations . . . . .	<u>782</u>	<u>875</u>	<u>895</u>
<b>Total segment profit</b> . . . . .	<u>1,431</u>	<u>1,571</u>	<u>1,823</u>
Other income and expenditure			
Investment return and other income . . . . .	86	89	22
Interest payable on core structural borrowings . . . . .	(168)	(172)	(209)
Corporate expenditure:			
Group Head Office . . . . .	(129)	(130)	(146)
Asia Regional Head Office . . . . .	(38)	(41)	(57)
Charge for share-based payments for Prudential schemes (note viii) . . . . .	(11)	(6)	(5)
Total . . . . .	<u>(260)</u>	<u>(260)</u>	<u>(395)</u>
Restructuring costs . . . . .	(19)	(28)	(23)
<b>Operating profit based on longer-term investment returns</b> (note i) . . . . .	<u>1,152</u>	<u>1,283</u>	<u>1,405</u>
Short-term fluctuations in investment returns on shareholder-backed business			
(note vi) . . . . .	(51)	(1,721)	36
Shareholders' share of actuarial and other gains and losses on defined benefit			
pension schemes (note vii) . . . . .	(1)	(13)	(74)
Loss on sale and results for Taiwan agency business (note iii) . . . . .	(37)	1	(621)
<b>Profit (loss) from continuing operations before tax attributable to shareholders</b> . . . . .	<u>1,063</u>	<u>(450)</u>	<u>746</u>

#### Notes

- i Operating profit based on longer-term investment returns: Operating profit based on longer-term investment returns is a supplemental measure of results and is the basis on which management regularly reviews the performance of the Prudential Group's segments as defined by IFRS 8. For the purposes of measuring operating profit, investment returns on shareholder-financed business are based on expected long-term rates of return as discussed in note A4. The expected long-term rates of return are intended to reflect historical real rates of return and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The most significant operation that requires adjustment for the difference between actual and long-term investment returns is Jackson. The amounts included in operating results for long-term capital returns for Jackson's debt securities comprise two components. These are a risk margin reserve based charge for long-term expected defaults, which is determined by reference to the credit quality of the portfolio, and amortisation of interest-related realised gains and losses to operating results based on longer-term results to the date when sold bonds would otherwise have matured. Consistent with the policy of including longer-term investment returns in the measure of operating profit, movements in policyholder liabilities are also, where appropriate, delineated between amounts included in operating profits and movements arising from short-term market conditions, which are recorded in short-term fluctuations in investment returns.

- ii Effect of changes to assumptions, estimates and bases of determining life assurance liabilities: The results of the Prudential Group's long-term business operations are affected by changes to assumptions and bases of preparation. These are described in notes D2(h), D3(h) and D4(h).
- iii Sale of Taiwan agency business: In order to facilitate comparisons of operating profit based on longer-term investment returns that reflect the Prudential Group's retained operations, the results attributable to the Taiwan business for which the sale process was completed in June 2009 are included separately within the supplementary analysis of profit.
- iv Jackson operating results based on longer-term investment returns: IFRS basis operating profits for US operations include the following amounts (net of related change in amortisation of deferred acquisition costs, where applicable) so as to derive longer-term investment returns;

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Debt securities:			
Amortisation of interest related realised gains and losses . . . . .	31	24	47
Risk margin reserve charge for longer-term credit related losses (see below) . . . . .	(37)	(41)	(60)
Equity type investments:			
Longer-term returns . . . . .	<u>47</u>	<u>62</u>	<u>69</u>

The risk margin reserve ("RMR") charge for longer-term credit related losses included in operating profit based on longer-term investment returns is based on an average annual RMR of 22, 23 and 27 basis points, for 2007, 2008 and 2009 respectively, on average book values for the year as shown below.

Moody's rating category (or equivalent under NAIC rating of RMBS)	2007				2008				2009			
	Average book value		Annual expected losses		Average book value		Annual expected losses		Average book value		Annual expected losses	
	US \$m	RMR bps	US \$m	£m	US \$m	RMR bps	US \$m	£m	US \$m	RMR bps	US \$m	£m
	Average											
A3 or higher . . . . .	20,231	0.03	(6)	(3)	21,098	0.03	(6)	(3)	19,509	0.03	(5)	(3)
Baa1, 2, 3 . . . . .	20,306	0.22	(46)	(23)	20,145	0.23	(46)	(25)	21,072	0.23	(47)	(30)
Ba1, 2, 3 . . . . .	1,687	1.13	(19)	(9)	1,635	1.11	(18)	(10)	2,035	1.13	(23)	(15)
Bl, 2, 3 . . . . .	530	2.88	(15)	(7)	514	2.80	(14)	(8)	594	2.86	(17)	(11)
Below B3 . . . . .	240	4.00	(10)	(5)	373	3.98	(15)	(8)	691	3.91	(27)	(17)
<b>Total</b> . . . . .	<u>42,994</u>	<u>0.22</u>	<u>(96)</u>	<u>(47)</u>	<u>43,765</u>	<u>0.23</u>	<u>(99)</u>	<u>(54)</u>	<u>43,901</u>	<u>0.27</u>	<u>(119)</u>	<u>(76)</u>
Related change to amortisation of deferred acquisition costs (see below) . . . . .			<u>20</u>	<u>10</u>			<u>23</u>	<u>13</u>			<u>25</u>	<u>16</u>
Risk margin reserve charge to operating profit for longer-term credit related losses . . . . .			<u>(76)</u>	<u>(37)</u>			<u>(76)</u>	<u>(41)</u>			<u>(94)</u>	<u>(60)</u>

During 2009 the National Association of Insurance Commissioners ("NAIC") changed its approach to the determination of regulatory ratings of residential mortgage-backed securities ("RMBS"). This recognised the complexities associated with these investments and the limitations of the credit rating previously applied. The new ratings framework has been applied by an external third party, PIMCO, and provides regulatory ratings details for more than 20,000 RMBS securities owned by US insurers at the end of 2009. Jackson has decided to use the ratings resulting from this model to determine the average annual RMR for 2009 as this is considered more relevant information for the RMBS securities concerned. If the previous approach of using ratings by Nationally Recognised Statistical Ratings Organisation ("NRSROS") such as Moody's, Standard and Poor's or Fitch for these investments had been used this would have resulted in an annual RMR of 31 basis points for 2009, an additional £11 million of annual expected losses for the year. It should be noted that this change has no impact on the valuation applied to these securities within the IFRS statement of financial position and there is no impact to IFRS profit before tax or shareholders' equity as a result of this change.

The longer-term rates of return for equity-type investments ranged from 8.1% to 10.1% for 2007, 6.3% to 8.4% for 2008, and 6.7% to 7.9% for 2009 depending on the type of investments. These rates are currently based on spreads over 10 year US treasury rates of 400 to 600 basis points.

Market value movements on equity-based derivatives and embedded derivatives are also recorded within operating profits based on longer-term investment returns so as to be consistent with the market related effects on fees and reserve movements for equity-based products. Market value movements on other derivatives are excluded from operating profit, and are included in short-term fluctuations in investment returns.

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

- v UK operations transferred its general insurance business to Churchill in 2002, with general insurance commission representing the commission receivable net of expenses for Prudential-branded general insurance products as part of this arrangement.
- vi Short-term fluctuations in investment returns on shareholder-backed business;

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Insurance operations:			
Asia . . . . .	15	(138)	31
US . . . . .	(18)	(1,058)	27
UK . . . . .	(47)	(212)	108
IGD hedge costs . . . . .	—	—	(235)
Other . . . . .	(1)	(313)	105
	<u>(51)</u>	<u>(1,721)</u>	<u>36</u>

## General overview of defaults

There were no default losses in 2007. The Prudential Group incurred defaults of £206 million in 2008 and £11 million in 2009 on its debt securities portfolio. The defaults of £11 million in 2009 were experienced by the UK shareholder-backed annuity business. Jackson experienced less than £1 million of default losses during 2009. Defaults in 2008 of £206 million (including losses on sale) arose primarily in respect of Lehman Brothers (£110 million) and Washington Mutual (£91 million), the majority of which arose in Jackson.

## Asian insurance operations

For 2007, the £15 million of short-term fluctuations primarily reflect strong equity market movements in Vietnam. For 2008, fluctuations primarily related to £(81) million for Vietnam, reflecting a significant fall in the Vietnamese bond and equity markets. The fluctuations for Asian operations in 2009 primarily relate to strong market performance in Taiwan and Japan partially offset by the fall in the Vietnamese bond markets.

## US insurance operations

The short-term fluctuations in investment returns for US insurance operations for the year comprise of the following items:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Short-term fluctuations related to debt securities			
Charges in the year*			
Defaults . . . . .	—	(78)	—
Losses on sales of impaired and deteriorating bonds . . . . .	(51)	(130)	(6)
Bond write downs . . . . .	(35)	(419)	(630)
Recoveries/reversals . . . . .	8	3	5
	(78)	(624)	(631)
Less: risk margin charge included in operating profit based on longer-term investment returns . . . . .	48	54	76
	<u>(30)</u>	<u>(570)</u>	<u>(555)</u>
Interest related gains (losses)			
Arising in the year . . . . .	31	(25)	125
Less: amortisation gains and losses arising in current and prior years to operating profit based on longer-term investment returns . . . . .	(37)	(28)	(59)
	(6)	(53)	66
Related change to amortisation of deferred acquisition costs . . . . .	9	88	75
Total short-term fluctuations related to debt securities . . . . .	(27)	(535)	(414)
Derivatives (other than equity related): market value movements (net of related change to Amortisation of deferred acquisition costs)(†) . . . . .	(19)	(369)	385
Equity type investments: actual less longer-term return (net of related change to amortisation of deferred acquisition costs) . . . . .	42	(69)	(59)
Other items (net of related change to amortisation of deferred acquisition costs)(‡) . . . . .	(14)	(85)	115
Total . . . . .	<u>(18)</u>	<u>(1,058)</u>	<u>27</u>

\* Additional supplementary detailed disclosure of changes by type of security has been provided for 2008 and 2009. The charges on the debt securities of Jackson comprise the following:

	<b>2008</b>				
	<b>Defaults</b>	<b>Losses on sale of impaired and deteriorating bonds</b>	<b>Bond write downs</b>	<b>Recoveries/ reversals</b>	<b>Total £m</b>
Residential mortgage-backed securities					
Prime . . . . .	—	—	25	—	25
Alt-A. . . . .	—	—	138	—	138
Sub-prime. . . . .	—	—	4	—	4
Total residential mortgage-backed securities. . . . .	—	—	167	—	167
Corporate debt securities . . . . .	78	130	233	—	441
Other . . . . .	—	—	19	(3)	16
<b>Total</b> . . . . .	<u>78</u>	<u>130</u>	<u>419</u>	<u>(3)</u>	<u>624</u>
					<b>2009</b>
	<b>Defaults</b>	<b>Losses on sale of impaired and deteriorating bonds</b>	<b>Bond write downs</b>	<b>Recoveries/ reversals</b>	<b>Total £m</b>
Residential mortgage-backed securities					
Prime . . . . .	—	—	268	—	268
Alt-A. . . . .	—	(10)	192	—	182
Sub-prime. . . . .	—	—	49	—	49
Total residential mortgage-backed securities. . . . .	—	(10)	509	—	499
Corporate debt securities . . . . .	—	16	91	—	107
Other . . . . .	—	—	30	(5)	25
<b>Total</b> . . . . .	<u>—</u>	<u>6</u>	<u>630</u>	<u>(5)</u>	<u>631</u>

As disclosed above total 2007 defaults, losses on sale, write downs and recoveries were £(78) million compared to £(624) million in 2008 and £(631) million in 2009. Given the smaller scale of losses in 2007 a break down by type of debt security has not been provided.

Other bond write downs and defaults of £30 million relates to Piedmont Securities in 2009. Piedmont is an investment vehicle investing in certain asset-backed and mortgage backed securities in the US.

† Market value movements of (£19) million, (£369) million and £385 million, for 2007, 2008 and 2009 respectively, relate to freestanding derivatives held to manage the fixed annuity and other general account business. Under IAS 39, unless hedge accounting is applied, value movements on derivatives are recognised in the income statement.

Derivative value movements in respect of equity risk within variable annuity business are included within the operating profit based on longer-term investment returns to broadly match with the commercial effects to which the variable annuity derivative programme relates, (subject to some limitations to GMDB liabilities where US GAAP does not fully reflect the economic features being hedged.) Other derivative value movements are separately identified within short-term fluctuations in investment returns.

For the derivatives programme attaching to the fixed annuity and other general account business the Prudential Group has continued its approach of not seeking to apply hedge accounting under IAS 39. This decision reflects the inherent constraints of IAS 39 for hedge accounting investments and life assurance assets and liabilities under 'grandfathered' US GAAP under IFRS 4.

‡ The charge of £85 million and the gain of £115 million, for 2008 and 2009 respectively, in relation to other items shown above contains a charge of £70 million and a gain of £85 million in 2008 and 2009 respectively in respect of the difference between the charge for embedded derivatives included in the operating result and the charge to the total result, and a charge of £15 million and a gain of £30 million in 2008 and 2009 respectively, in respect of other items. For embedded derivatives, the operating result reflects the application of 10-year average AA corporate bond rate curves and a static historical equity volatility assumption.

For 2008 and 2009, the total result reflects the application of year end AA corporate bond rate curves and current equity volatility levels.

In addition, for US insurance operations, included within the statement of comprehensive income, is an increase in net unrealised losses of £244 million and £2,104 million for 2007 and 2008 respectively, and reduction in net unrealised losses on debt securities classified as available-for-sale of £2,669 million for 2009. These temporary market value movements do not reflect defaults or impairments. Additional details on the movement in the value of the Jackson portfolio are included in note D3.

#### UK insurance operations

The short-term fluctuation charge for 2007 were mostly PRIL. The fluctuation principally reflected the impact of widened credit spreads on the corporate bond securities backing the shareholders' equity of the business. The 2008 charge of £212 million reflected £170 million for asset value movements, principally for shareholder-backed annuity business, and £42 million for the effect of credit downgrades on the calculation of liabilities for shareholder-backed annuity business in PRIL and the PAC non-profit sub-fund. The short-term fluctuations gain for UK insurance operations of £108 million in 2009 reflects principally asset value movements principally for shareholder-backed annuity business.

## IGD hedge costs

During the severe equity market conditions experienced in the first quarter of 2009 coupled with historically high equity volatility the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to the regular operational hedging programmes. The hedge contracts have expired and have not been renewed.

## Other

Short-term fluctuations of other operations, in addition to the previously discussed IGD hedge costs, arise from:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Unrealised value movements on swaps held centrally to manage Group assets and liabilities . . . . .	(18)	(38)	28
Unrealised value movements on Prudential Capital's bond portfolio . . . . .	(24)	(190)	66
Unrealised value movements on investments held by other operations . . . . .	9	(14)	11
Amounts related to Asian investment in India mutual fund . . . . .	<u>32</u>	<u>(71)</u>	<u>—</u>
	<u>(1)</u>	<u>(313)</u>	<u>105</u>

vii Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Actuarial gains and losses</b>			
Actual less expected return on scheme assets . . . . .	4	(97)	23
Experience gains (losses) on scheme liabilities . . . . .	(4)	19	17
Gains (losses) on changes of assumptions for scheme liabilities . . . . .	<u>(7)</u>	<u>71</u>	<u>(147)</u>
	(7)	(7)	(107)
Less: amount attributable to the PAC with-profits sub-fund . . . . .	<u>6</u>	<u>(2)</u>	<u>47</u>
	<u>(1)</u>	<u>(9)</u>	<u>(60)</u>
<b>Other gains and losses</b>			
Movement in the provision for deficit funding of PSPS . . . . .	—	(13)	(48)
Less: amount attributable to the PAC with-profits sub-fund . . . . .	<u>—</u>	<u>9</u>	<u>34</u>
	<u>—</u>	<u>(4)</u>	<u>(14)</u>
Total . . . . .	<u>(1)</u>	<u>(13)</u>	<u>(74)</u>

The actuarial gains and losses shown in the table above relate to the Scottish Amicable, M&G and until 2009 the small Taiwan defined benefit pension scheme. The amounts did not include actuarial gains and losses for the Prudential Staff Pension Scheme (PSPS) for which the Prudential Group has not recognised its interest in the scheme's underlying surplus.

The losses of £147 million in 2009 on change of assumptions comprise mainly the effect of a decrease in the risk discount rate combined with the effect of an increase in inflation rates. The gains of £71 million in 2008 on change in assumptions comprises the effect of an increase in the risk discount rate combined with the effect of decreases in inflation rates.

Other gains and losses relate to the change in the year of the provision for deficit funding obligation for PSPS

Further details on the Prudential Group's defined benefit pension schemes and the effect of the accounting policy change are shown in note I2.

viii Share-based payments

The charge for share-based payments for Prudential schemes is for the SAYE and Prudential Group performance-related schemes.

ix Restructuring costs are incurred in the UK as part of EEV covered business (2007: £7 million, 2008: £10 million, 2009: £16 million) and as part of central operations (EEV non-covered business)(2007: £12 million, 2008: £18 million, 2009: £7 million)

## **B2: Earnings per share**

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, excluding those held in employee share trusts, which are treated as cancelled.

For diluted earnings per share, the weighted average number of shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Prudential Group's only class of dilutive potential ordinary shares are those share options granted to employees where the exercise price is less than the average market price of Prudential's ordinary shares during the year. No adjustment is made if the impact is anti-dilutive overall.

	<b>2007</b>					
	<u>Before tax</u> <u>note B1</u>	<u>Tax</u> <u>note F5</u>	<u>Minority</u> <u>interests</u>	<u>Net of tax and</u> <u>minority</u> <u>interests</u>	<u>Basic</u> <u>earnings</u> <u>per share</u>	<u>Diluted</u> <u>earnings</u> <u>per share</u>
	£m	£m	£m	£m	Pence	Pence
Based on operating profit based on longer-term investment returns . . . . .	1,152	(352)	(4)	796	32.5p	32.5p
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	(51)	20	1	(30)	(1.2)p	(1.2)p
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	(1)	1	—	—	0.0p	0.0p
Adjustment for result of Taiwan agency business . . . . .	<u>(37)</u>	<u>(23)</u>	<u>—</u>	<u>(60)</u>	<u>(2.5)p</u>	<u>(2.5)p</u>
Based on profit for the year from continuing operations . . . . .	<u>1,063</u>	<u>(354)</u>	<u>(3)</u>	<u>706</u>	<u>28.8p</u>	<u>28.8p</u>
Adjustments for post-tax results of discontinued operations* . . . . .	<u>222</u>	<u>19</u>	<u>—</u>	<u>241</u>	<u>9.9p</u>	<u>9.8p</u>
Based on profit for the year . . . . .	<u><u>1,285</u></u>	<u><u>(335)</u></u>	<u><u>(3)</u></u>	<u><u>947</u></u>	<u><u>38.7p</u></u>	<u><u>38.6p</u></u>

\* Discontinued operations in 2007 related entirely to UK Banking operations following the sale on 1 May 2007 of Egg Banking plc to Citibank Overseas Investment Corporation, a subsidiary of Citigroup Inc.

	<b>2008</b>					
	<u>Before tax</u> <u>note B1</u>	<u>Tax</u> <u>note F5</u>	<u>Minority</u> <u>interests</u>	<u>Net of tax and</u> <u>minority</u> <u>interests</u>	<u>Basic</u> <u>earnings</u> <u>per share</u>	<u>Diluted</u> <u>earnings</u> <u>per share</u>
	£m	£m	£m	£m	Pence	Pence
Based on operating profit based on longer-term investment returns . . . . .	1,283	(292)	(4)	987	39.9p	39.9p
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	(1,721)	352	(1)	(1,370)	(55.4)p	(55.4)p
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	(13)	3	—	(10)	(0.4)p	(0.4)p
Adjustment for result of sold Taiwan agency business . . . . .	<u>1</u>	<u>(4)</u>	<u>—</u>	<u>(3)</u>	<u>(0.1)p</u>	<u>(0.1)p</u>
Based on loss for the year . . . . .	<u><u>(450)</u></u>	<u><u>59</u></u>	<u><u>(5)</u></u>	<u><u>(396)</u></u>	<u><u>(16.0)p</u></u>	<u><u>(16.0)p</u></u>

	<b>2009</b>					
	<u>Before tax</u> <u>note B1</u> <u>£m</u>	<u>Tax</u> <u>note F5</u> <u>£m</u>	<u>Minority</u> <u>interests</u> <u>£m</u>	<u>Net of tax and</u> <u>minority</u> <u>interests</u> <u>£m</u>	<u>Basic</u> <u>earnings</u> <u>per share</u> <u>Pence</u>	<u>Diluted</u> <u>earnings</u> <u>per Share</u> <u>Pence</u>
Based on operating profit based on longer-term investment returns . . . . .	1,405	(318)	(2)	1,085	43.4p	43.3p
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	36	224	1	261	10.4p	10.4p
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(74)	21	—	(53)	(2.1)p	(2.1)p
Adjustment from loss on sale and result of Taiwan agency business . . .	<u>(621)</u>	<u>18</u>	<u>—</u>	<u>(603)</u>	<u>(24.1)p</u>	<u>(24.0)p</u>
Based on profit for the year from continuing operations . . . . .	746	(55)	(1)	690	27.6p	27.6p
Adjustments for post-tax results of discontinued operations (note I9) . . .	<u>(14)</u>	<u>—</u>	<u>—</u>	<u>(14)</u>	<u>(0.6)p</u>	<u>(0.6)p</u>
Based on profit for the year . . . . .	<u><u>732</u></u>	<u><u>(55)</u></u>	<u><u>(1)</u></u>	<u><u>676</u></u>	<u><u>27.0p</u></u>	<u><u>27.0p</u></u>

### Parent company profits

The consolidated profit after tax attributable to equity shareholders of the company includes a loss of £26 million, a profit of £475 million and profit of £908 million, in respect of the standalone company (including dividends from subsidiaries), for 2007, 2008 and 2009 respectively.

### Number of shares

A reconciliation of the weighted average number of ordinary shares used for calculating basic and diluted earnings per share is set out as below:

	<u>2007 m</u>	<u>2008 m(note i)</u>	<u>2009 m</u>
Weighted average shares for calculation of basic earnings per share . . . . .	2,445	2,472	2,501
Shares under option at end of year . . . . .	9	—	12
Number of shares that would have been issued at fair value on assumed option exercise . . . . .	<u>(6)</u>	<u>—</u>	<u>(7)</u>
Weighted average shares for calculation of diluted earnings per share . . . . .	<u><u>2,448</u></u>	<u><u>2,472</u></u>	<u><u>2,506</u></u>

#### Note i

For the year ended 31 December 2008 there were 7 million shares under option offset by 6 million shares that would have been issued at fair value on assumed option exercise. The net one million shares have not been included in the 2008 diluted earnings per share calculation as their inclusion would have decreased the loss per share.

### B3: Dividends

	<u>2007</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>
Dividends declared and paid in reporting period			
Parent company:			
Interim dividend (2007: 5.70p, 2008: 5.99p, 2009: 6.29p per share) . . . . .	140	149	159
Final dividend for prior period (2007: 11.72p, 2008: 12.30p, 2009: 12.91p per share) . .	286	304	322
Subsidiary company dividend payments attributable to minority interests . . . . .	<u>5</u>	<u>2</u>	<u>—</u>
Total . . . . .	<u><u>431</u></u>	<u><u>455</u></u>	<u><u>481</u></u>

As a result of shares issued in lieu of dividends of £176 million, £157 million and £137 million, dividends paid in cash, as set out in the consolidated statement of cash flows, were £255 million, £297 million and £344 million for 2007, 2008 and 2009 respectively.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Parent company dividends relating to reporting period:			
Interim dividend (2007: 5.70p, 2008: 5.99p, 2009: 6.29p per share) . . . . .	140	149	159
Final dividend (2007: 11.72p, 2008: 12.91p, 2009: 13.56p per share) . . . . .	<u>304</u>	<u>322</u>	<u>343</u>
Total . . . . .	<u>444</u>	<u>471</u>	<u>502</u>

**B4: Exchange translation**

Exchange movement recognised in other comprehensive income

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Asian operations . . . . .	16	456	(189)
US operations . . . . .	(43)	581	(244)
Unallocated to a segment (central funds) . . . . .	<u>38</u>	<u>(646)</u>	<u>227</u>
	<u>11</u>	<u>391</u>	<u>(206)</u>

The movements for Asian and US operations reflect the application of year end exchange rates to the assets and liabilities and average exchange rates to the income statement on translation of these operations into the presentation currency of the Prudential Group. The movement unallocated to a segment mainly reflects the translation of currency borrowings and forward contracts which have been designated as a net investment hedge against the currency risk of the net investment in Jackson.

The exchange rates applied were:

<u>Local currency: £</u>	<u>Opening rate at 1 Jan 2007</u>	<u>Closing rate at 31 Dec 2007</u>	<u>Average for 2007</u>	<u>Closing rate at 31 Dec 2008</u>	<u>Average for 2008</u>	<u>Closing rate at 31 Dec 2009</u>	<u>Average for 2009</u>
Hong Kong . . . . .	15.22	15.52	15.62	11.14	14.42	<b>12.52</b>	<b>12.14</b>
Indonesia . . . . .	17,601.63	18,696.71	18,295.63	15,799.22	17,749.22	<b>15,171.52</b>	<b>16,173.28</b>
Japan . . . . .	233.20	222.38	235.64	130.33	192.09	<b>150.33</b>	<b>146.46</b>
Malaysia . . . . .	6.90	6.58	6.88	5.02	6.15	<b>5.53</b>	<b>5.51</b>
Singapore . . . . .	3.00	2.87	3.02	2.07	2.61	<b>2.27</b>	<b>2.27</b>
Taiwan . . . . .	63.77	64.56	65.75	47.28	58.24	<b>51.65</b>	<b>51.65</b>
US . . . . .	1.96	1.99	2.00	1.44	1.85	<b>1.61</b>	<b>1.57</b>

**B5: New business**

*Insurance products and investment products (note i)*

	<u>Insurance products gross premiums</u>			<u>Investment products gross inflows (note ii)</u>			<u>Total</u>		
	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
Asian operations . . . . .	2,901	2,422	2,019	38,954	46,957	71,176	41,855	49,379	73,195
US operations . . . . .	6,534	6,941	8,909	60	36	6	6,594	6,977	8,915
UK operations . . . . .	<u>6,879</u>	<u>7,183</u>	<u>5,014</u>	<u>14,745</u>	<u>16,154</u>	<u>24,875</u>	<u>21,624</u>	<u>23,337</u>	<u>29,889</u>
Group total . . . . .	<u>16,314</u>	<u>16,546</u>	<u>15,942</u>	<u>53,759</u>	<u>63,147</u>	<u>96,057</u>	<u>70,073</u>	<u>79,693</u>	<u>111,999</u>

**Insurance products — new business premiums and contributions (note i)**

	Single			Regular			Annual premium and contribution equivalents		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Asian operations</b> (note iv)									
China (Group's 50% interest) . . . . .	45	63	72	24	32	38	29	38	45
Hong Kong . . . . .	501	507	94	117	154	232	167	205	241
India (Group's 26% interest) . . . . .	26	60	47	177	202	163	180	208	168
Indonesia . . . . .	118	94	41	109	167	186	121	176	190
Japan . . . . .	122	115	57	22	30	46	34	42	52
Korea . . . . .	179	78	38	241	211	118	259	219	122
Malaysia . . . . .	41	28	63	78	99	140	82	102	146
Singapore . . . . .	593	341	297	67	78	98	126	112	128
Taiwan(note iii) . . . . .	10	36	104	21	55	97	22	58	107
Other . . . . .	36	18	29	55	54	59	58	56	62
<b>Total Asian operations</b> . . . . .	<b>1,671</b>	<b>1,340</b>	<b>842</b>	<b>911</b>	<b>1,082</b>	<b>1,177</b>	<b>1,078</b>	<b>1,216</b>	<b>1,261</b>
<b>US operations</b> (note iv)									
Fixed annuities . . . . .	573	1,724	1,053	—	—	—	57	172	105
Fixed index annuities . . . . .	446	501	1,433	—	—	—	45	50	143
Variable annuities . . . . .	4,554	3,491	6,389	—	—	—	455	349	639
Life . . . . .	7	7	10	19	24	24	20	25	25
<b>Total US operations — Retail</b> . . . . .	<b>5,580</b>	<b>5,723</b>	<b>8,885</b>	<b>19</b>	<b>24</b>	<b>24</b>	<b>577</b>	<b>596</b>	<b>912</b>
Guaranteed investment contracts and Medium Term Notes . . . . .	935	1,194	—	—	—	—	94	120	—
<b>Total US operations</b> . . . . .	<b>6,515</b>	<b>6,917</b>	<b>8,885</b>	<b>19</b>	<b>24</b>	<b>24</b>	<b>671</b>	<b>716</b>	<b>912</b>
<b>UK operations</b>									
<i>Product summary</i>									
Internal vesting annuities . . . . .	1,399	1,600	1,357	—	—	—	140	160	136
Direct and partnership annuities . . . . .	842	703	590	—	—	—	84	70	59
Intermediated annuities . . . . .	555	497	242	—	—	—	56	50	24
<b>Total individual annuities</b> . . . . .	<b>2,796</b>	<b>2,800</b>	<b>2,189</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>280</b>	<b>280</b>	<b>219</b>
Income drawdown . . . . .	34	75	91	—	—	—	3	8	9
Equity release . . . . .	156	242	127	—	—	—	16	24	13
Individual pensions . . . . .	38	115	198	1	3	7	5	14	27
Corporate pensions . . . . .	283	221	81	84	88	86	112	110	94
Unit-linked bonds . . . . .	243	109	122	—	—	—	24	11	12
With-profits bonds . . . . .	297	869	1,264	—	—	—	30	87	126
Protection . . . . .	—	—	—	5	6	17	5	6	17
Offshore products . . . . .	434	551	317	4	4	3	47	59	35
PruHealth . . . . .	—	—	—	13	16	11	13	16	11
<b>Total retail retirement</b> . . . . .	<b>4,281</b>	<b>4,982</b>	<b>4,389</b>	<b>107</b>	<b>117</b>	<b>124</b>	<b>535</b>	<b>615</b>	<b>563</b>
Corporate pensions . . . . .	198	227	111	115	116	105	135	139	116
Other products . . . . .	190	132	79	25	21	17	44	34	25
DWP rebates . . . . .	143	153	127	—	—	—	14	15	13
<b>Total mature life and pensions</b> . . . . .	<b>531</b>	<b>512</b>	<b>317</b>	<b>140</b>	<b>137</b>	<b>122</b>	<b>193</b>	<b>188</b>	<b>154</b>
<b>Total retail</b> . . . . .	<b>4,812</b>	<b>5,494</b>	<b>4,706</b>	<b>247</b>	<b>254</b>	<b>246</b>	<b>728</b>	<b>803</b>	<b>717</b>
Wholesale annuities . . . . .	1,799	1,417	39	—	—	—	180	142	4
Credit life . . . . .	21	18	23	—	—	—	2	2	2
<b>Total UK operations</b> . . . . .	<b>6,632</b>	<b>6,929</b>	<b>4,768</b>	<b>247</b>	<b>254</b>	<b>246</b>	<b>910</b>	<b>947</b>	<b>723</b>

	Single			Regular			Annual premium and contribution equivalents		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Channel summary</b>									
Direct and partnership . . . . .	2,385	2,352	1,814	212	215	201	451	450	382
Intermediated . . . . .	2,284	2,990	2,765	35	39	45	263	338	322
Wholesale . . . . .	1,820	1,434	62	—	—	—	182	144	6
<b>Sub-total</b> . . . . .	<b>6,489</b>	<b>6,776</b>	<b>4,641</b>	<b>247</b>	<b>254</b>	<b>246</b>	<b>896</b>	<b>932</b>	<b>710</b>
DWP rebates . . . . .	143	153	127	—	—	—	14	15	13
<b>Total UK operations</b> . . . . .	<b>6,632</b>	<b>6,929</b>	<b>4,768</b>	<b>247</b>	<b>254</b>	<b>246</b>	<b>910</b>	<b>947</b>	<b>723</b>
Group total . . . . .	<u>14,818</u>	<u>15,186</u>	<u>14,495</u>	<u>1,177</u>	<u>1,360</u>	<u>1,447</u>	<u>2,659</u>	<u>2,879</u>	<u>2,896</u>

**Investment products — funds under management (note (ii) and (iv))**

	2007				
	1 Jan 2007	Market gross inflows	Redemptions	Market exchange translation and other movements	31 Dec 2007
	£m				
Asian operations . . . . .	12,253	38,954	(35,993)	2,179	17,393
US operations . . . . .	—	60	(4)	(1)	55
UK operations . . . . .	<u>44,946</u>	<u>14,745</u>	<u>(9,787)</u>	<u>1,317</u>	<u>51,221</u>
Group total . . . . .	<u>57,199</u>	<u>53,759</u>	<u>(45,784)</u>	<u>3,495</u>	<u>68,669</u>
	2008				
	1 Jan 2008	Market gross inflows	Redemptions	Market exchange translation and other movements	31 Dec 2008
	£m				
Asian operations . . . . .	17,393	46,957	(46,102)	(3,016)	15,232
US operations . . . . .	55	36	(32)	(9)	50
UK operations . . . . .	<u>51,221</u>	<u>16,154</u>	<u>(12,747)</u>	<u>(7,631)</u>	<u>46,997</u>
Group total . . . . .	<u>68,669</u>	<u>63,147</u>	<u>(58,881)</u>	<u>(10,656)</u>	<u>62,279</u>
	2009				
	1 Jan 2009	Market gross inflows	Redemptions	Market exchange translation and other movements	31 Dec 2009
	£m				
Asian operations . . . . .	15,232	71,176	(69,177)	2,243	19,474
US operations . . . . .	50	6	(66)	10	—
UK operations . . . . .	<u>46,997</u>	<u>24,875</u>	<u>(11,397)</u>	<u>9,831</u>	<u>70,306</u>
Group total . . . . .	<u>62,279</u>	<u>96,057</u>	<u>(80,640)</u>	<u>12,084</u>	<u>89,780</u>

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.

Annual Premium Equivalents (APEs) are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. New business premiums for regular premium products are shown on an annualised basis. Department of Work and Pensions (DWP) rebate business is classified as single recurrent business. Internal vesting business is classified as new business where the contracts include an open market option.

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, i.e. falling within one of the classes of insurance specified in Part II of Schedule 1 to the Regulated Activities Order under FSA 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 Investment products referred to in the table 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, as described in the preceding paragraph, although similar IFRS recognition and measurement principles apply to the acquisition costs and fees attaching to this type of business.
- iii The tables above include new business for the Taiwan bank distribution operation. New business of the Taiwan Agency business, which was sold in June 2009 (as explained in note I1) are excluded from the tables. Comparative figures have been adjusted accordingly.
- iv New business and market gross inflows and redemption have been translated at the average exchange rate for the year applicable. Funds under management at points in time are translated at the exchange rate applicable at those dates.

## B6: Group statement of financial position

To explain more comprehensively the assets, liabilities and capital of the Prudential Group's businesses it is appropriate to provide an analysis of the Prudential Group's statement of financial position by operating segment and type of business. The tables below aggregate the three asset management segments for ease of presentation and hence should be read in conjunction with the associated tables on asset management in note E2.

### B6 (a) Group statement of financial position by operating segment

This analysis is shown below for the Prudential Group statement of financial position by operating segment.

#### (i) Position at 31 December 2007

By operating segment	2007							
	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec 2007 group total
	UK D2	US D3	Asia D4					
	£m							
<b>Assets</b>								
Intangible assets attributable to shareholders:								
Goodwill . . . . .	—	—	111	111	1,230	—	—	1,341
Deferred acquisition costs and other intangible assets . . . . .	157	1,928	745	2,830	6	—	—	2,836
Total(H1) . . . . .	157	1,928	856	2,941	1,236	—	—	4,177
Intangible assets attributable to with-profits funds:								
In respect of acquired subsidiaries for venture fund and other investment purposes . . . . .	192	—	—	192	—	—	—	192
Deferred acquisition costs and other intangible assets . . . . .	19	—	—	19	—	—	—	19
Total(H2) . . . . .	211	—	—	211	—	—	—	211
Total . . . . .	368	1,928	856	3,152	1,236	—	—	4,388
Deferred tax assets(H4) . . . . .	105	657	73	835	95	21	—	951
Other non-investment and non-cash assets(H3-H6) . . . . .								
Investment of long-term business and other operations:	4,110	994	689	5,793	426	4,292	(5,499)	5,012
Investment properties . . . . .	13,666	8	14	13,688	—	—	—	13,688
Investments accounted for using the equity method . . . . .	—	—	—	—	—	12	—	12
Financial investments:								
Loans(note c) . . . . .	1,245	3,258	1,087	5,590	2,334	—	—	7,924
Equity securities and portfolio holdings in unit trusts . . . . .	60,829	15,507	9,804	86,140	17	—	—	86,157
Debt securities(note c) . . . . .	57,180	19,002	6,920	83,102	882	—	—	83,984
Other investments . . . . .	3,391	762	42	4,195	155	46	—	4,396
Deposits . . . . .	7,228	258	377	7,863	26	—	—	7,889
Total investments(G1,H7,H8) . . . . .	143,539	38,795	18,244	200,578	3,414	58	—	204,050
Properties held for sale(H9) . . . . .	30	—	—	30	—	—	—	30
Cash and cash equivalents(H10) . . . . .	1,869	169	679	2,717	1,840	394	—	4,951
<b>Total assets</b> . . . . .	<b>150,021</b>	<b>42,543</b>	<b>20,541</b>	<b>213,105</b>	<b>7,011</b>	<b>4,765</b>	<b>(5,499)</b>	<b>219,382</b>

By operating segment	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec 2007 group total
	UK D2	US D3	Asia D4					
	£m							
<b>Equity and liabilities</b>								
<b>Equity</b>								
Shareholders' equity(H11) . . . . .	1,364	2,690	1,369	5,423	1,677	(1,038)	—	6,062
Minority interests . . . . .	42	1	7	50	52	—	—	102
Total equity . . . . .	<u>1,406</u>	<u>2,691</u>	<u>1,376</u>	<u>5,473</u>	<u>1,729</u>	<u>(1,038)</u>	<u>—</u>	<u>6,164</u>
<b>Liabilities</b>								
Policyholder liabilities and unallocated surplus of with-profits funds:								
Insurance contract liabilities(H12) . . . . .	82,938	32,926	16,912	132,776	—	—	—	132,776
Investment contract liabilities with discretionary participation features(G1) . . . . .	29,466	—	84	29,550	—	—	—	29,550
Investment contract liabilities without discretionary participation features(G1) . . . . .	12,073	1,922	37	14,032	—	—	—	14,032
Unallocated surplus of with-profits funds (D2fii,H12) . . . . .	<u>13,813</u>	<u>—</u>	<u>146</u>	<u>13,959</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>13,959</u>
Total policyholder liabilities and unallocated surplus of with-profits funds(note d) . . . . .	<u>138,290</u>	<u>34,848</u>	<u>17,179</u>	<u>190,317</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>190,317</u>
Core structural borrowings of shareholder-financed operations:(H13)								
Subordinated debt . . . . .	—	—	—	—	—	1,570	—	1,570
Other . . . . .	—	125	—	125	—	797	—	922
Total . . . . .	<u>—</u>	<u>125</u>	<u>—</u>	<u>125</u>	<u>—</u>	<u>2,367</u>	<u>—</u>	<u>2,492</u>
Operational borrowings attributable to shareholder-financed operations(G1,H13) . . . . .								
Borrowings attributable to with-profits operations (G1,H13) . . . . .	12	591	—	603	1	2,477	—	3,081
Other non-insurance liabilities:(G1,H4,H14,H15)	987	—	—	987	—	—	—	987
Obligations under funding, securities lending and sale and repurchase agreements . . . . .								
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	1,360	2,721	—	4,081	—	—	—	4,081
Deferred tax liabilities . . . . .	1,751	65	506	2,322	1,234	—	—	3,556
Current tax liabilities . . . . .	2,383	639	362	3,384	11	7	—	3,402
Accruals and deferred income . . . . .	507	—	24	531	36	670	—	1,237
Other creditors . . . . .	289	—	111	400	199	—	—	599
Provisions . . . . .	1,913	333	627	2,873	3,440	206	(5,499)	1,020
Derivative liabilities . . . . .	326	19	33	378	166	31	—	575
Other liabilities . . . . .	699	158	2	859	176	45	—	1,080
Total . . . . .	<u>98</u>	<u>353</u>	<u>321</u>	<u>772</u>	<u>19</u>	<u>—</u>	<u>—</u>	<u>791</u>
Total . . . . .	<u>9,326</u>	<u>4,288</u>	<u>1,986</u>	<u>15,600</u>	<u>5,281</u>	<u>959</u>	<u>(5,499)</u>	<u>16,341</u>
Total liabilities . . . . .	<u>148,615</u>	<u>39,852</u>	<u>19,165</u>	<u>207,632</u>	<u>5,282</u>	<u>5,803</u>	<u>(5,499)</u>	<u>213,218</u>
<b>Total equity and liabilities . . . . .</b>	<u><u>150,021</u></u>	<u><u>42,543</u></u>	<u><u>20,541</u></u>	<u><u>213,105</u></u>	<u><u>7,011</u></u>	<u><u>4,765</u></u>	<u><u>(5,499)</u></u>	<u><u>219,382</u></u>

(ii) *Position at 31 December 2008*

By operating segment	2008							
	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec 2008 Group total
	UK D2	US D3	Asia D4					
	£m							
<b>Assets</b>								
Intangible assets attributable to shareholders:								
Goodwill . . . . .	—	—	111	111	1,230	—	—	1,341
Deferred acquisition costs and other intangible assets . . . . .	134	3,962	1,247	5,343	6	—	—	5,349
Total(H1) . . . . .	134	3,962	1,358	5,454	1,236	—	—	6,690
Intangible assets attributable to with-profits funds:								
In respect of acquired subsidiaries for venture fund and other investment purposes . . . . .	174	—	—	174	—	—	—	174
Deferred acquisition costs and other intangible assets . . . . .	13	—	113	126	—	—	—	126
Total(H2) . . . . .	187	—	113	300	—	—	—	300
Total . . . . .	321	3,962	1,471	5,754	1,236	—	—	6,990
Deferred tax assets(H4) . . . . .	513	1,969	101	2,583	160	143	—	2,886
Other non-investment and non-cash assets(H3-H6) . . . . .	4,962	1,819	1,416	8,197	135	3,553	(5,608)	6,277
Investment of long-term business and other operations:								
Investment properties . . . . .	11,959	13	20	11,992	—	—	—	11,992
Investments accounted for using the equity method . . . . .	—	—	—	—	—	10	—	10
Financial investments:								
Loans(note c) . . . . .	1,902	5,121	1,705	8,728	1,763	—	—	10,491
Equity securities and portfolio holdings in unit trusts . . . . .	38,880	15,142	8,077	62,099	23	—	—	62,122
Debt securities(note c) . . . . .	58,871	24,249	11,113	94,233	991	—	—	95,224
Other investments . . . . .	4,160	1,256	144	5,560	462	279	—	6,301
Deposits . . . . .	6,090	390	750	7,230	64	—	—	7,294
Total investments(G1,H7,H8) . . . . .	121,862	46,171	21,809	189,842	3,303	289	—	193,434
Properties held for sale(H9) . . . . .	—	—	—	—	—	—	—	—
Cash and cash equivalents(H10) . . . . .	2,571	246	1,501	4,318	1,472	165	—	5,955
<b>Total assets</b> . . . . .	<b>130,229</b>	<b>54,167</b>	<b>26,298</b>	<b>210,694</b>	<b>6,306</b>	<b>4,150</b>	<b>(5,608)</b>	<b>215,542</b>

By operating segment	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a segment (central operations)		Intra-group Eliminations	31 Dec 2008 Group total
	UK D2	US D3	Asia D4						
	£m								
<b>Equity and liabilities</b>									
<i>Equity</i>									
Shareholders' equity(H11)	1,655	1,698	2,167	5,520	1,642	(2,104)	—	5,058	
Minority interests	47	—	7	54	1	—	—	55	
Total equity	<u>1,702</u>	<u>1,698</u>	<u>2,174</u>	<u>5,574</u>	<u>1,643</u>	<u>(2,104)</u>	<u>—</u>	<u>5,113</u>	
<i>Liabilities</i>									
Policyholder liabilities and unallocated surplus of with-profits funds:									
Insurance contract liabilities(H12)	72,756	42,476	20,798	136,030	—	—	—	136,030	
Investment contract liabilities with discretionary participation features(G1)	23,367	—	79	23,446	—	—	—	23,446	
Investment contract liabilities without discretionary participation features(G1)	11,584	2,885	32	14,501	—	—	—	14,501	
Unallocated surplus of with-profits funds (D2fii,H12)	<u>8,254</u>	<u>—</u>	<u>160</u>	<u>8,414</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>8,414</u>	
Total policyholder liabilities and unallocated surplus of with-profits funds(note d)	<u>115,961</u>	<u>45,361</u>	<u>21,069</u>	<u>182,391</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>182,391</u>	
Core structural borrowings of shareholder-financed operations:(H13)									
Subordinated debt	—	—	—	—	—	1,987	—	1,987	
Other	—	173	—	173	—	798	—	971	
Total	<u>—</u>	<u>173</u>	<u>—</u>	<u>173</u>	<u>—</u>	<u>2,785</u>	<u>—</u>	<u>2,958</u>	
Operational borrowings attributable to shareholder-financed operations(G1,H13)	54	511	130	695	4	1,278	—	1,977	
Borrowings attributable to with-profits operations(G1,H13)	1,308	—	—	1,308	—	—	—	1,308	
Other non-insurance liabilities:(G1,H4,H14,H15)									
Obligations under funding, securities lending and sale and repurchase agreements	2,251	3,321	—	5,572	—	—	—	5,572	
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	1,536	88	1,154	2,778	1,065	—	—	3,843	
Deferred tax liabilities	1,421	1,337	441	3,199	11	19	—	3,229	
Current tax liabilities	127	—	76	203	40	599	—	842	
Accruals and deferred income	265	—	130	395	205	30	—	630	
Other creditors	1,619	529	796	2,944	2,898	1,262	(5,608)	1,496	
Provisions	267	23	37	327	97	37	—	461	
Derivative liabilities	3,401	863	32	4,296	292	244	—	4,832	
Other liabilities	317	263	259	839	51	—	—	890	
Total	<u>11,204</u>	<u>6,424</u>	<u>2,925</u>	<u>20,553</u>	<u>4,659</u>	<u>2,191</u>	<u>(5,608)</u>	<u>21,795</u>	
Total liabilities	<u>128,527</u>	<u>52,469</u>	<u>24,124</u>	<u>205,120</u>	<u>4,663</u>	<u>6,254</u>	<u>(5,608)</u>	<u>210,429</u>	
<b>Total equity and liabilities</b>	<u>130,229</u>	<u>54,167</u>	<u>26,298</u>	<u>210,694</u>	<u>6,306</u>	<u>4,150</u>	<u>(5,608)</u>	<u>215,542</u>	

## (iii) Position at 31 December 2009

By operating segment	2009							
	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a segment (central operations)	Intra-group eliminations	31 Dec 2009 Group total
	UK D2	US D3	Asia D4					
£m								
<b>Assets</b>								
Intangible assets attributable to shareholders:								
Goodwill . . . . .	—	—	80	80	1,230	—	—	1,310
Deferred acquisition costs and other intangible assets . . . . .	127	3,092	822	4,041	8	—	—	4,049
Total(H1) . . . . .	127	3,092	902	4,121	1,238	—	—	5,359
Intangible assets attributable to with-profits funds:								
In respect of acquired subsidiaries for venture fund and other investment purposes . . . . .								
Deferred acquisition costs and other intangible assets . . . . .	124	—	—	124	—	—	—	124
Total(H2) . . . . .	133	—	97	230	—	—	—	230
Total . . . . .	260	3,092	999	4,351	1,238	—	—	5,589
Deferred tax assets(H4) . . . . .	292	1,944	132	2,368	132	208	—	2,708
Other non-investment and non-cash assets(H3-H6) . . . . .	3,074	1,404	880	5,358	718	4,393	(5,044)	5,425
Investment of long-term business and other operations:								
Investment properties . . . . .	10,861	33	11	10,905	—	—	—	10,905
Investments accounted for using the equity method . . . . .	4	—	2	6	—	—	—	6
Financial investments:								
Loans(note c) . . . . .	1,815	4,319	1,207	7,341	1,413	—	—	8,754
Equity securities and portfolio holdings in unit trusts . . . . .	37,051	20,984	11,182	69,217	137	—	—	69,354
Debt securities(note c) . . . . .	67,772	22,831	9,984	100,587	1,164	—	—	101,751
Other investments . . . . .	3,630	955	258	4,843	113	176	—	5,132
Deposits . . . . .	11,557	454	746	12,757	63	—	—	12,820
Total investments(G1,H7,H8) . . . . .	132,690	49,576	23,390	205,656	2,890	176	—	208,772
Properties held for sale(H9) . . . . .	—	3	—	3	—	—	—	3
Cash and cash equivalents(H10) . . . . .	2,265	340	837	3,442	970	895	—	5,307
<b>Total assets</b> . . . . .	<b>138,581</b>	<b>56,359</b>	<b>26,238</b>	<b>221,178</b>	<b>5,948</b>	<b>5,672</b>	<b>(5,044)</b>	<b>227,754</b>

By operating segment	2009							
	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a Segment (central operations)	Intra-group Eliminations	31 Dec 2009 Group total
	UK D2	US D3	Asia D4					
£m								
<b>Equity and liabilities Equity</b>								
Shareholders' equity(H11) . . . . .	1,939	3,011	1,462	6,412	1,659	(1,800)	—	6,271
Minority interests . . . . .	28	—	1	29	3	—	—	32
Total equity . . . . .	1,967	3,011	1,463	6,441	1,662	(1,800)	—	6,303
<b>Liabilities</b>								
Policyholder liabilities and unallocated surplus of with-profits funds:								
Insurance contract liabilities(H12) . . . . .	77,655	46,346	21,712	145,713	—	—	—	145,713
Investment contract liabilities with discretionary participation features(G1) . . . . .	24,780	—	100	24,880	—	—	—	24,880
Investment contract liabilities without discretionary participation features(G1) . . . . .	13,794	1,965	46	15,805	—	—	—	15,805
Unallocated surplus of with-profits funds (reflecting application of "realistic" basis provisions for UK regulated with-profits funds) (D2dii,H12) . . . . .	9,966	—	53	10,019	—	—	—	10,019

By operating segment	Insurance operations			Total insurance operations	Asset management operations E2	Unallocated to a Segment (central operations)	Intra-group Eliminations	31 Dec 2009 Group total
	UK D2	US D3	Asia D4					
£m								
Total policyholder liabilities and unallocated surplus of with-profits funds(note(d))	126,195	48,311	21,911	196,417	—	—	—	196,417
Core structural borrowings of shareholder-financed operations:(H13)								
Subordinated debt	—	—	—	—	—	2,691	—	2,691
Other	—	154	—	154	—	549	—	703
Total	—	154	—	154	—	3,240	—	3,394
Operational borrowings attributable to shareholder-financed operations(G1,H13)	158	203	210	571	142	2,038	—	2,751
Borrowings attributable to with-profits operations(G1,H13)	1,284	—	—	1,284	—	—	—	1,284
Other non-insurance liabilities:(G1,H4,H14,H15)								
Obligations under funding, securities lending and sale and repurchase agreements	2,108	1,374	—	3,482	—	—	—	3,482
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	2,534	47	818	3,399	410	—	—	3,809
Deferred tax liabilities	1,606	1,858	384	3,848	5	19	—	3,872
Current tax liabilities	426	89	85	600	35	580	—	1,215
Accruals and deferred income	271	—	105	376	209	9	—	594
Other creditors	726	532	760	2,018	3,292	1,346	(5,044)	1,612
Provisions	406	10	50	466	127	50	—	643
Derivative liabilities	709	461	146	1,316	49	136	—	1,501
Other liabilities	191	309	306	806	17	54	—	877
Total	8,977	4,680	2,654	16,311	4,144	2,194	(5,044)	17,605
Total liabilities	136,614	53,348	24,775	214,737	4,286	7,472	(5,044)	221,451
<b>Total equity and liabilities</b>	<b>138,581</b>	<b>56,359</b>	<b>26,238</b>	<b>221,178</b>	<b>5,948</b>	<b>5,672</b>	<b>(5,044)</b>	<b>227,754</b>

## B6 (b) Group statement of financial position by business type

Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type at 31 December:

By business type	Shareholder-backed business								2009
	31 Dec 2007 Group total	31 Dec 2008 Group total	Partici- pating funds	Unit- linked and variable annuity	Non- linked business D4	Asset management operations E2	Unallocated to a segment (central operations)	Intra- group eliminations	31 Dec 2009 Group total
	£m								
<b>Assets</b>									
Intangible assets attributable to shareholders:									
Goodwill . . . . .	1,341	1,341	—	—	80	1,230	—	—	1,310
Deferred acquisition costs and other intangible assets . . . . .	2,836	5,349	—	—	4,041	8	—	—	4,049
<b>Total(H1) . . . . .</b>	<b>4,177</b>	<b>6,690</b>	<b>—</b>	<b>—</b>	<b>4,121</b>	<b>1,238</b>	<b>—</b>	<b>—</b>	<b>5,359</b>
Intangible assets attributable to with-profits funds:									
In respect of acquired subsidiaries for venture fund and other investment purposes . . . . .	192	174	124	—	—	—	—	—	124
Deferred acquisition costs and other intangible assets . . . . .	19	126	106	—	—	—	—	—	106
<b>Total(H2) . . . . .</b>	<b>211</b>	<b>300</b>	<b>230</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>230</b>
<b>Total . . . . .</b>	<b>4,388</b>	<b>6,990</b>	<b>230</b>	<b>—</b>	<b>4,121</b>	<b>1,238</b>	<b>—</b>	<b>—</b>	<b>5,589</b>
Deferred tax assets(H4) . . . . .	951	2,886	156	—	2,212	132	208	—	2,708
Other non-investment and non-cash assets(H3-H6) . . . . .	5,012	6,277	2,017	630	2,711	718	4,393	(5,044)	5,425
Investment of long-term business and other operations:									
Investment properties . . . . .	13,688	11,992	8,759	662	1,484	—	—	—	10,905
Investments accounted for using the equity method . . . . .	12	10	—	—	6	—	—	—	6
Financial investments:									
Loans(note c) . . . . .	7,924	10,491	1,887	27	5,427	1,413	—	—	8,754
Equity securities and portfolio holdings in unit trusts . . . . .	86,157	62,122	29,962	38,620	635	137	—	—	69,354
Debt securities(note c) . . . . .	83,984	95,224	47,327	8,848	44,412	1,164	—	—	101,751
Other investments . . . . .	4,396	6,301	3,448	110	1,285	113	176	—	5,132
Deposits . . . . .	7,889	7,294	9,638	746	2,373	63	—	—	12,820
<b>Total investments (notes G1,H7,H8) . . . . .</b>	<b>204,050</b>	<b>193,434</b>	<b>101,021</b>	<b>49,013</b>	<b>55,622</b>	<b>2,890</b>	<b>176</b>	<b>—</b>	<b>208,722</b>
Properties held for sale . . . . .	30	—	—	—	3	—	—	—	3
Cash and cash equivalents(H10) . . . . .	4,951	5,955	1,421	1,174	847	970	895	—	5,307
<b>Total assets . . . . .</b>	<b>219,382</b>	<b>215,542</b>	<b>104,845</b>	<b>50,817</b>	<b>65,516</b>	<b>5,948</b>	<b>5,672</b>	<b>(5,044)</b>	<b>227,754</b>

By business type	Shareholder-backed								31 Dec 2009 Group total
	31 Dec 2007 £m Group total	31 Dec 2008 £m Group total	Partici- pating funds	Unit- linked and variable annuity	Non- linked business D4 £m	Asset management operations E2	Unallocated to a segment (central operations)	Intra- group Elimina- tions	
<b>Equity and liabilities</b>									
<b>Equity</b>									
Shareholders' equity(H11) . . . . .	6,062	5,058	—	—	6,412	1,659	(1,800)	—	6,271
Minority interests . . . . .	102	55	28	—	1	3	—	—	32
Total equity . . . . .	<u>6,164</u>	<u>5,113</u>	<u>28</u>	<u>—</u>	<u>6,413</u>	<u>1,662</u>	<u>(1,800)</u>	<u>—</u>	<u>6,303</u>
<b>Liabilities</b>									
Policyholder liabilities and unallocated surplus of with-profits funds:									
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) . . . . .									
	176,358	173,977	86,337	49,391	50,670	—	—	—	186,398
Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds)(D2fii,H12) . . . . .									
	<u>13,959</u>	<u>8,414</u>	<u>10,019</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>10,019</u>
Total policyholder liabilities and unallocated surplus of with-profits funds(note b) . . . . .									
	<u>190,317</u>	<u>182,391</u>	<u>96,356</u>	<u>49,391</u>	<u>50,670</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>196,417</u>
Core structural borrowings of shareholder-financed operations:(H13)									
Subordinated debt . . . . .									
	1,570	1,987	—	—	—	—	2,691	—	2,691
Other . . . . .									
	<u>922</u>	<u>971</u>	<u>—</u>	<u>—</u>	<u>154</u>	<u>—</u>	<u>549</u>	<u>—</u>	<u>703</u>
Total . . . . .									
	<u>2,492</u>	<u>2,958</u>	<u>—</u>	<u>—</u>	<u>154</u>	<u>—</u>	<u>3,240</u>	<u>—</u>	<u>3,394</u>
Operational borrowings attributable to shareholder-financed operations(G1,H13) . . . . .									
	3,081	1,977	—	—	571	142	2,038	—	2,751
Borrowings attributable to with-profits funds(G1,H13) . . . . .									
	987	1,308	1,284	—	—	—	—	—	1,284
Deferred tax liabilities . . . . .									
	3,402	3,229	1,420	12	2,416	5	19	—	3,872
Other non insurance liabilities . . . . .									
	<u>12,939</u>	<u>18,566</u>	<u>5,757</u>	<u>1,414</u>	<u>5,292</u>	<u>4,139</u>	<u>2,175</u>	<u>(5,044)</u>	<u>13,733</u>
Total liabilities . . . . .									
	<u>213,218</u>	<u>210,429</u>	<u>104,817</u>	<u>50,817</u>	<u>59,103</u>	<u>4,286</u>	<u>7,472</u>	<u>(5,044)</u>	<u>221,451</u>
<b>Total equity and liabilities . . . . .</b>									
	<u><u>219,382</u></u>	<u><u>215,542</u></u>	<u><u>104,845</u></u>	<u><u>50,817</u></u>	<u><u>65,516</u></u>	<u><u>5,948</u></u>	<u><u>5,672</u></u>	<u><u>(5,044)</u></u>	<u><u>227,754</u></u>

**B6 (c) Debt securities and loans**

*i Information on the credit risks of debt securities*

Position at 31 December:

	<b>2007</b>					
	<b>Insurance operations</b>			<b>Total insurance operations</b>	<b>Asset management</b>	<b>Group total</b>
	<b>UK</b>	<b>US</b>	<b>Asia</b>			
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
S&P — AAA . . . . .	21,556	3,896	2,284	27,736	278	28,014
S&P — AA+ to AA- . . . . .	6,173	1,187	1,994	9,354	319	9,673
S&P — A+ to A- . . . . .	12,557	3,657	675	16,889	198	17,087
S&P — BBB+ to BBB- . . . . .	5,409	5,415	193	11,017	—	11,017
S&P — Other . . . . .	942	1,113	149	2,204	—	2,204
	<u>46,637</u>	<u>15,268</u>	<u>5,295</u>	<u>67,200</u>	<u>795</u>	<u>67,995</u>
Moody's — Aaa . . . . .	1,021	549	201	1,771	46	1,817
Moody's — Aa1 to Aa3 . . . . .	587	118	45	750	—	750
Moody's — A1 to A3 . . . . .	944	47	28	1,019	—	1,019
Moody's — Baa1 to Baa3 . . . . .	490	79	19	588	—	588
Moody's — Other . . . . .	410	78	58	546	—	546
	<u>3,452</u>	<u>871</u>	<u>351</u>	<u>4,674</u>	<u>46</u>	<u>4,720</u>
Fitch . . . . .	682	380	1	1,063	—	1,063
Other . . . . .	6,409	2,483	1,273	10,165	41	10,206
Total debt securities . . . . .	<u>57,180</u>	<u>19,002</u>	<u>6,920</u>	<u>83,102</u>	<u>882</u>	<u>83,984</u>
						<b>2008</b>
	<b>Insurance operations</b>			<b>Total insurance operations</b>	<b>Asset management</b>	<b>Group total</b>
	<b>UK</b>	<b>US</b>	<b>Asia</b>			
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
S&P — AAA . . . . .	18,981	5,321	2,632	26,934	342	27,276
S&P — AA+ to AA- . . . . .	6,012	853	3,746	10,611	274	10,885
S&P — A+ to A- . . . . .	15,929	5,244	808	21,981	319	22,300
S&P — BBB+ to BBB- . . . . .	7,413	7,077	902	15,392	—	15,392
S&P — Other . . . . .	1,033	1,321	253	2,607	—	2,607
	<u>49,368</u>	<u>19,816</u>	<u>8,341</u>	<u>77,525</u>	<u>935</u>	<u>78,460</u>
Moody's — Aaa . . . . .	681	458	494	1,633	24	1,657
Moody's — Aa1 to Aa3 . . . . .	833	100	108	1,041	15	1,056
Moody's — A1 to A3 . . . . .	678	111	398	1,187	—	1,187
Moody's — Baa1 to Baa3 . . . . .	454	100	60	614	—	614
Moody's — Other . . . . .	162	95	50	307	—	307
	<u>2,808</u>	<u>864</u>	<u>1,110</u>	<u>4,782</u>	<u>39</u>	<u>4,821</u>
Fitch . . . . .	560	464	41	1,065	—	1,065
Other . . . . .	6,135	3,105	1,621	10,861	17	10,878
Total debt securities . . . . .	<u>58,871</u>	<u>24,249</u>	<u>11,113</u>	<u>94,233</u>	<u>991</u>	<u>95,224</u>

	Insurance operations			Total	Asset	Group total
	UK	US	Asia	insurance	manage-	
	£m	£m	£m	operations	ment	
S&P — AAA	16,091	3,287	2,259	21,637	469	22,106
S&P — AA+ to AA-	6,472	846	1,594	8,912	148	9,060
S&P — A+ to A-	19,693	5,192	1,496	26,381	468	26,849
S&P — BBB+ to BBB-	12,183	7,659	682	20,524	57	20,581
S&P — Other	2,667	895	917	4,479	—	4,479
	<u>57,106</u>	<u>17,879</u>	<u>6,948</u>	<u>81,933</u>	<u>1,142</u>	<u>83,075</u>
Moody's — Aaa	463	273	134	870	—	870
Moody's — Aa1 to Aa3	276	43	349	668	19	687
Moody's — A1 to A3	801	32	309	1,142	2	1,144
Moody's — Baa1 to Baa3	815	64	40	919	—	919
Moody's — Other	339	57	15	411	—	411
	<u>2,694</u>	<u>469</u>	<u>847</u>	<u>4,010</u>	<u>21</u>	<u>4,031</u>
Implicit ratings of RMBS based on NAIC valuations (see below)						
- NAIC 1	—	747	—	747	—	747
- NAIC 2	—	105	—	105	—	105
- NAIC 3-6	—	473	—	473	—	473
	<u>—</u>	<u>1,325</u>	<u>—</u>	<u>1,325</u>	<u>—</u>	<u>1,325</u>
Fitch	1,022	281	39	1,342	—	1,342
Other	6,950	2,877	2,150	11,977	1	11,978
Total debt securities	<u>67,772</u>	<u>22,831</u>	<u>9,984</u>	<u>100,587</u>	<u>1,164</u>	<u>101,751</u>

In the tables above, with the exception of residential mortgage backed securities within Jackson, Standard & Poor's (S&P) ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative. During 2009, the National Association of Insurance Commissioners in the US revised the regulatory ratings process for more than 20,000 residential mortgage-backed securities. The table above includes those securities, held by Jackson, using the regulatory ratings levels established by an external third party (PIMCO). Notes D2(c), D3(c), D4(c) and E2 provide further details on the credit risks of debt securities by segment.

#### ii Prudential Group exposure to holdings in asset-backed securities

Additional supplementary disclosure has been provided for 2008 and 2009. The Prudential Group's exposure to holdings in asset-backed securities which comprise residential mortgage-backed securities (RMBS), commercial mortgage backed securities (CMBS), collateralised debt obligation (CDO) funds and other asset-backed securities (ABS), at 31 December is as follows:

	2008	2009
	£m	£m
<b>Shareholder-backed operations:</b>		
UK insurance operations(note i)	1,075	2,044
US insurance operations(note ii)	7,464	6,376
Asian insurance operations(note iii)	15	59
Other operations(note iv)	407	326
	<u>8,961</u>	<u>8,805</u>
<b>With-profits operations:</b>		
UK insurance operations(note i)	4,977	6,451
Asian insurance operations(note iii)	328	378
	<u>5,305</u>	<u>6,829</u>
<b>Total</b>	<u>14,266</u>	<u>15,634</u>

*i UK insurance operations*

The UK insurance operations' exposure to asset-backed securities at 31 December is analysed as follows:

	<u>2008</u>	<u>2009</u>
	£m	£m
Shareholder-backed business (2008: 70% AAA, 19% AA; 2009: 29% AAA, 24% AA) . . . . .	1,075	2,044
With-profits operations (2008: 74% AAA, 10% AA; 2009: 33% AAA, 14% AA) . . . . .	<u>4,977</u>	<u>6,451</u>
	<u>6,052</u>	<u>8,495</u>

All of the £1,075 million and £2,044 million, for 2008 and 2009 respectively, exposure of the shareholder-backed business relates to the UK market and primarily relate to investments held by PRIL. £2,721 million of the £4,977 million and £4,695 million of the £6,451 million exposure of the with-profits operations relates to exposure to the UK market while the remaining £2,256 million and £1,756 million relates to exposure to the US market, for 2008 and 2009 respectively.

*ii US insurance operations*

US insurance operations' exposure to asset-backed securities at 31 December comprises:

	<u>2008</u>	<u>2009</u>
	£m	£m
<b>RMBS†:</b>		
Sub-prime (2008: 91% AAA, 3% AA; 2009: 76% AAA, 1% AA) . . . . .	291	194
Alt-A 2007 (2008: 60% AAA, 15% AA; 2009: 24% AAA, 5% AA) . . . . .	646	443
Prime (2008: 87% AAA, 5% AA; 2009: 82% AAA, 4% AA) . . . . .	3,572	2,679
CMBS (2008: 85% AAA, 9% AA; 2009: 46% AAA, 14% AA) . . . . .	1,869	2,104
CDO funds (2008: 34% AAA, 14% AA; 2009: 29% AAA, 10% AA),* including £6 million exposure to sub-prime in 2008 and £3 million in 2009 . . . . .	320	79
Other ABS (2008: 31% AAA, 16% AA; 2009: 25% AAA, 18% AA), including £51 million exposure to sub-prime in 2008 and nil 2009 . . . . .	<u>766</u>	<u>877</u>
<b>Total</b> . . . . .	<u>7,464</u>	<u>6,376</u>

† RMBS ratings refer to the rating implicit within NAIC risk-based capital valuation (see B6(c)(i)).

\* Including the Prudential Group's economic interest in Piedmont and other consolidated CDO funds. Further details on Jackson's RMBS sub-prime and Alt-A securities are given in note D3(c).

*iii Asian insurance operations*

The Asian insurance operations' exposure to asset-backed securities is primarily held by the with-profits operations.

The £328 million and £378 million, at 31 December 2008 and at 31 December 2009 respectively, asset-backed securities exposure of the Asian with-profits operations comprises:

	<u>2008</u>	<u>2009</u>
	£m	£m
RMBS — all without sub-prime exposure . . . . .	46	—
CMBS . . . . .	88	91
CDO funds and ABS . . . . .	<u>194</u>	<u>287</u>
<b>Total</b> . . . . .	<u>328</u>	<u>378</u>

The £328 million and £378 million includes £259 million and £228 million, for 2008 and 2009 respectively, held by investment funds are consolidated under IFRS in recognition of the control arrangements for those funds. The consolidated funds include an amount not owned by the Prudential Group with a corresponding liability of £32 million and £61 million (at 31 December 2008 and at 31 December 2009 respectively) on the statement of financial position for net asset value attributable to external unit-holders in respect of these funds, which are non-recourse to the Prudential Group. Of the £328 million and £378 million, 70% and 72% are investment graded by Standard & Poor's as at 31 December 2008 and 31 December 2009 respectively.

iv Other operations

Other operations' exposure to asset-backed securities at 31 December is held by Prudential Capital and comprises:

	<u>2008</u>	<u>2009</u>
	£m	£m
RMBS: Prime (2008: 75% AAA, 10% AA; 2009: 92% AAA, 8% AA) . . . . .	106	91
CMBS (2008: 68% AAA, 20% AA; 2009: 48% AAA, 18% AA) . . . . .	230	193
CDO funds and other ABS . . . . .	<u>71</u>	<u>42</u>
Total . . . . .	<u>407</u>	<u>326</u>

(iii) Loans

Information on the credit quality of the portfolio of loans, which almost wholly is for amounts which are neither past due or impaired is shown in notes D2, D3, D4 and E2. Details of allowances for loans, losses and amounts past due are shown in notes G1 and G2. No additional analysis is provided of the element of loans and receivables that were neither past due nor impaired from those of the total portfolio on the grounds of the immateriality of the difference between the neither past due nor impaired element and the total portfolio.

**(d) Reconciliation of movement 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 the Prudential Group from the beginning of the year to the end of the year is as follows:

	<u>Insurance operations</u>			<u>Total insurance operations</u>
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>£m</u>
	£m	£m	£m	
At 1 January 2007 . . . . .	133,904	31,746	12,889	178,539
Premiums . . . . .	8,853	6,352	3,958	19,163
Surrenders . . . . .	(4,528)	(3,476)	(1,032)	(9,036)
Maturities/Deaths . . . . .	(6,787)	(490)	(395)	(7,672)
Shareholders' transfers post tax . . . . .	(279)	—	(21)	(300)
Investment-related items and other movements . . . . .	7,194	1,225	1,458	9,877
Foreign exchange translation differences . . . . .	<u>(67)</u>	<u>(509)</u>	<u>322</u>	<u>(254)</u>
At 31 December 2007/1 January 2008 . . . . .	<u>138,290</u>	<u>34,848</u>	<u>17,179</u>	<u>190,317</u>
Premiums . . . . .	9,372	6,728	4,162	20,262
Surrenders . . . . .	(4,281)	(3,852)	(1,191)	(9,324)
Maturities/Deaths . . . . .	(8,324)	(564)	(354)	(9,242)
Shareholders' transfers post tax . . . . .	(284)	—	(23)	(307)
Investment-related items and other movements . . . . .	(16,331)	(4,552)	(4,293)	(25,176)
Foreign exchange translation differences . . . . .	<u>(2,481)</u>	<u>12,753</u>	<u>5,589</u>	<u>15,861</u>
At 31 December 2008/1 January 2009 . . . . .	<u>115,961</u>	<u>45,361</u>	<u>21,069</u>	<u>182,391</u>
Premiums . . . . .	6,867	9,177	3,807	19,851
Surrenders . . . . .	(3,971)	(3,255)	(1,201)	(8,427)
Maturities/Deaths . . . . .	(7,239)	(733)	(342)	(8,314)
Shareholders' transfers post tax . . . . .	(202)	—	(20)	(222)
Changes in reserving basis in Malaysia . . . . .	—	—	(63)	(63)
Assumption changes (shareholder-backed business) . . . . .	(46)	—	(4)	(50)
Investment-related items and other movements . . . . .	14,118	2,986	4,242	21,346
Foreign exchange translation differences . . . . .	707	(5,225)	(2,069)	(6,587)
Disposal of Taiwan agency business . . . . .	—	—	(3,508)	(3,508)
At 31 December 2009 . . . . .	<u>126,195</u>	<u>48,311</u>	<u>21,911</u>	<u>196,417</u>

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.

Premiums, surrenders, and maturities/deaths represent the amounts impacting policyholder liabilities and may not represent the total cash paid/received (for example, premiums are net of any deductions to cover acquisition costs).

## **C: GROUP RISK MANAGEMENT**

### ***a Overview***

As a provider of financial services, including insurance, the Prudential Group's business is the managed acceptance of risk. The control procedures and systems established within the Prudential Group are designed to manage, rather than eliminate, the risk of failure to meet business objectives. They can only provide reasonable and not absolute assurance against material misstatement or loss, and focus on aligning the levels of risk-taking with the achievement of business objectives.

The Prudential Group's internal control processes are detailed in the Group Governance Manual. This is supported by the Prudential Group risk framework, which provides an overview of the group-wide philosophy and approach to risk management. Where appropriate, more detailed policies and procedures have been developed at Prudential Group and/or business unit levels. These include group-wide mandatory policies on certain operational risks, including: health, safety, fraud, money laundering, bribery, business continuity, information security and operational security, and policies on certain financial risks. Additional guidelines are provided for some aspects of actuarial and finance activity.

Prudential's risk governance framework requires that all of the Prudential Group's businesses and functions establish processes for identifying, evaluating and managing the key risks faced by the Prudential Group. The risk governance framework is based on the concept of 'three lines of defence': Risk management, risk oversight and independent assurance. Primary responsibility for strategy, performance management and risk control lies with the Board, the Group Chief Executive and the chief executives of each business unit. Risk oversight is provided by group-level risk committees, chaired by the Group Chief Risk Officer or the Group Chief Financial Officer. Independent assurance on the Prudential Group's and business unit internal control and risk management systems is provided by group-wide Internal Audit reporting to the Prudential Group and business unit audit committees.

The Prudential Group's risk reporting framework forms an important part of the Prudential Group's business planning process. Business units review their risks as part of the annual preparation of their business plans and review opportunities and risks against business objectives regularly with Prudential Group executive management.

Additional information on the Prudential Group's risk framework is included in the risk and capital management section of the Prudential Group's business review.

The management of the risk attached to the Prudential Group's financial instruments and insurance liabilities, together with the inter-relationship with the management of capital may be summarised in the following sections.

### ***b Group risk appetite***

The Prudential Group risk appetite framework sets out the Prudential Group's tolerance to risk management and return optimisation. The Prudential Group defines and monitors aggregate risk limits for its earnings volatility and its capital requirements based on financial and non-financial stresses.

#### ***i Earnings volatility:***

The objectives of the limits are to ensure that (a) the volatility of earnings is consistent with stakeholder expectations, (b) the Prudential Group has adequate earnings (and cash flows) to service debt and expected dividends and (c) that earnings (and cash flows) are managed properly across geographies and are consistent with the Prudential Group's funding strategies. The two measures used currently are European Embedded Value (EEV) operating profit based on longer-term investment returns and International Financial Reporting Standards (IFRS) operating profit based on longer-term investment returns. Additionally, EEV and IFRS total profits are also assessed.

#### ***ii Capital requirements:***

The objectives of the limits are to ensure that (a) the Prudential Group meets the internal economic capital requirements at all times, (b) the Prudential Group achieves its desired target rating to meet its business objectives and (c) supervisory intervention is avoided. The two measures used are EU Insurance Groups Directive (IGD) capital requirements and internal economic capital requirements. In addition, the Prudential Group also monitors capital requirement on a local statutory basis.

Business units must establish suitable market, credit, underwriting and liquidity limits that maintain financial risk exposures within the defined Prudential Group risk appetite.

The Prudential Group's risk appetite framework forms an integral part of its annual business planning cycle. Throughout the year, the Group risk function monitors the Prudential Group's risk profile against the agreed limits. Using submissions from business units, Group risk function calculates the Prudential Group's aggregated position (allowing for diversification effects between business units) relative to the limits implied by the risk appetite statements.

Market risk is managed such that as conditions evolve the risk profile is maintained within risk appetite in addition to business unit operational limits on credit risk, the Prudential Group sets counterparty risk limits at group level. Limits on the total group-wide exposures to a single counterparty are specified within different credit rating 'categories'. Actual exposures are monitored against these limits on a monthly basis.

### *c Risk mitigation and hedging*

The Prudential Group manages its actual risk profile against its tolerance of risk. To do this, it maintains risk registers that include details of the identified risks and of the controls and mitigating actions employed in managing them. Any mitigation strategies involving large transactions, such as a material derivative transaction, are subject to scrutiny at group level before implementation.

It uses a range of risk management and mitigation strategies. The most important of these include: adjusting asset portfolios to reduce investment risks (such as duration mismatches or overweight counterparty exposures); using derivatives to hedge market risks; implementing reinsurance programmes to limit insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.

#### *i Use of derivatives*

In the UK and Asia, Prudential uses derivatives to reduce equity and credit risk, interest rate and currency exposures, and to facilitate efficient investment management. In the US, Prudential uses derivatives to reduce interest rate risk, to facilitate efficient portfolio management and to match liabilities under annuity policies, and for certain equity-based product management activities.

Further details of the Prudential Group's use of derivatives are explained in note G3.

#### *ii Asset/liability management*

Prudential manages its assets and liabilities locally, in accordance with local regulatory requirements and reflecting the differing types of liabilities of each business unit. Stochastic asset/liability modelling is carried out locally by business units to perform dynamic solvency testing and assess capital requirements. Reserve adequacy testing under a range of scenarios and dynamic solvency analysis is carried out, including under certain scenarios mandated by the US, the UK and Asian regulators.

A stochastic approach models the inter-relationship between asset and liability movements, taking into account asset correlation and policyholder behaviour, under a large number of possible scenarios. These scenarios are projected forward over a period of time, typically 25 years, and the liabilities and solvency position of the fund are calculated in each scenario in each future year. This allows the identification of which extreme scenarios will have the most adverse effects and what the best estimate outcome may be. The fund's policy on management actions, including bonus and investment policy, are then set in order that they are consistent with the available capital and the targeted risk of default. This differs from a deterministic model, which would only consider the results from one carefully selected scenario.

For businesses that are most sensitive to interest rate changes, such as immediate annuity business, Prudential uses cash flow analysis to create a portfolio of fixed income securities whose value changes in line with the value of liabilities when interest rates change. This type of analysis helps protect profits and the capital position from changing interest rates. In the UK, the cash flow analysis is used in Prudential Group's annuity business while, in the US, it is used for its interest-sensitive and fixed index annuities and stable value products such as Guaranteed Investment Contracts (GICs). Perfect matching is not possible, for example because of the nature of the liabilities (which might include guaranteed surrender values) and options for prepayment contained in the assets or the unavailability of assets with a sufficiently long duration.

For businesses that are most sensitive to equity price changes, Prudential uses stochastic modelling and scenario testing to look at the expected future returns on its investments under different scenarios that best reflect the large diversity in returns that equities can produce. This allows Prudential to devise an investment and with-profits policyholder bonus strategy that, on the model assumptions, allows it to optimise returns to its policyholders and

shareholders over time, while maintaining appropriate financial strength. Prudential uses this method extensively in connection with its UK with-profits business.

All of Prudential Group's investments are held either for risk management or investment purposes. This is because almost all of the investments support policyholder or customer liabilities of one form or another. Any assets that the Prudential Group holds centrally that are not supporting customer liabilities are predominantly invested in short-term fixed income and fixed maturity securities.

The Prudential Group has contingency plans in place for a range of operational risk scenarios, including incident management and business continuity plans. As a contingency plan for liquidity risk, the Prudential Group has arranged access to committed revolving credit facilities and committed securities lending facilities.

#### *d Risk exposures*

The Prudential Group publishes separately within 'Additional Information' of its Group Annual Report a section on key risk factors, which discusses inherent risks in the business and trading environment.

#### *i Market risks*

Market risk is the risk that arises from adverse changes in the value of, or income from, assets and changes in interest rates or exchange rates.

#### **Equity and interest rate risk**

Prudential faces equity risk and interest rate risk because most of its assets are investments that are either equity type investments and subject to equity price risk, or bonds, mortgages or cash deposits, the values of which are subject to interest rate risk. The amount of risk borne by Prudential's shareholders depends on the extent to which its customers share the investment risk through the structure of the Prudential Group's products.

The split of the Prudential Group's investments between equity investments and interest-sensitive instruments depends principally on the type of liabilities supported by those investments and the amount of capital the Prudential Group has available. The nature of some liabilities allows it to invest a substantial portion of its investment funds in equity and property investments that Prudential believes produce greater returns over the long term. On the other hand the Prudential Group has some liabilities that contain guaranteed returns and allow instant access (for example, interest-sensitive fixed annuities and immediate annuities), which generally will be supported by fixed income investments.

#### **Foreign exchange risk**

Prudential faces foreign exchange risk, primarily because its presentation currency is pounds sterling, whereas approximately 45%, 53% and 62% of the Prudential Group operating profit from continuing operations based on longer-term investment returns, as described in note B1, for the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, came from the US and Asian operations. The exposure relating to the translation of reported earnings is not separately managed although its impact is reduced by interest payments on foreign currency borrowings and by the adoption of average exchange rates for the translation of foreign currency revenues.

Approximately 70%, 83% and 77% of the Prudential Group's IFRS basis shareholders' equity at 31 December 2007, 31 December 2008 and 31 December 2009 respectively arose in Prudential's US and Asian operations. To mitigate the exposure of the US component US\$1.55 billion, US\$1.55 billion and US\$1.55 billion of borrowings were held centrally, which are formally designated as net investment hedges, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. Net of the currency position arising from these borrowings some 40%, 49% and 52% of the Prudential Group's shareholders' funds are represented by net assets in currencies other than sterling as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

Additional details on the market risks' exposures of the UK, US and Asian insurance operations are provided in notes D2, D3 and D4, respectively.

#### *ii Credit risk*

Credit risk is the risk of loss to the Prudential Group if another party fails to perform its obligations, or fails to perform them in a timely manner. Credit risk is the Prudential Group's most significant financial risk.

Some of the Prudential Group businesses, in particular Jackson, the PAC with-profits fund and the Prudential Group UK pension annuity business hold large amounts of interest-sensitive investments that contain credit risk on which a certain level of defaults is expected. These expected losses are considered when Prudential determines the crediting rates, deposit rates and premium rates for the products that will be supported by these assets. The key shareholder business exposed to credit risks is Jackson. Certain over-the-counter derivatives contain a credit risk element that is controlled through evaluation of collateral agreements and master netting agreements on interest rate and currency swaps. Prudential is also exposed to credit-related losses in the event of non-performance by counterparties.

Further analysis of the credit quality of debt securities held by the Prudential Group is shown in note B6. Additional details on the credit quality of the debt security portfolios of UK, US and Asian insurance operations are shown in notes D2, D3 and D4, respectively.

### *iii Liquidity risk*

The assets of insurers are in general relatively liquid whilst liabilities to policyholders are mainly illiquid. Accordingly, for insurers, the focus is on parent capital and liquidity measures. Prudential regularly monitors and analyses its liquidity position at the parent (group centre) level and performs stress tests of this position. For Prudential, liquidity risk is the risk that though solvent on a statement of financial position basis, the Prudential Group either does not have the financial resources to meet its obligations as they fall due or can secure the resources only at excessive cost. The liquidity of the Prudential Group is monitored on a monthly basis by comparing the predicted cash needs of the Prudential Group centre to meet corporate and financing costs (net of expected dividends from the business units) to the liquid resources available to it. These liquid resources include cash held and cash that could be raised through internal resources (for example by repoing unencumbered bonds). Base costs and stress scenarios reported monthly to the Balance Sheet and Capital Management Committee. The main stress is the assumption that the external financing markets are completely closed to Prudential, no new external funding can be obtained, and existing funding cannot be rolled over. In addition Group liquidity risk reports are prepared regularly. In summary, these address the accuracy of external back-up lines, internal sources of liquidity, and monitor how external liabilities and other commitments over the next 12 months compare with internal and external sources. The parent company has significant internal resources of liquidity which are sufficient to meet all of its foreseeable future needs without having to utilise external funding. The Prudential Group maintains committed facilities that at 31 December 2009 include £1.4 billion of undrawn syndicated committed banking facility and two £100 million bi-lateral facilities on the same terms, maturing in 2011 and 2012 respectively, as well as a committed £500 million annually renewable securities lending back-up facility.

### *iv Insurance risk*

Insurance risk is the inherent uncertainty as to the occurrence, amount and timing of insurance liabilities. This includes adverse mortality, morbidity and persistency experience.

Prudential needs to make assumptions about a number of factors in determining the pricing of its products and for reporting the results of its long-term business operations. In common with other industry participants, the profitability of the Prudential Group's businesses depends on a mix of factors including mortality and morbidity trends, voluntary discontinuance rates, investment performance, unit cost of administration and new business acquisition expenses.

For example, the assumption that Prudential makes about future expected levels of mortality is particularly relevant for its UK annuity business where, in exchange for their accumulated pension fund, pension annuity policyholders receive a guaranteed payment, for as long as they live. Prudential conducts rigorous research into longevity risk using data from its substantial annuitant portfolio. As part of its pension annuity pricing and reserving policy, Prudential UK assumes that current rates of mortality continuously improve over time at levels based on adjusted data from the Continuous Mortality Investigations (CMI) projections as published by the Institute and Faculty of Actuaries.

Prudential's voluntary discontinuance (persistency) assumptions reflect recent past experience for each relevant line of business, and any expectations of future persistency. Where appropriate, allowance is also made for the relationship, which is either assumed or historically observed, between persistency and investment returns and the resulting additional risk is allowed for.

### *v Non-financial risks — operational, business environment and strategic risk*

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, systems or from external events. Business environment risk may arise from exposure to forces in the external

environment that could significantly change the fundamentals that drive the business's overall objectives and strategy. Strategic risk may arise from ineffective, inefficient or inadequate senior management processes for the development and implementation of business strategy in relation to the business environment and the Prudential Group's capabilities.

Prudential Group is exposed to operational, business environment and strategic risk in the course of running its businesses. The Prudential Group processes a large number of complex transactions across numerous and diverse products, and is subject to a number of different legal and regulatory regimes. The Prudential Group has a significant number of third-party relationships that are important to the distribution and processing of its products, as market counterparties and as business partners.

The Prudential Group uses the qualitative and quantitative analysis of operational risk exposures material to the Prudential Group to support business decisions, to inform overall levels of capital held and to assess the adequacy of the corporate insurance programme.

#### *e Regulatory capital requirements*

Regulatory capital requirements apply at an individual company level for the Prudential Group's life assurance and asset management business. These are described in sections D5 and E3 respectively.

In addition, the Prudential Group as a whole is subject to the capital adequacy requirements of the Insurance Groups Directive (IGD) as implemented by the FSA. The IGD pertains to groups whose activities are primarily concentrated in the insurance sector. Under this test the surplus capital held in each of the regulated subsidiaries is aggregated with the free assets of non-regulated subsidiaries. From this total Prudential Group borrowings are deducted, other than subordinated debt issues which qualify as capital. No credit for the benefit of diversification is allowed for under this approach. The test is passed when this aggregate number is positive: a negative result at any point in time is a notifiable breach of UK regulatory requirements.

Due to the geographically diverse nature of the Prudential Group's operations, the application of these requirements to Prudential is complex. In particular, for many of the Prudential Group's Asian operations the assets, liabilities and capital requirements have to be recalculated based on FSA regulations as if the companies were directly subject to FSA regulation.

The FSA has established a structure for determining how much hybrid debt can count as capital which is similar to that used for banks. It categorises capital as Tier 1 (equity and preference shares), Upper Tier 2 and Lower Tier 2. Up to 15% of Tier 1 capital can be in the form of hybrid debt and is called 'Innovative Tier 1'. At 31 December 2007, 31 December 2008 and 31 December 2009 the Prudential Group held £763 million, £1,059 million and £1,422 million respectively of Innovative Tier 1 capital in the form of perpetual securities, and £nil of Upper Tier 2 for all years. At 31 December 2007, 31 December 2008 and 31 December 2009, Prudential held £807 million, £928 million and £1,269 million respectively of Lower Tier 2 capital. In addition, Jackson held £125 million, £173 million and £154 million of surplus notes at the end of each of the financial years respectively which, although the US does not have a similar capital categorisation under its regulatory framework, are akin to the FSA's Lower Tier 2 capital and have been disclosed as such in note H13. The increase in these amounts arises from the issue in May 2009 of £400 million of subordinated debt (Lower Tier 2), the issue in July 2009 of \$750 million perpetual subordinated capital securities (Innovative Tier 1) and exchange rate movements during 2008 and 2009 (no issuance was made during 2007 and 2008). Further details on these amounts and other Prudential Group borrowings are shown in note H13.

At 31 December 2007 and 31 December 2008, the Prudential Group met the requirements of the IGD with £1.9 billion and £1.5 billion respectively of surplus capital before allowing for the 2007 and 2008 final dividend respectively. The IGD position as at 31 December 2009 is that the surplus capital under the test was £3.4 billion before allowing for the 2009 final dividend giving a solvency ratio of 283%. The main components of the increase in IGD surplus during 2009 are:

- net capital generation mainly through operating earnings (in-force releases less investment in new business) of £1.1 billion;
- the sale of the Taiwan agency business (increasing IGD surplus by £0.8 billion);
- the hybrid debt issues in May and July (increasing IGD surplus by 0.9 billion);
- an additional recognition of £0.4 billion in respect of part of the shareholders' interest in the future transfers from the PAC with-profits fund, recognition of £0.2 billion of future profits in the UK and Hong Kong and other intra-group capital efficiencies of £0.3 billion;

- offset by dividend payments, external financing costs and other central costs, credit related impacts in the US, impacts from regulatory changes and foreign exchange movements.

Prudential's approach to capital allocation takes into account a range of factors, especially risk adjusted returns on capital, the impact of alternative capital measurement bases (accounting, regulatory, economic and ratings agency assessments), tax efficiency and wider strategic objectives.

The Prudential Group optimises capital allocation across the Prudential Group by using a consistent set of capital performance metrics across all business units to ensure meaningful comparison. Capital utilisation, return on capital and new business value creation are measured at a product level. The use of these capital performance metrics is embedded into our decision-making processes for product launches, product design and product pricing.

The Prudential Group capital performance metrics are based on economic capital, which provides a realistic and consistent view of our capital requirements across the Prudential Group, allowing for diversification benefits. Economic capital also provides valuable insights into our risk profile and is used both for risk measurement and capital management.

The Prudential Group detailed understanding of risk adjusted performance allows the Prudential Group to manage proactively its allocation of capital to write new business to maximise risk adjusted value creation.

## **D: LIFE ASSURANCE BUSINESSES**

### ***D1: Prudential Group overview***

#### *a Products and classification for IFRS reporting*

The measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts under IFRS. Under IFRS 4, contracts are initially classified as being either 'insurance' contracts, if the level of insurance risk in the contracts is significant, or investment contracts, if the risk is insignificant.

#### **Insurance contracts**

Insurance contracts are permitted to be accounted for under previously applied GAAP. The Prudential Group has chosen to adopt this approach. However, as an improvement to accounting policy, permitted by IFRS 4, the Prudential Group has applied the measurement principles for with-profits contracts of UK regulated entities and disclosures of the UK Standard FRS 27 from 1 January 2005. An explanation of the provisions under FRS 27 is provided in note D2.

Under the previously applied GAAP, UK GAAP, the assets and liabilities of contracts are reported in accordance with the MSB of reporting as set out in the ABI SORP.

The insurance contracts of the Prudential Group's shareholder-backed business fall broadly into the following categories:

- UK insurance operations
  - bulk and individual annuity business, written primarily by Prudential Retirement Income Limited and other categories of non-participating UK business;
- Jackson
  - fixed and variable annuity business and life insurance; and
- Prudential Corporation Asia
  - non-participating term, whole life, and unit-linked policies, together with accident and health policies.

#### **Investment contracts**

Investment contracts are further delineated under IFRS 4 between those with and without discretionary participation features. For those contracts with discretionary participation features, IFRS 4 also permits the continued application of previously applied GAAP. The Prudential Group has adopted this approach, again subject to the FRS 27 improvement.

For investment contracts that do not contain discretionary participation features, IAS 39 and, where the contract includes an investment management element, IAS 18, apply measurement principles to assets and liabilities attaching to the contract that may diverge from those previously applied.

Contracts of the Prudential Group, which are classified as investment contracts that do not contain discretionary participation features, can be summarised as:

- UK
  - certain unit-linked savings and similar contracts;
- Jackson
  - GICs and funding agreements
  - minor amounts of ‘annuity certain’ contracts; and
- Prudential Corporation Asia
  - minor amounts for a number of small categories of business.

The accounting for the investment contracts of UK insurance operations and Jackson’s GICs and funding agreements are considered in turn below:

*i Certain UK unit-linked savings and similar contracts*

**Deferred acquisition costs**

Acquisition costs are deferred to the extent that it is appropriate to recognise an asset that represents the entity’s contractual right to benefit from providing investment management services and are amortised as the entity recognises the related revenue. IAS 18 further reduces the costs potentially capable of deferral to incremental costs only. Deferred acquisition costs are amortised to the income statement in line with service provision.

**Deferred income reserves**

These are required to be established under IAS 18 with amortisation over the expected life of the contract. The majority of the relevant UK contracts are single premium with the initial deferred income reflecting the ‘front-end load’ i.e. the difference between the premium paid and the amount credited to the unit fund. Deferred income is amortised to the income statement in line with service provision. The amortisation profile is either on a straight-line basis or, if more appropriate, a further deferral of income recognition is applied.

**Sterling reserves**

Prudent provisions established for possible future expenses not covered by future margins at a policy level reflecting the regulatory approach in the UK are not permitted for those contracts with insignificant insurance risk that are classified as investment contracts.

*ii Jackson — GICs and funding arrangements*

Under a traditional GIC, the policyholder makes a lump sum deposit. The interest rate paid is fixed and established when the contract is issued. Funding agreements are of a similar nature but the interest rate may be floating, based on a rate linked to an external index. The US GAAP accounting requirements for such contracts are very similar to those under IFRS on the amortised cost model for liability measurement.

*b Concentration of risk*

*i Business accepted*

The Prudential Group’s exposure to life assurance risks is well-diversified. This is achieved through the geographical spread of the Prudential Group’s operations and, within those operations, through a broad mix of product types.

As part of the risk management framework, the Prudential Group regularly monitors concentration of risk using a variety of risk monitoring tools including:

- Scenario testing and sensitivity analysis for the Prudential Group capital and profitability metrics involving IGD, Prudential Group economic capital, EEV and IFRS help identify concentrations of risks by risk types, products and business units, as well as the benefits of diversification of risks.

An example of the diversification benefits for Prudential Group is that adverse scenarios do not affect all business units in the same way, providing natural hedges within the group. For example, the US business is sensitive to increasing interest rates, whereas, in contrast, several business units in Asia benefit from increasing rates.

Conversely, these Asian business units are sensitive towards low interest rates, whereas certain products in the US benefit from falling interest rates. The economic capital framework also takes into account situations where factors are correlated, for example the extent of correlation between UK and US economies.

- Business units are also required to disclose to the group risk function all material risks, along with information on their severity and likelihood, and mitigating actions taken or planned.

Credit risk remains one of the largest risk exposures. This reflects the relative size of exposure in Jackson and the UK Shareholder annuities business. The Prudential Group manages concentration of credit risks by setting limits on the maximum exposure to each counterparty based on their credit ratings.

## *ii Ceded business*

The Prudential Group cedes certain business to other insurance companies. Although the ceding of insurance does not relieve the Prudential Group of liability to its policyholders, the Prudential Group participates in such agreements for the purpose of managing its loss exposure. The Prudential Group evaluates the financial condition of its reinsurers and monitors concentration of credit risk from similar geographic regions, activities or economic characteristics of the reinsurers to minimise its exposure from reinsurer insolvencies. There are no significant concentrations of reinsurance risk. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively the Prudential Group's UK and US operations ceded 98, 98 and 98% of the reinsurance recoverable insurance assets. Of those amounts, 88, 93 and 92% were from reinsurers with Standard & Poor's rating A- and above as at 31 December 2007, 31 December 2008 and 31 December 2009.

## *c Guarantees*

Notes D2(d), D3(d) and D4(d) provide details of guarantee features of the Prudential Group's life assurance products. In the UK, guarantees of the with-profits products are valued for accounting purposes on a market consistent basis in 2007, 2008 and 2009 as described in section D2(f)(ii). The UK business also has products with guaranteed annuity option features, mostly within SAIF, as described in section D2(d). There is little exposure to financial options and guarantees in the shareholder-backed business of the UK operations. The US business annuity products have a variety of option and guarantee features as described in section D3(d). Jackson's derivative programme seeks to manage the exposures as described in section D3(e). The Prudential Group's exposure to guarantees was significantly reduced during 2009 as a result of the disposal of the Taiwan agency business.

## *d Sensitivity of EEV basis profit and equity for market and other risks*

The Prudential Group prepares supplementary EEV basis financial information for half yearly and annual publication. These statements include sensitivity disclosures which are part of the market risk information provided to key management.

## *e Sensitivity of IFRS basis profit or loss and equity to market and other risks*

### *i Overview of risks by business unit*

The financial assets and liabilities attaching to the Prudential Group's life assurance business are, to varying degrees, subject to market and insurance risk and other changes of experience assumptions that may have a material effect on IFRS basis profit or loss and equity.

Market risk is the risk that the fair value or future cash flows of a financial instrument or, in the case of liabilities of insurance contracts, their carrying value will fluctuate because of changes in market prices. Market risk comprises three types of risk, namely:

- Currency risk: due to changes in foreign exchange rates;
- interest rate risk: due to changes in market interest rates; and
- other price risk: due to fluctuations in market prices (other than those arising from interest rate risk or currency risk).

Policyholder liabilities relating to the Prudential Group's life assurance businesses are also sensitive to the effects of other changes in experience, or expected future experience, such as for mortality, other insurance risk and lapse risk.

In addition, the profitability of the Prudential Group's life assurance businesses and, as described in Section E, asset management business, is indirectly affected by the performance of the assets covering policyholder liabilities and related capital.

Three key points are to be noted, namely:

- The Prudential Group's with-profit and unit-linked funds absorb most market risk attaching to the funds' investments. Except for second order effects, for example on asset management fees and shareholders' share of cost of bonuses for with-profits business, shareholder results are not directly affected by market value movements on the assets of these funds;
- the Prudential Group's shareholder results are most sensitive to market risks for assets of shareholder-backed business; and
- the main exposures of the Prudential Group's IFRS basis results to market risk for life assurance operations on investments of shareholder-backed business are for debt securities.

The most significant items for which the IFRS basis shareholders' profit or loss and equity for the Prudential Group's life assurance business is sensitive to these variables are shown in the following tables. The distinction between direct and indirect exposure is not intended to indicate the relative size of the sensitivity.

Type of business	Market and credit risk			Insurance and lapse risk
	Investments/derivatives	Liabilities/unallocated	Other exposure	
<i>UK insurance operations (see also section D2(i))</i>				
With-profits business (including Prudential Annuities Limited)	Net neutral direct exposure (Indirect exposure only)		Investment performance subject to smoothing through declared bonuses	Persistency risk to future shareholder transfers
SAIF sub-fund	Net neutral direct exposure (Indirect exposure only)		Asset management fees earned by M&G	
Unit-linked business	Net neutral direct exposure (Indirect exposure only)		Investment performance through asset management fees	Persistency risk
Shareholder-backed annuity business	Asset/liability mismatch risk			Mortality experience and assumptions for longevity
	Credit risk Interest rate risk for assets in excess of liabilities i.e. representing shareholder capital			
<i>US insurance operations (see also section D3(i))</i>				
All business	Currency risk			Persistency risk
Variable annuity business	Net effect of market risk arising from incidence of guarantee features and variability of asset management fees offset by derivative hedging programme			
Fixed index annuity business	Derivative hedge programme to the extent not fully hedged against liability and fund performance	Incidence of equity participation features		
Fixed index annuity, Fixed annuity and GIC business	Credit risk Interest rate risk  These risks are reflected in volatile profit or loss and shareholders' equity for derivative value movements and impairment losses, and, in addition, for shareholders' equity for value movements on fixed income securities classified as 'available for sale' under IAS 39		Spread difference between earned rate and rate credited to policyholders	Lapse risk but the effects of extreme events are mitigated by the use of swaption contracts
<i>Asian insurance operations (see also section D4(i))</i>				
All business	Currency risk			Mortality and morbidity risk Persistency risk
With-profits business	Net neutral direct exposure (Indirect exposure only)		Investment performance subject to smoothing through declared bonuses	
Unit-linked business	Net neutral direct exposure (Indirect exposure only)		Investment performance through asset management fees	
Non-participating business	Interest rate and price risk	Long-term interest rates		

## ii IFRS shareholder results — Exposures for market and other risk

### Key Prudential Group exposures

The IFRS operating profit based on longer-term investment returns for UK insurance operations has high potential sensitivity for changes to longevity assumptions affecting the carrying value of liabilities to policyholders for shareholder-backed annuity business. In addition, at the total IFRS profit level the result is sensitive to temporary value movements on assets backing IFRS equity.

For Jackson at the level of operating profit based on longer-term investment returns, the results are sensitive to market conditions to the extent of income earned on spread-based products and equity-based exposure not mitigated by the equity and interest derivative programmes. Further information is given below under the US operations section of market and credit risk.

Jackson's derivative programme is used to substantially mitigate equity market risk attaching to its equity-based products and interest rate risk associated with its spread-based products. Movements in interest rates and credit spreads materially affect the carrying value of derivatives which are used to manage the liabilities to policyholders and backing investment assets of fixed annuity and other general account business. Combined with the use of US GAAP measurement (as grandfathered under IFRS 4) for the asset and liabilities for the insurance contracts liabilities, which is largely insensitive to current period market movements, the Jackson total profit (i.e. including short-term fluctuations in investment returns) is very sensitive to market movements. In addition to these effects the Jackson IFRS equity is sensitive to the impact of interest rate and credit spread movements on the value of fixed income securities. Movements in unrealised appreciation on these securities are included as movement in equity (i.e. outside the income statement).

For Asian operations, the operating profit based on longer-term investment returns is mainly affected by the impact of market levels on unit-linked business persistency, and other insurance risk.

At the total IFRS profit level the Asian result is affected by short-term value movements on the asset portfolio for non-linked shareholder-backed business.

M&G profits are affected primarily by movements in the growth in funds under management and of the effect any impairment on the loan book and fair value movements on debt securities held by Prudential Capital.

### Market and credit risk

#### UK insurance operations

With-profits business

- **With-profits business**

Shareholder results of UK with-profits business are sensitive to market risk only through the indirect effect of investment performance on declared policyholder bonuses.

The investment assets of the PAC with-profits fund are subject to market risk. However, changes in their carrying value, net of related changes to asset-share liabilities of with-profit contracts, affect the level of unallocated surplus of the fund. As unallocated surplus is accounted for as a liability under IFRS, movements in its value do not affect shareholders' profit or equity.

The shareholder results of the UK with-profits fund correspond to the shareholders' share of the cost of bonuses declared on the with-profits business. This currently corresponds to one-ninth of the cost of bonuses declared.

Investment performance is a key driver of bonuses, and hence the shareholders' share of cost of bonuses. Due to the 'smoothed' basis of bonus declaration the sensitivity to investment performance in a single year is low. However, over multiple periods it is important.

- Prudential Annuities Limited (PAL)

PAL's business is not with-profits, it writes annuity business. However, as PAL is owned by the PAC with-profits sub-fund, changes in the carrying value of PAL's assets and liabilities are reflected in the liability for unallocated surplus which as described above, do not affect shareholder results.

- Scottish Amicable Insurance Fund (SAIF)

SAIF is a ring-fenced fund in which, apart from asset management fees, shareholders have no interest. Accordingly, the Prudential Group's IFRS profit and equity are insensitive to the direct effects of market risk attaching to SAIF's assets and liabilities.

#### Shareholder-backed business

The factors that may significantly affect the IFRS results of UK shareholder-backed business are the mortality experience and assumptions and credit risk attaching to the annuity business of Prudential Retirement Income Limited and the PAC non-profit sub-fund.

- Prudential Retirement Income Limited (PRIL)

The assets covering PRIL's liabilities are principally debt securities and other investments that are held to match the expected duration and payment characteristics of the policyholder liabilities. These liabilities are valued for IFRS reporting purposes by applying discount rates that reflect the market rates of return attaching to the covering assets.

Except to the extent of any asset/liability duration mismatch which is reviewed regularly, and exposure to credit risk, the sensitivity of the Prudential Group's results to market risk for movements in the carrying value of PRIL's liabilities and covering assets is broadly neutral on a net basis.

The main market risk sensitivity for PRIL arises from interest rate risk on the debt securities which substantially represent IFRS equity. This equity comprises the net assets held within the long-term fund of the company that cover regulatory basis liabilities that are not recognised for IFRS reporting purposes, for example contingency reserves, and shareholder capital held outside the long-term fund.

The principal items affecting the IFRS results for PRIL are mortality experience and assumptions and credit risk.

- PAC non-profit sub-fund

The PAC non-profit sub-fund principally comprises annuity business previously written by SAL, credit life, unit-linked and other non-participating business.

The financial assets covering the liabilities for those types of business are subject to market risk. However, for the annuity business the same considerations as described above for PRIL apply, whilst the liabilities of the unit-linked business change in line with the matching linked assets. Other liabilities of the PAC non-profit sub-fund are broadly insensitive to market risk.

- Other shareholder-backed unit-linked business

Due to the matching of policyholder liabilities to attaching asset value movements the UK unit-linked business is not directly affected by market or credit risk. The principal factor affecting the IFRS results is investment performance through asset management fees.

#### **US insurance operations (Jackson)**

The IFRS basis results of Jackson are highly sensitive to market risk on the assets covering liabilities other than variable annuity business segregated in the separate accounts.

Invested assets covering liabilities (other than the separate accounts) and related capital comprise principally debt securities classified as available-for-sale. Value movements for these securities are reflected as movements in shareholders' equity through the statement of comprehensive income. Other invested assets and derivatives are carried at fair value with the value movements reflected in the income statement.

By contrast, the IFRS insurance liabilities for business written by Jackson, by the application of grandfathered GAAP under IFRS 4, are measured on US GAAP bases which with the exception of certain items covered by the equity hedging programme, are generally insensitive to temporary changes in market conditions or the short-term returns on the attaching asset portfolios.

These differences in carrying value of debt securities, other invested assets, derivatives and insurance liabilities give rise to potentially significant volatility in the IFRS income statement and shareholders' equity. As with other shareholder-backed business the profit or loss for Jackson is presented in the Prudential Group's segmental analysis of profit as described in note B1, by distinguishing the result for the year between an operating result based on longer-term investment returns and short-term fluctuations in investment returns. In this way the most significant direct effect of market changes that have taken place to the Jackson result are separately identified.

Excluding these short-term effects, the factors that most significantly affect the Jackson IFRS operating result based on long-term investment returns are:

- Variable annuity business — net effect of market risk arising from the incidence and valuation of guarantee features and variability of asset management fees offset by derivative hedging performance, in 2008 and 2009. The net effect of market risk in Jackson's guarantees and derivatives included in operating result excludes the impact of changes in market implied volatility in addition to those years. Further movements in reserves for guarantees reflected in operating result are also based on a discount rate using a long-term average Corporate AA credit curve instead of the actual Corporate AA credit curve at the valuation date. The derivative hedging programme is designed to be economically effective and there can be some accounting mis-matches for those guarantee features which are not economically valued under grandfathered US GAAP, for example guaranteed minimum death benefits. These accounting mis-matches are magnified in periods of market dislocation:
- fixed annuity business — the spread differential between the earned rate and the rate credited to policyholders; and
- fixed index annuity business — the spread differential between the earned rate and the rate credited to policyholders and incidence of equity index participation features, net of the related hedging performance.

In addition, the total profit for Jackson is affected by the level of impairment losses on the debt securities portfolios, short-term value movements on derivatives held to manage the fixed annuity and other general account business, other temporary value movements on portfolio investments classified as fair value through profit and loss, and those arising on revaluing the embedded derivative components of variable annuity liabilities for the effects of short-term movements in AA corporate bond rate curves and equity volatility levels.

### **Asian insurance operations**

For Asian with-profits business the same features apply as described above for UK with-profits business. Similarly, as for other parts of the Prudential Group, for unit-linked business the main factor affecting IFRS basis results is investment performance through asset management fees.

The sensitivity of the IFRS basis results of the Prudential Group's Asian operations to market risk is primarily restricted to the non-participating business.

This sensitivity is primarily reflected through the volatility of asset returns coupled with the fact that the accounting carrying value of liabilities to policyholders are only partially sensitive to changed market conditions. As for UK shareholder-backed operations and Jackson, the IFRS profit is distinguished in the Prudential Group's segmental analysis so as to distinguish operating profits based on longer-term investment return and short-term fluctuations in investment returns.

### **Insurance and lapse risk**

The features described above cover the main sensitivities of IFRS profit and loss and equity for market, insurance and credit risk. Lapse and longevity risk may also be a key determination of IFRS basis results with variable impacts.

In the UK, adverse persistency experience can affect the level of profitability from with-profits and unit-linked business.

For with-profits business in any given year, the amount represented by the shareholders' share of cost of bonus may be only marginally affected. However, altered persistency trends may affect future expected shareholder transfers.

By contrast, Prudential Group IFRS operating profit is particularly sensitive to longevity outlook that result in changes of assumption for the UK shareholder-backed annuity business.

Jackson is sensitive to lapse risk. However, Jackson uses swaption derivatives to ameliorate the effect of a sharp rise in interest rates, which would be the most likely cause of a sudden change in policyholder behaviour.

In Asia adverse persistency experience can impact the IFRS profitability of certain business written in the region. This risk is managed at a business unit level through monthly monitoring of experience and the implementation of management actions as necessary. These actions could include product enhancements, increased management focus on premium collection as well as other customer retention efforts. The potential financial impact of lapses is often mitigated through the specific features of the products, e.g. surrender charges.

### *iii Impact of diversification on risk exposure*

The Prudential Group enjoys significant diversification benefits. This arises because not all risk scenarios will happen at the same time and across all geographic regions. The Prudential Group tests the sensitivities of results to different correlation factors such as:

Correlation across geographic regions

- Financial risk factors
- Non-financial risk factors.

Correlation across risk factors

- Longevity risk
- Expenses
- Persistency
- Other risks.

The effect of group diversification is to significantly reduce the aggregate standalone volatility risk to IFRS operating profit based on longer-term investment returns. The effect is almost wholly explained by the correlations across risk types, in particular longevity risk.

### *f Duration of liabilities*

Under the terms of the Prudential Group's contracts, as for life assurance contracts generally, the contractual maturity date is the earlier of the end of the contract term, death, other insurable events or surrender. The Prudential Group has therefore chosen to provide details of liability duration that reflect the actuarially determined best estimate of the likely incidence of these factors on contract duration. Details are shown in sections D2(j), D3(j) and D4(j).

In the years 2005 to 2009, claims paid on the Prudential Group's life assurance contracts including those classified as investment contracts under IFRS 4 ranged from £13 billion to £19 billion. Indicatively, it is to be expected that, of the Prudential Group's policyholder liabilities (excluding unallocated surplus) at 31 December 2009 of £186.4 billion, the amounts likely to be paid in 2010 will be of a similar magnitude.

## **D2: UK insurance operations**

### *a Summary statement of financial position*

Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type. In order to explain the different types of UK business and fund structure, the statement of financial position of the UK insurance operations may be analysed by the assets and liabilities of the Scottish Amicable Insurance Fund (SAIF), the PAC with-profits sub-fund, unit-linked assets and liabilities and annuity (principally PRIL) and other business. The assets and liabilities of these funds and subsidiaries as at 31 December are shown in the table below.

	PAC with-profits sub-fund note i						Other funds and subsidiaries		UK insurance operations 2009 Total	
	UK insurance operations		Scottish Amicable Insurance	Excluding Prudential Annuities Limited	Prudential Annuities Limited	Total	Unit-linked assets and long-term business	Annuity and other		
	2007 Total	2008 Total	Fund note ii	Annunities Limited	Limited note iii	note iv	liabilities	business		Total
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
<b>Assets</b>										
Intangible assets attributable to shareholders:										
Deferred acquisition costs and other intangible assets . . . . .										
	157	134	—	—	—	—	—	127	127	127
	<u>157</u>	<u>134</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>127</u>	<u>127</u>	<u>127</u>
Intangible assets attributable to PAC with-profits fund:										
In respect of acquired subsidiaries for venture fund and other investment purposes . . . . .										
	192	174	—	124	—	124	—	—	—	124
Deferred acquisition costs . . . . .										
	19	13	2	7	—	7	—	—	—	9
	<u>211</u>	<u>187</u>	<u>2</u>	<u>131</u>	<u>—</u>	<u>131</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>133</u>
Total . . . . .	<u>368</u>	<u>321</u>	<u>2</u>	<u>131</u>	<u>—</u>	<u>131</u>	<u>—</u>	<u>127</u>	<u>127</u>	<u>260</u>
Deferred tax assets . . . . .	105	513	2	84	70	154	—	136	136	292
Other non-investment and non-cash assets . . . . .	4,110	4,962	419	1,020	344	1,364	547	744	1,291	3,074
Investments of long-term business and other operations:										
Investment properties . . . . .										
	13,666	11,959	710	7,330	719	8,049	662	1,440	2,102	10,861
Investments accounted for using the equity method . . . . .										
	—	—	—	—	—	—	—	4	4	4
Financial investments:										
Loans(note v) . . . . .										
	1,245	1,902	138	825	143	968	—	709	709	1,815
Equity securities and portfolio holdings in unit trusts . . . . .										
	60,829	38,880	2,994	23,062	215	23,277	10,757	23	10,780	37,051
Debt securities(note D2(c)). . . . .										
	57,180	58,871	4,797	25,358	12,184	37,542	6,386	19,047	25,433	67,772
Other investments(note vi) . . . . .										
	3,391	4,160	340	2,879	156	3,035	66	189	255	3,630
Deposits . . . . .										
	7,228	6,090	869	8,378	377	8,755	550	1,383	1,933	11,557
Total investments . . . . .	<u>143,539</u>	<u>121,862</u>	<u>9,848</u>	<u>67,832</u>	<u>13,794</u>	<u>81,626</u>	<u>18,421</u>	<u>22,795</u>	<u>41,216</u>	<u>132,690</u>
Properties held for sale . . . . .	30	—	—	—	—	—	—	—	—	—
Cash and cash equivalents . . . . .	<u>1,869</u>	<u>2,571</u>	<u>214</u>	<u>948</u>	<u>34</u>	<u>982</u>	<u>939</u>	<u>130</u>	<u>1,069</u>	<u>2,265</u>
<b>Total assets . . . . .</b>	<u><u>150,021</u></u>	<u><u>130,229</u></u>	<u><u>10,485</u></u>	<u><u>70,015</u></u>	<u><u>14,242</u></u>	<u><u>84,257</u></u>	<u><u>19,907</u></u>	<u><u>23,932</u></u>	<u><u>43,839</u></u>	<u><u>138,581</u></u>

	PAC with-profits sub-fund note i						Other funds and subsidiaries			UK insurance operations 2009 Total
	UK insurance operations		Scottish Amicable Insurance Fund note ii	Excluding Prudential Annuities Limited	Prudential Annuities Limited note iii	Total note iv	Unit-linked assets and liabilities	Annuity and long-term business	Total	
	2007	2008	£m	£m	£m	£m	£m	£m	£m	
	Total	Total	£m	£m	£m	£m	£m	£m	£m	
<b>Equity and liabilities</b>										
<b>Equity</b>										
Shareholders' equity . . . . .	1,364	1,655	—	—	—	—	—	1,939	1,939	1,939
Minority interests . . . . .	42	47	—	28	—	28	—	—	—	28
Total equity . . . . .	<u>1,406</u>	<u>1,702</u>	<u>—</u>	<u>28</u>	<u>—</u>	<u>28</u>	<u>—</u>	<u>1,939</u>	<u>1,939</u>	<u>1,967</u>
<b>Liabilities</b>										
Policyholder liabilities and unallocated surplus of with-profits funds:										
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) . . . . .	124,477	107,707	9,972	55,588	11,969	67,557	19,035	19,665	38,700	116,229
Unallocated surplus of with-profits funds (reflecting application of 'realistic' provisions for UK regulated with-profits funds) . . . . .	13,813	8,254	—	8,421	1,545	9,966	—	—	—	9,966
Total . . . . .	<u>138,290</u>	<u>115,961</u>	<u>9,972</u>	<u>64,009</u>	<u>13,514</u>	<u>77,523</u>	<u>19,035</u>	<u>19,665</u>	<u>38,700</u>	<u>126,195</u>
Operational borrowings attributable to shareholder-financed operations . . . . .	12	54	—	—	—	—	—	158	158	158
Borrowings attributable to with-profits funds . . . . .	987	1,308	118	1,166	—	1,166	—	—	—	1,284
Deferred tax liabilities . . . . .	2,383	1,421	66	807	281	1,088	—	452	452	1,606
Other non-insurance liabilities . . . . .	6,943	9,783	329	4,005	447	4,452	872	1,718	2,590	7,371
Total liabilities . . . . .	<u>148,615</u>	<u>128,527</u>	<u>10,485</u>	<u>69,987</u>	<u>14,242</u>	<u>84,229</u>	<u>19,907</u>	<u>21,993</u>	<u>41,900</u>	<u>136,614</u>
<b>Total equity and liabilities . . . . .</b>	<u><u>150,021</u></u>	<u><u>130,229</u></u>	<u><u>10,485</u></u>	<u><u>70,015</u></u>	<u><u>14,242</u></u>	<u><u>84,257</u></u>	<u><u>19,907</u></u>	<u><u>23,932</u></u>	<u><u>43,839</u></u>	<u><u>138,581</u></u>

**Notes**

- i For the purposes of this table and subsequent explanation, references to the PAC WPSF also include, for convenience, the amounts attaching to the Defined Charges Participating Sub-fund which includes the with-profits annuity business transferred to Prudential from the Equitable Life Assurance Society on 1 December 2007 (with assets of approximately £1.7 billion at that date). Profits to shareholders on this with-profits annuity business emerge on a 'charges less expenses' basis and policyholders are entitled to 100% of the investment earnings.
- ii SAIF is a separate sub-fund within the PAC long-term business fund.
- iii Wholly-owned subsidiary of the PAC WPSF that writes annuity business.
- iv Excluding policyholder liabilities of the Hong Kong branch of PAC.
- v The loans of the Prudential Group's UK insurance operations of £1,245 million, £1,902 million and £1,815 million as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, comprise loans held by the PAC WPSF of £946 million, £1,345 million and £1,106 million, for 31 December 2007, 31 December 2008 and 31 December 2009 respectively, and loans held by shareholder-backed business of £299 million, £557 million, and £709 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. The loans held by the PAC WPSF at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, comprise mortgage loans of £156 million, £150 million and £145 million, policy loans of £35 million, £29 million and £24 million and other loans of £755 million, £1,166 million and £937 million respectively. The mortgage loans are collateralised by properties. Other loans held by the PAC with-profits fund are all commercial loans and comprise mainly syndicated loans. The loans held by the UK shareholder-backed business at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, comprise mortgage loans collateralised by properties of £293 million, £551 million, and £702 million and other loans of £6 million, £6 million and £7 million.

vi Other investments comprise:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Derivative assets*(note G3) . . . . .	571	1,326	910
Partnerships in investment pools and other** . . . . .	2,820	2,834	2,720
	<u>3,391</u>	<u>4,160</u>	<u>3,630</u>

\* In the UK, Prudential uses derivatives to reduce equity and credit risk, interest rate and currency exposures, and to facilitate efficient portfolio management. After derivative liabilities of £689 million, £3,401 million and £709 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, which are also included in the statement of financial position, the overall derivative position was a net liability of £118 million, a net liability of £2,075 million, and a net asset of £201 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

\*\* Partnerships in investment pools and other comprise mainly investments held by the PAC with-profits fund. These investments are primarily venture fund investments and investment in property funds and limited partnerships.

*b Reconciliation of movement 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 insurance operations from the beginning of the year to the end of the year is as follows:

	SAIF and PAC with-profits sub-fund	Other funds and Subsidiaries		UK insurance operations Total
		Unit-linked liabilities	Annuity and other long-term business	
	£m	£m	£m	£m
At 1 January 2007 . . . . .	101,616	18,187	14,101	133,904
Premiums . . . . .	4,459	2,115	2,279	8,853
Surrenders . . . . .	(2,879)	(1,636)	(13)	(4,528)
Maturities/Deaths . . . . .	<u>(4,987)</u>	<u>(790)</u>	<u>(1,010)</u>	<u>(6,787)</u>
Net cash flows . . . . .	(3,407)	(311)	1,256	(2,462)
Shareholders transfers post tax . . . . .	(279)	—	—	(279)
Switches . . . . .	(352)	352	—	—
Assumption changes (shareholder-backed business)(note D2(h), note c) . . . . .	—	—	(34)	(34)
Investment-related items and other movements . . . . .	6,256	749	223	7,228
Foreign exchange translation differences . . . . .	<u>(62)</u>	<u>—</u>	<u>(5)</u>	<u>(67)</u>
At 31 December 2007/1 January 2008 . . . . .	103,772	18,977	15,541	138,290
Premiums . . . . .	3,157	2,435	3,780	9,372
Surrenders . . . . .	(2,336)	(1,838)	(107)	(4,281)
Maturities/Deaths . . . . .	<u>(6,309)</u>	<u>(666)</u>	<u>(1,349)</u>	<u>(8,324)</u>
Net cash flows (note a) . . . . .	(5,488)	(69)	2,324	(3,233)
Shareholders transfers post tax . . . . .	(284)	—	—	(284)
Switches . . . . .	(360)	360	—	—
Assumption changes (shareholder-backed business)(note D2(h), note c) . . . . .	—	—	447	447
Investment-related items and other movements (note b) . . . . .	(13,049)	(2,952)	(777)	(16,778)
Foreign exchange translation differences . . . . .	<u>(2,483)</u>	<u>2</u>	<u>—</u>	<u>(2,481)</u>
At 31 December 2008/1 January 2009 . . . . .	82,108	16,318	17,535	115,961
Premiums . . . . .	3,271	1,860	1,736	6,867
Surrenders . . . . .	(2,394)	(1,535)	(42)	(3,971)
Maturities/Deaths . . . . .	<u>(5,147)</u>	<u>(670)</u>	<u>(1,422)</u>	<u>(7,239)</u>
Net cash flows (note a) . . . . .	(4,270)	(345)	272	(4,343)

	SAIF and PAC with-profits sub-fund £m	Other funds and Subsidiaries		UK insurance operations Total £m
		Unit-linked liabilities £m	Annuity and other long-term business £m	
Shareholders transfers post tax . . . . .	(202)	—	—	(202)
Switches . . . . .	(270)	270	—	—
Assumption changes (shareholder-backed business)(note D2(h), note c) . . . . .	—	—	(46)	(46)
Investment-related items and other movements (note b) . . . . .	9,365	2,849	1,904	14,118
Foreign exchange translation differences . . . . .	764	(57)	—	707
At 31 December 2009 . . . . .	87,495	19,035	19,665	126,195

Notes

- (a) Net cash flows of negative £4,343 million have increased from negative £3,233 million in 2008, principally as a result of a decrease in premiums following the decision to limit bulk annuity transactions in the period.
- (b) Investment-related items and other movements of £14,118 million across fund types reflected the strong performance of UK equity markets in 2009, as well as the increase in value of debt securities and the reversal of unrealised losses on property investments recorded in 2008.
- (c) Assumption changes principally represent the net impact of changes to the deflation reserve, expense assumptions and modelling changes.

c Information on credit risk of debt securities

Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type. The following table summarises by rating the securities held by UK insurance operations as at 31 December:

	2009									
	PAC with-profits sub-fund					Other funds and subsidiaries				
	UK insurance Operations		Scottish Amicable Insurance Fund £m	Excluding Prudential Annuities Limited £m	Prudential Annuities Limited £m	Total £m	Unit- linked assets and liabilities £m	Other annuity and long-term business PRIL £m	Other annuity and long-term business £m	UK insurance operations 2009 Total £m
	2007 Total £m	2008 Total £m								
S&P — AAA . . . . .	21,556	18,981	1,018	4,594	2,531	7,125	2,451	4,702	795	16,091
S&P — AA+ to AA- . . . . .	6,173	6,012	399	2,242	1,131	3,373	765	1,716	219	6,472
S&P — A+ to A- . . . . .	12,557	15,929	1,210	6,954	3,685	10,639	1,788	5,366	690	19,693
S&P — BBB+ to BBB- . . . . .	5,409	7,413	1,124	6,141	1,287	7,428	905	2,276	450	12,183
S&P — Other . . . . .	942	1,033	316	1,618	168	1,786	360	182	23	2,667
	46,637	49,368	4,067	21,549	8,802	30,351	6,269	14,242	2,177	57,106
Moody's — Aaa . . . . .	1,021	681	59	252	51	303	4	76	21	463
Moody's — Aa1 to Aa . . . . .	587	833	18	108	40	148	—	85	25	276
Moody's — A1 to A3 . . . . .	944	678	36	181	290	471	—	251	43	801
Moody's — Baa1 to Baa3 . . . . .	490	454	65	324	258	582	—	141	27	815
Moody's — Other . . . . .	410	162	27	140	61	201	—	102	9	339
	3,452	2,808	205	1,005	700	1,705	4	655	125	2,694
Fitch . . . . .	682	560	46	300	331	631	—	314	31	1,022
Other . . . . .	6,409	6,135	479	2,504	2,351	4,855	113	1,423	80	6,950
Total debt securities . . . . .	57,180	58,871	4,797	25,358	12,184	37,542	6,386	16,634	2,413	67,772

Where no external ratings are available, internal ratings produced by the Prudential Group's asset management operation, which are prepared on Prudential's assessment of a comparable basis to external ratings, are used where possible. Of the £6,409 million, £6,135 million and £6,950 million total debt securities held at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, which are not externally rated, £2,972 million, £2,325 million and £2,190 million were internally rated AAA to A-, £2,844 million, £3,149 million and £3,445 million were internally rated BBB to B- and £593 million, £661 million and £1,315 million were rated below B- or unrated. The majority of unrated debt security investments were held in SAIF and the PAC with-profits fund and relate to convertible debt and other investments which are not covered by ratings analysts nor have an internal rating attributed to them. Of the £1,503 million PRIL and other annuity and long-term business investments

which are not externally rated, £15 million were internally rated AAA, £88 million AA, £495 million A, £647 million BBB, £123 million BB and £135 million were internally rated B+ and below at 31 December 2009.

As detailed in note D2(i) below, the primary sensitivity of IFRS basis profit or loss and shareholders' equity relates to non-linked shareholder-backed business which covers "PRIL" and "other annuity and long-term business" in the table above.

#### *d Products and guarantees*

Prudential's long-term products in the UK consist of life insurance, pension products and pension annuities.

These products are written primarily in:

- One of three separate sub-funds of the PAC long-term fund, namely the with-profits sub-fund, SAIF, and the non-profit sub-fund;
- Prudential Annuities Limited, which is owned by the PAC with-profits sub-fund;
- Prudential Retirement Income Limited, a shareholder-owned subsidiary; or
- Other shareholder-backed subsidiaries writing mainly non-profit unit-linked business.

#### *i With-profits products and PAC with-profits sub-fund*

Within the statement of financial position of UK insurance operations at 31 December 2007, 31 December 2008 and 31 December 2009, as shown in note D2(a), there are policyholder liabilities and unallocated surplus of £90.5 billion, £72.1 billion and £77.5 billion, respectively, that relate to the WPSF. These amounts include the liabilities and capital of Prudential Annuities Limited, a wholly owned subsidiary of the fund. The WPSF mainly contains with-profits business but it also contains some non-profit business (unit-linked, term assurances and annuities). The WPSF's profits are apportioned 90% to its policyholders and 10% to shareholders as surplus for distribution is determined via the annual actuarial valuation.

The WPSF held a provision of £45 million at 31 December 2007, £42 million at 31 December 2008 and £31 million at 31 December 2009 to honour guarantees on a small amount of guaranteed annuity products. SAIF's exposure to guaranteed annuities is described below.

Beyond the generic guarantees described above, there are very few explicit options or guarantees such as minimum investment returns, surrender values or annuities at retirement and any granted have generally been at very low levels.

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. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration.

The main factors that influence the determination of bonus rates are the return on the investments of the with-profits fund, inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. The overall rate of return earned on investments and the expectation of future investment returns are the most important influences on bonus rates. A high proportion of the assets backing the with-profits business are invested in equities and real estate. If the financial strength of the with-profits business is affected, then a higher proportion of fixed interest or similar assets might be held by the fund.

Further details on the determination of the two types of the bonuses: "regular" and "final", the application of significant judgement, key assumptions and the degree of smoothing of investment returns in determining the bonus rates are provided below.

#### **Regular bonus rates**

For regular bonuses, the bonus rates are determined for each type of policy primarily by targeting the bonus level at a prudent proportion of the long-term expected future investment return on underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by the date of payment of the premium or date of issue of the policy or if the accumulated annual bonuses are particularly high or low relative to a prudent proportion of the achieved investment return.

When target bonus levels change the PAC board has regard to the overall strength of the long-term fund when determining the length of time over which it will seek to achieve the amended prudent target bonus level.

In normal investment conditions, PAC expects changes in regular bonus rates to be gradual over time, and these are not expected to exceed 1% per annum over any year. However, the PAC Directors retain the discretion whether or not to declare a regular bonus each year, and there is no limit on the amount by which regular bonus rates can change.

### **Final bonus rates**

A final bonus which is normally declared yearly, may be added when a claim is paid or when units of a unitised product are realised.

The rates of final bonus usually vary by type of policy and by reference to the period, usually a year, in which the policy commences or each premium is paid. These rates are determined by reference to the asset shares for the sample policies but subject to the smoothing approach, explained below.

In general, the same final bonus scale applies to maturity, death and surrender claims except that:

- the total surrender value may be impacted by the application of a Market Value Reduction — MVR — (for accumulating with-profits policies) and is affected by the surrender bases (for conventional with-profits business); and
- for the SAIF and Scottish Amicable Life (SAL), the final bonus rates applicable on surrender may be adjusted to reflect expected future bonus rates.

### **Application of significant judgement**

The application of the above method for determining bonuses requires the PAC board of directors to apply significant judgement in many respects, including in particular the following:

- Determining what constitutes fair treatment of customers: Prudential is required by UK law and regulation to consider the fair treatment of its customers in setting bonus levels. The concept of determining what constitutes fair treatment, while established by statute, is not defined.
- Smoothing of investment returns: This is an important feature of with-profits products. Determining when particular circumstances, such as a significant rise or fall in market values, warrant variations in the standard bonus smoothing limits that apply in normal circumstances requires the PAC Board to exercise significant judgement.
- Determining at what level to set bonuses to ensure that they are competitive: The overall return to policyholders is an important competitive measure for attracting new business.

### **Key assumptions**

As noted above, the overall rate of return on investments and the expectation of future investment returns are the most important influences in bonus rates, subject to the smoothing described below. Prudential determines the assumptions to apply in respect of these factors, including the effects of reasonably likely changes in key assumptions, in the context of the overarching discretionary and smoothing framework that applies to its with-profits business as described above. As such, it is not possible to specifically quantify the effects of each of these assumptions or of reasonably likely changes in these assumptions.

Prudential's approach, in applying significant judgement and discretion in relation to determining bonus rates, is consistent conceptually with the approach adopted by other firms that manage a with-profits business. It is also consistent with the requirements of UK law, which require all UK firms that carry out a with-profits business to define, and make publicly available, the Principles and Practices of Financial Management (PPFM) that are applied in the management of their with-profits funds.

Accordingly, Prudential's PPFM contains an explanation of how it determines regular and final bonus rates within the discretionary framework that applies to all with-profits policies, subject to the general legislative requirements applicable. The purpose of Prudential's PPFM is therefore to:

- explain the nature and extent of the discretion available;
- show how competing or conflicting interests or expectations of:
  - different groups and generations of policyholders, and

— policyholders and shareholders are managed so that all policyholders and shareholders are treated fairly, and

- provide a knowledgeable observer (e.g. a financial adviser) with an understanding of the material risks and rewards from starting and continuing to invest in a with-profits policy with Prudential.

Furthermore, in accordance with industry-wide regulatory requirements, the PAC board has appointed:

- an Actuarial Function Holder who provides the PAC board with all actuarial advice;
- a With-Profits Actuary whose specific duty is to advise the PAC board on the reasonableness and proportionality of the manner in which its discretion has been exercised in applying the PPFM and the manner in which any conflicting interests have been addressed; and
- a With-Profits Committee of independent individuals, which assesses the degree of compliance with the PPFM and the manner in which conflicting rights have been addressed.

### Smoothing of investment return

In determining bonus rates for the UK with-profits policies, smoothing is applied to the allocation of the overall earnings of the UK with-profits fund of which the investment return is a significant element. The smoothing approach differs between accumulating and conventional with-profits policies to reflect the different contract features. In normal circumstances, Prudential does not expect most payout values on policies of the same duration to change by more than 10% up or down from one year to the next, although some larger changes may occur to balance payout values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values, and in such situations the PAC board may decide to vary the standard bonus smoothing limits in order to protect the overall interests of policyholders.

The degree of smoothing is illustrated numerically by comparing in the following table the relatively “smoothed” level of policyholder bonuses declared as part of the surplus for distribution with the more volatile movement in investment return and other items of income and expenditure of the UK component of the PAC with-profits fund for each period presented.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Net income of the fund:			
Investment return . . . . .	5,881	(14,595)	10,461
Claims incurred . . . . .	(6,512)	(7,068)	(6,253)
Movement in policyholder liabilities . . . . .	(2,307)	13,504	(3,692)
Add back policyholder bonuses for the year (as shown below) . . . . .	<u>2,522</u>	<u>2,565</u>	<u>1,827</u>
Claims incurred and movement in policyholder liabilities (including charge for provision for asset shares and excluding policyholder bonuses) . . . . .	(6,297)	9,001	(8,118)
Earned premiums, net of reinsurance . . . . .	4,181	2,927	3,063
Other income . . . . .	1,417	(36)	(2)
Acquisition costs and other operating expenditure . . . . .	(2,105)	(408)	(842)
Tax credit (charge) . . . . .	<u>(24)</u>	<u>1,191</u>	<u>(640)</u>
Net income of the fund before movement in unallocated surplus . . . . .	3,053	(1,920)	3,922
Movement in unallocated surplus . . . . .	<u>(252)</u>	<u>4,769</u>	<u>(1,893)</u>
Surplus for distribution . . . . .	<u>2,801</u>	<u>2,849</u>	<u>2,029</u>
Surplus for distribution allocated as follows:			
— 90% policyholders bonus (as shown above) . . . . .	2,522	2,565	1,827
— 10% shareholders’ transfers . . . . .	<u>279</u>	<u>284</u>	<u>202</u>
	<u>2,801</u>	<u>2,849</u>	<u>2,029</u>

### ii Annuity business

Prudential’s conventional annuities include level, fixed increase and retail price index (RPI) annuities. They are mainly written within the subsidiaries PAL, PRIL, Prudential Pensions Limited and the PAC with-profits sub-fund, but there are some annuity liabilities in the non-profit sub-fund and SAIF.

Prudential's fixed-increase annuities incorporate automatic increases in annuity payments by fixed amounts over the policyholder's life. The RPI annuities that the Prudential Group offers provide for a regular annuity payment to which an additional amount is added periodically based on the increase in the UK RPI.

Prudential's with-profits annuities, which are written in the WPSF, combine the income features of annuity products with the investment smoothing features of with-profits products and enable policyholders to obtain exposure to investment return on the WPSF's equity shares, property and other investment categories over time. Policyholders select an 'anticipated bonus' from the specific range the Prudential Group offers for the particular product. The amount of the annuity payment each year depends upon the relationship between the anticipated bonus rate selected by the policyholder when the product is purchased and the bonus rates the Prudential Group subsequently declares each year during the term of the product. If the total bonus rates fall below the anticipated rate, then the annuity income falls.

At 31 December 2007, 31 December 2008 and 31 December 2009, £29.5 billion, £29.4 billion and £32.3 billion, respectively, of investments relate to annuity business of PAL and PRIL. These investments are predominantly in debt securities (including retail price index-linked bonds to match retail price index-linked annuities), loans and deposits and are duration matched with the estimated duration of the liabilities they support.

### *iii SAIF*

SAIF is a ring-fenced sub-fund of the PAC long-term fund formed following the acquisition of the mutually owned Scottish Amicable Life Assurance Society in 1997. No new business may be written in SAIF, although regular premiums are still being paid on policies in-force at the time of the acquisition and incremental premiums are permitted on these policies.

The fund is solely for the benefit of policyholders of SAIF. Shareholders have no interest in the profits of this fund although they are entitled to asset management fees on this business.

The process for determining policyholder bonuses of SAIF with-profits policies, which constitute the vast majority of obligations of the funds, is similar to that for the with-profits policies of the WPSF. However, in addition, the surplus assets in SAIF are allocated to policies in an orderly and equitable distribution over time as enhancements to policyholder benefits i.e. in excess of those based on asset share.

Provision is made for the risks attaching to some SAIF unitised with-profits policies that have MVR-free dates and for those SAIF products which have a guaranteed minimum benefit on death or maturity of premiums accumulated at 4% per annum.

The Prudential Group's main exposure to guaranteed annuities in the UK is through SAIF and a provision of £563 million, £391 million, and £284 million was held in SAIF at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, to honour the guarantees. As SAIF is a separate sub-fund solely for the benefit of policyholders of SAIF this provision has no impact on the financial position of the Prudential Group's shareholders' equity.

### *iv Unit-linked (non-annuity) and other non-profit business*

The Prudential Group's UK insurance operations also have an extensive book of unit-linked policies of varying types and provide a range of other non-profit business such as credit life and protection contracts. These contracts do not contain significant financial guarantees.

There are no guaranteed maturity values or guaranteed annuity options on unit-linked policies except for minor amounts for certain policies linked to cash units within SAIF.

### *e Exposure to market risk*

#### *i Non-linked life and pension business*

For with-profits business, the absence of guaranteed surrender values and the flexibility given by the operation of the bonus system means that a high proportion of the investments backing the with-profits business are in equities and real estate with the balance in debt securities, deposits and loans.

The investments supporting the protection business are small in value and tend to be assets with a fixed term duration reflecting the guaranteed nature of the liabilities.

## *ii Pension annuity business*

Prudential's UK annuity business mainly employs fixed income investments (including UK retail price index-linked assets) because the liabilities consist of guaranteed payments for as long as each annuitant or surviving partner is alive. Retail price index-linked assets are used to back pension annuities where the payments are linked to the RPI.

## *iii Unit-linked business*

Except through the second order effect on asset management fees, the unit-linked business of the UK insurance operations is not exposed to market risk. The lack of exposure arises from the contract nature whereby policyholder benefits reflect asset value movements of the unit-linked funds.

## *f Process for setting assumptions and determining contract liabilities*

### *i Overview*

The calculation of the contract liabilities involves the setting of assumptions for future experience. This is done following detailed review of the relevant experience including, in particular, mortality, expenses, tax, economic assumptions and where applicable, persistency.

For with-profits business written in the WPSF or SAIF, a market consistent valuation is performed (as described in section (ii) below). Additional assumptions required are for persistency and the management actions under which the fund is managed. Assumptions used for a market consistent valuation typically do not contain margins, whereas those used for the valuation of other classes of business do.

Mortality assumptions are set based on the results of the most recent experience analysis looking at the experience over recent years of the relevant business. For non-profit business, a margin for adverse deviation is added. Different assumptions are applied for different product groups. For annuitant mortality, assumptions for current mortality rates are based on recent experience investigations and expected future improvements in mortality. The expected future improvements are based on recent experience and projections of the business and industry experience generally.

Maintenance and, for some classes of business, termination expense assumptions are expressed as per policy amounts. They are set based on the expenses incurred during the year, including an allowance for ongoing investment expenditure and allocated between entities and product groups in accordance with the operation's internal cost allocation model. For non-profit business a margin for adverse deviation is added to this amount. Expense inflation assumptions are set consistent with the economic basis and based on the difference between yields on nominal gilts and index-linked gilts.

The actual renewal expenses charged to SAIF continued to be based on the tariff arrangement specified in the Scottish Amicable Life Assurance Society Scheme up to 31 December 2007, when the tariff arrangement terminated. This provided an additional margin in SAIF as the unit costs derived from actual expenses (and used to derive the recommended assumptions) were generally significantly greater than the tariff costs.

From 1 January 2008 when the previous tariff arrangement terminated, the actual renewal expenses incurred on behalf of SAIF by other group companies are recharged in full to SAIF.

The assumptions for asset management expenses are based on the charges specified in agreements with the Prudential Group's asset management operations, plus a margin for adverse deviation for non-profit business.

Tax assumptions are set equal to current rates of taxation.

For non-profit business excluding unit-linked business, the valuation interest rates used to discount the liabilities are based on the yields as at the valuation date on the assets backing the technical provisions. For fixed interest securities the gross redemption yield is used except for the PAL and PRIL annuity business where the internal rate of return of the assets backing the liabilities is used. Properties are valued using the rental yield, and for equities it is the greater of the dividend yield and the average of the dividend yield and the earnings yield. An adjustment is made to the yield on non risk-free fixed interest securities and property to reflect credit risk. To calculate the non-unit reserves for linked business, assumptions have been set for the gross unit growth rate and the rate of inflation of maintenance expenses, as well as for the valuation interest rate as described above.

## *ii WPSF and SAIF*

The policyholder liabilities reported for the WPSF are primarily for two broad types of business. These are accumulating and conventional with-profits contracts. The policyholder liabilities of the WPSF are accounted for under FRS 27.

The provisions have been determined on a basis consistent with the detailed methodology included in regulations contained in the FSA's rules for the determination of reserves on the FSA's 'realistic' Peak 2 basis. In aggregate, the regime has the effect of placing a value on the liabilities of UK with-profits contracts, which reflects the amounts expected to be paid based on the current value of investments held by the with-profits funds and current circumstances. These contracts are a combination of insurance and investment contracts with discretionary participation features, as defined by IFRS 4.

The FSA's Peak 2 calculation under the realistic regime requires the value of liabilities to be calculated as:

- The with-profits benefits reserve (WPBR); plus
- future policy related liabilities (FPRL); plus
- the realistic current liabilities of the fund.

The WPBR is primarily based on the retrospective calculation of accumulated asset shares but is adjusted to reflect future expected policyholder benefits and other outgoings. Asset shares are calculated as the accumulation of all items of income and outgo that are relevant to each policy type. Income comprises credits for premiums, investment returns (including unrealised gains), and miscellaneous profits. Outgo comprises charges for tax (including an allowance for tax on unrealised gains), guarantees and smoothing, mortality and morbidity, shareholders' profit transfers, miscellaneous losses, and expenses and commission (net of any tax relief).

The FPRL must include a market consistent valuation of costs of guarantees, options and smoothing, less any related charges, and this amount must be determined using either a stochastic approach, hedging costs or a series of deterministic projections with attributed probabilities.

The assumptions used in the stochastic models are calibrated to produce risk-free returns on each asset class. Volatilities of, and correlations between, investment returns from different asset classes are as determined by the Prudential Group's Portfolio Management Group and aim to be market consistent.

The cost of guarantees, options and smoothing is very sensitive to the bonus, market value reduction (MVR), and investment policy employed and therefore the stochastic modelling incorporates a range of management actions that would help to protect the fund in adverse investment scenarios. Substantial flexibility has been included in the modelled management actions in order to reflect the discretion that is retained in adverse investment conditions, thereby avoiding the creation of unreasonable minimum capital requirements. The management actions assumed are consistent with the Prudential Group's management policy for with-profits funds and the Prudential Group's disclosures in the publicly available PPFM.

The contract liabilities for with-profits business also require assumptions for persistency. These are set based on the results of recent experience analysis.

## *iii Annuity business*

### **Credit risk provisions**

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 for discounting projected future annuity payments to policyholders that would have otherwise applied. Since mid-2007 there has been a significant increase in the actual and perceived credit risk associated with corporate bonds as reflected in the significant widening that has occurred in corporate bond spreads. Although bond spreads over swap rates have narrowed from their peak in March 2009, they are still high compared with the levels seen in the years immediately preceding the start of the dislocated markets in 2007. The allowance that should therefore be made for credit risk remains a particular area of judgement.

The additional yield received on corporate bonds relative to swaps can be broken into the following constituent parts:

- the expected level of future defaults;
- the credit risk premium that is required to compensate for the potential volatility in default levels; and
- the liquidity premium that is required to compensate for the lower liquidity of corporate bonds relative to swaps.

The credit risk allowance is a function of the asset mix and the credit quality of the underlying portfolio. At 31 December 2008 and 2009, respectively, 75 and 80% of the assets backing the shareholder annuity and other business were debt securities as shown in D2(a). This comprises both government and corporate bonds. Government bonds are generally given a credit default allowance of zero. For corporate bonds the credit allowance varies by credit rating. An analysis of the credit ratings of debt securities is included in note D2(c).

Given that the normal business model for Prudential's annuity business is to hold bonds to match long-term liabilities, the valuation rate that is applied includes a liquidity premium that reflects the residual element of current bond spreads over swap rates after providing for the credit risk.

Historically, until the second half of 2007, when corporate bond spreads widened significantly, the allowance for credit risk was calculated as the long-term expected defaults and a long-term credit risk premium. This long-term credit risk was supplemented by a short-term allowance from 31 December 2007 to allow for the concern that credit ratings applied by the rating agencies may be downgraded and defaults in the short term might be higher than the long-term assumptions.

The weighted components of the bond spread over swap rates for shareholder-backed fixed and linked annuity business for PRIL at 31 December 2007, 31 December 2008 and 31 December 2009 based on the asset mix at the relevant balance sheet date are as follows:

	<b>2007</b>		
	<b>Pillar 1 Regulatory basis (bps)</b>	<b>Adjustment from regulatory to IFRS basis (bps)</b>	<b>IFRS (bps)</b>
Bond spread over swap rates <sup>(note i)</sup> . . . . .	<u>76</u>	—	<u>76</u>
Credit risk allowance			
Long-term expected defaults <sup>(note ii)</sup> . . . . .	13	—	13
Long-term credit risk premium <sup>(note iii)</sup> . . . . .	10	(3)	7
Short-term allowance for credit risk <sup>(note iv)</sup> . . . . .	<u>10</u>	<u>(10)</u>	—
Total credit risk allowance . . . . .	<u>33</u>	<u>(13)</u>	<u>20</u>
Liquidity premium . . . . .	<u>43</u>	<u>13</u>	<u>56</u>
	<b>2008</b>		
	<b>Pillar 1 Regulatory basis (bps)</b>	<b>Adjustment from regulatory to IFRS basis (bps)</b>	<b>IFRS (bps)</b>
Bond spread over swap rates <sup>(note i)</sup> . . . . .	<u>323</u>	—	<u>323</u>
Credit risk allowance			
Long-term expected defaults <sup>(note ii)</sup> . . . . .	15	—	15
Long-term credit risk premium <sup>(note iii)</sup> . . . . .	11	—	11
Short-term allowance for credit risk <sup>(note iv)</sup> . . . . .	<u>54</u>	<u>(25)</u>	<u>29</u>
Total credit risk allowance . . . . .	<u>80</u>	<u>(25)</u>	<u>55</u>
Liquidity premium . . . . .	<u>243</u>	<u>25</u>	<u>268</u>

	2009		
	Pillar 1 Regulatory basis (bps)	Adjustment from regulatory to IFRS basis (bps)	IFRS (bps)
Bond spread over swap rates <sup>(note i)</sup> . . . . .	175	—	175
Credit risk allowance			
Long-term expected defaults <sup>(note ii)</sup> . . . . .	19	—	19
Long-term credit risk premium <sup>(note iii)</sup> . . . . .	13	—	13
Short-term allowance for credit risk <sup>(note iv)</sup> . . . . .	39	(24)	15
Total credit risk allowance . . . . .	71	(24)	47
Liquidity premium . . . . .	104	24	128

#### Notes

- i Bond spread over swap rates reflect market observed data.
- ii Long-term expected defaults are derived by applying Moody's data from 1970 to 2004 uplifted by between 100% (B) and 200% (AAA) according to credit rating on the annuity asset portfolio. The credit rating assigned to each asset held is based on external credit rating and for this purpose the credit rating assigned to each asset held is the lowest credit rating published by Moody's, Standard and Poors and Fitch.
- iii The long-term credit risk premium provides compensation against the risk of potential volatility in the level of defaults and is derived by applying the 95th percentile from Moody's data from 1970 to 2004 to the annuity asset portfolio.
- iv During the second half of 2007, corporate bond spreads widened significantly and the methodology was reviewed to ensure that it still made appropriate allowance for credit risk. As a result of this review a short-term allowance for credit risk was established in the Pillar 1 reserves at 31 December 2007 to allow for the concern that credit ratings applied by rating agencies to individual bonds might be over optimistic and that default experience in the short-term might be higher than the long-term assumptions.

The short-term allowance for credit risk assumed in the Pillar 1 solvency valuations at 31 December 2007 and 31 December 2008 were determined as 25% of the increase in corporate bond spreads (as estimated from the movements in published corporate bond indices) since 31 December 2006.

The very prudent Pillar 1 regulatory basis reflects the overriding objective of ensuring sufficient provisions and capital to ensure payments to policyholders can be made. The approach for IFRS, on the other hand, aims to establish liabilities that are closer to 'best estimate'. In years prior to 2008 long-term IFRS default assumptions had been set mid-way between the EEV and Pillar 1 assumptions. At 31 December 2008, in light of the increased uncertainty surrounding future credit default experience, the IFRS long-term assumptions were strengthened to bring them into line with the long-term Pillar 1 default assumptions. In addition a short-term allowance for credit risk was established but at a lower level than allowed for in the Pillar 1 regulatory basis.

#### *Factors affecting the credit risk allowance at 31 December 2009*

The main factors influencing the credit risk allowance at 31 December 2009 are as follows:

##### a) Credit downgrades and default experience

As highlighted above, the short term allowance at 31 December 2008 was intended to cover both short term credit downgrades and losses in excess of the longer term expectations. Downgrades in 2009 have been within the opening Pillar 1 assumptions and hence the increase in the long term allowance as a result of credit downgrades has been offset by an equal decrease in the short term allowance. Defaults for the UK shareholder-backed annuity business totaled £11 million during 2009, below the amount allowed for within the short term allowance. The allowance (in bps terms) has been adjusted to eliminate any experience profits that would have otherwise arisen.

##### b) Asset trading in relation to subordinated financial debt

During the second half of 2009, the Prudential Group decided to trade out of subordinated financial debt into higher quality assets. This resulted in a gross transaction loss arising from the lower expected yield on the newly purchased assets. The reduction in subordinated financial debt holdings improved the overall credit quality of the corporate bond portfolio and so allowed a release of long-term credit reserves to offset this loss. In addition the allowance for the short-term defaults above has been notionally allocated to the highest yielding assets and so the allowance attaching to the subordinated debt sold has also been released.

On a Pillar 1 basis this transaction had no overall impact on the solvency surplus of PRIL, the PAC non-participating sub-fund and PAL. On an IFRS basis, a lower short-term default reserve was held at 31 December 2008 and the release of the reserves in respect of the subordinated debt is therefore lower. Overall the reduction in subordinated financial debt holdings generated a pre-tax IFRS operating loss of £51 million.

c) Asset purchases in respect of new business

The assets purchased during 2009 to back new business have been of better average credit quality than the assets held at 31 December 2008, in particular no subordinated bank debt or sub-investment grade assets have been bought to back new business. As a result of the lower credit risk of the new business assets, the overall allowance for credit risk required at 31 December 2009 is reduced when the new business assets and in-force assets are aggregated together.

d) Overall impact on the PRIL credit risk allowance

After taking account of the factors noted above the movement on the average basis points allowances for PRIL on the Pillar 1 regulatory and IFRS bases are as follows:

	Pillar 1 Regulatory basis (bps)			IFRS (bps)		
	Long term	Short term	Total	Long term	Short term	Total
Total allowance for credit risk at 31 December 2008.....	26	54	80	26	29	55
Credit downgrades .....	14	(14)	—	14	(14)	—
Retention of surplus from favourable default experience .....	—	5	5	—	1	1
Asset trading .....	(8)	(4)	(12)	(8)	(1)	(9)
New business .....	—	(2)	(2)	—	(1)	(1)
Other .....	—	—	—	—	<u>1</u>	<u>1</u>
<b>Total allowance for credit risk at 31 December 2009.....</b>	<b><u>32</u></b>	<b><u>39</u></b>	<b><u>71</u></b>	<b><u>32</u></b>	<b><u>15</u></b>	<b><u>47</u></b>

Overall this has led to the credit allowance for Pillar 1 purposes to be 41% (2008: 25%) of the bond spread over swap rates. For IFRS purposes it represents 27% of the bond spread over swap rates (2008: 17%).

## Mortality

The mortality assumptions are set in light of recent population and internal experience. The assumptions used are percentages of standard actuarial mortality tables with an allowance for future mortality improvements. Where annuities have been sold on an enhanced basis to impaired lives an additional age adjustment is made. The percentages of the standard table used are selected according to the source of business. The range of percentages used is set out in the following tables:

2007	PAL		PRIL	
	Males	Females	Males	Females
In payment	106% — 126% PNMA00 (C = 2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	84% — 117% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120	99% — 114% PNMA00 (C = 2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	85% — 103% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120
In deferment	AM92 minus 4 years	AF92 minus 4 years	AM92 minus 4 years	AF92 minus 4 years

<b>2008</b>	<b>PAL</b>		<b>PRIL</b>	
	<b>Males</b>	<b>Females</b>	<b>Males</b>	<b>Females</b>
In payment	102% — 126% PNMA00 (C = 2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	84% — 117% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120	97% — 102% PNMA00(C = 2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	88% — 98% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120
In deferment	AM92 minus 4 years	AF92 minus 4 years	AM92 minus 4 years	AF92 minus 4 years
<b>2009</b>	<b>PAL</b>		<b>PRIL</b>	
	<b>Males</b>	<b>Females</b>	<b>Males</b>	<b>Females</b>
In payment	102% — 126% PNMA00 (C = 2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	84% — 117% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120	96% — 102% PNMA00(C = 2000) with medium cohort improvement table with a minimum annual improvement of 2.25% up to age 90, tapering to zero at age 120	87% — 98% PNFA00 (C = 2000) with 75% of medium cohort improvement table with a minimum annual improvement of 1.25% up to age 90, tapering to zero at age 120
In deferment	AM92 minus 4 years	AF92 minus 4 years	AM92 minus 4 years	AF92 minus 4 years

*iv Unit-linked (non-annuity) and other non-profit business*

The majority of other long-term business written in the UK insurance operations is unit-linked business or other business with similar features. For these contracts the attaching liability reflects the unit value obligation and provision for expenses and mortality risk. The latter component is determined by applying mortality assumptions on a basis that is appropriate for the policyholder profile.

For unit-linked business, the assets covering unit liabilities are exposed to market risk, but the residual risk when considering the unit-linked liabilities and assets together is limited to the effect on fund-based charges.

For those contracts where the level of insurance risk is insignificant the assets and liabilities arising under the contracts are distinguished between those that relate to the financial instrument liability and acquisition costs and deferred income that relate to the component of the contract that relates to investment management. Acquisition costs and deferred income are recognised consistent with the level of service provision in line with the requirements of IAS 18.

*g Reinsurance*

The Prudential Group's UK insurance business cedes only minor amounts of business outside the Prudential Group. Reinsurance premiums for externally ceded business were £59 million, £61 million and £122 million for 2007, 2008 and 2009 respectively and reinsurance recoverable insurance assets were £335 million, £416 million and £502 million in aggregate, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. This resulted in a one-off benefit of £34 million to IFRS profit before tax. The gains and losses recognised in profit and loss for these contracts were immaterial.

*h Effect of changes in assumptions used to measure insurance assets and liabilities*

**2007**

For UK insurance operations, the 2007 results were determined after making changes to mortality assumptions for the annuity business and other assumptions for the WPSF and releasing excess margins in the aggregate liabilities that had previously been set aside as an indirect extra allowance for longevity related risks, as shown below.

	<b>2007</b>	
	<b>With-profits sub-fund</b>	<b>Shareholder- backed business</b>
	<b>£m</b>	<b>£m</b>
Effect of (strengthening) weakening of mortality assumptions <sup>(note a)</sup> . . . . .	(435)	(276)
Modelling of management actions <sup>(note b)</sup> . . . . .	(167)	—
Strengthening of other assumptions <sup>(note c)</sup> . . . . .	<u>(62)</u>	<u>—</u>
	(664)	(276)
Release of other margins:		
Projected benefit related <sup>(note d)</sup> . . . . .	13	104
Investment related: <sup>(note e)</sup>		
Default margins . . . . .	199	48
Asset management fees . . . . .	<u>60</u>	<u>—</u>
	259	48
Expense related <sup>(note c,f)</sup> . . . . .	—	68
Other <sup>(note c,g)</sup> . . . . .	<u>—</u>	<u>90</u>
	<u>272</u>	<u>310</u>
Net charge to unallocated surplus . . . . .	<u>(392)</u>	<u>—</u>
Net credit to shareholder result . . . . .	<u>—</u>	<u>34</u>

**Notes**

- a The mortality assumptions have been strengthened by increasing the minimum level of future improvement rate.
- b Given the continuing strong financial position of the fund, the assumed management actions relating to with-profits business have been revised in order to better reflect the benefits to policyholders that can be supported by the fund.
- c The effects of the strengthening of other assumptions for the WPSF of £62 million is net of a release of PAL's expense reserve of £11 million and other additional margins in PAL's liabilities of £40 million.
- d The release of projected benefit related margins primarily relates to modelling improvements that have been made during 2007.
- e The release of investment-related margins includes £48 million in respect of default margins for shareholder-backed business and £199 million for PAL. The resulting assumptions for expected defaults, after allowing for the release of margins, remain appropriate given economic conditions at 31 December 2007. In addition, for PAL, there is a release of £60 million in respect of asset management fees.
- f A release of expense reserves has been made following recent expense reductions.
- g This amount reflects the release of other additional margins in the liabilities that are no longer appropriate in light of the explicit strengthening of the mortality assumptions.

**2008**

**Mortality**

Overall mortality experience was in line with expectations and no change was therefore required to the overall strength of mortality assumptions at 31 December 2008. However, mortality assumptions were rebalanced across different categories of business so as to more closely align to the actual experience of each product category. The overall effect of rebalancing the assumptions between different product groups was financially neutral.

**Credit risk**

In total, for 2008, the effect of changes to the allowance for credit risk and the effect of portfolio rebalancing gave rise to a charge of £23 million. For shareholder-backed annuity and lifetime mortgage business, the operating profit based on longer-term investment returns included a charge of £413 million for the additional credit risk allowance for the annuity portfolio as a whole. Partially offsetting this was £390 million for the impact of £2.8 billion of portfolio rebalancing to more closely align management benchmark. The credit reflecting the additional yield expected after allowing for additional credit risk arising from the rebalancing.

## Aggregate effect of assumptions changes

For UK insurance operations, the effects of assumptions changes for 2008 were as follows:

	<b>2008</b>	
	<b>With-profits sub-fund</b>	<b>Shareholder- backed business</b>
	<b>£m</b>	<b>£m</b>
Effect of (strengthening) weakening of mortality assumptions . . . . .	(60)	(4)
Modelling of management actions (note a) . . . . .	421	—
(Strengthening) weakening of other assumptions . . . . .	<u>75</u>	<u>—</u>
	436	(4)
Release of other margins:		
Projected benefit related . . . . .	10	10
Investment related:		
Additional credit default margins . . . . .	(369)	(note b)(413)
Deflation risk margins . . . . .	(30)	(32)
Expense related . . . . .	<u>36</u>	<u>(8)</u>
Net credit to unallocated surplus . . . . .	<u>83</u>	<u>—</u>
Net charge to shareholder result . . . . .		<u><u>(447)</u></u>

### Notes

- a The £421 million credit for modelling of management actions relates primarily to enhancements for actions in the event of solvency distress scenarios.
- b Net of additional credit risk allowance attaching to effect of portfolio balancing described above.
- c In 2008, no changes to mortality assumptions were made or necessary.

## 2009

### Mortality

Recent mortality has been in line with expectations and no change is therefore required to the overall strength of mortality assumptions at 31 December 2009.

### Credit risk

The approach for reserving for credit risk is set out in note (f)(iii).

## Aggregate effect of assumptions changes

For UK insurance operations, the effects of assumptions changes for 2009 were as follows:

	<b>2009</b>	
	<b>With-profits sub-fund note a</b>	<b>Shareholder- backed business note b</b>
	<b>£m</b>	<b>£m</b>
Effect of changing expense assumptions for the with-profits sub-fund . . . . .	51	(9)
Release of investment-related margins:		
Deflation risk margins . . . . .	—	32
Asset management fees . . . . .	—	14
Weakening of other assumptions . . . . .	<u>14</u>	<u>9</u>
Net credit to unallocated surplus . . . . .	<u>65</u>	<u>—</u>
Net credit to shareholder result . . . . .		<u><u>46</u></u>

### Notes

- a Charges and expenses of the with-profits sub-fund have been updated to reflect the experience in 2009. The changes vary by product and the overall impact is a £51 million credit.
- b The assumption changes in 2009 for the shareholder-backed business primarily relate to changes to the deflation reserve, expense assumptions and modelling changes.

*i Sensitivity of IFRS basis profit or loss and equity to market and other risks*

The risks to which the IFRS basis results of the UK insurance operations are sensitive are asset/liability matching, mortality experience and payment assumptions for shareholder-backed annuity business. Further details are described below.

*i With-profits business*

**SAIF**

Shareholders have no interest in the profits of SAIF but are entitled to the asset management fees paid on the assets of the fund.

**With-profits sub-fund business**

For with-profits business (including non-participating business of PAL which is owned by the WPSF) adjustments to liabilities and any related tax effects are recognised in the income statement. However, except for any impact on the annual declaration of bonuses, shareholders' profit for with-profits business is unaffected. This is because IFRS basis profits for with-profits business, which are determined on the same basis as on preceding UK GAAP, solely reflect one-ninth of the cost of bonuses declared for the year.

The main factors that influence the determination of bonus rates are the return on the investments of the fund, the effect of inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. Mortality and other insurance risk are relatively minor factors.

Unallocated surplus represents the excess of assets over policyholder liabilities of the fund. As unallocated surplus of the WPSF is recorded as a liability, movements in its value do not affect shareholders' profits or equity.

The level of unallocated surplus is particularly sensitive to the level of investment returns on the portion of the life fund assets that represents the surplus. The effects for 2007, 2008 and 2009 are demonstrated in note D5.

*ii Shareholder-backed annuity business*

Profits from shareholder-backed annuity business are most sensitive to:

- The extent to which the duration of the assets held closely matches the expected duration of the liabilities under the contracts. Assuming close matching, the impact of short-term asset value movements as a result of interest rate movements will broadly offset changes in the value of liabilities caused by movements in valuation rates of interest;
- actual versus expected default rates on assets held;
- the difference between long-term rates of return on corporate bonds and risk-free rates;
- the variance between actual and expected mortality experience;
- the extent to which expected future mortality experience gives rise to changes in the measurement of liabilities; and
- changes in renewal expense levels.

A decrease in assumed mortality rates of 1% would decrease gross profits by approximately £35 million, £35 million and £44 million, for 2007, 2008 and 2009 respectively. A decrease in credit default assumptions of five basis points would increase gross profits by £72 million, £71 million and £91 million, for 2007, 2008 and 2009 respectively. A decrease in renewal expenses (excluding asset management expenses) of 5% would increase gross profits by £13 million, £15 million and £17 million, for 2007, 2008 and 2009 respectively. The effect on profits would be approximately symmetrical for changes in assumptions that are directionally opposite to those explained above.

*iii Unit-linked and other business*

Unit-linked and other business represents a comparatively small proportion of the in-force business of the UK insurance operations.

Profits from unit-linked and similar contracts primarily arise from the excess of charges to policyholders, for management of assets under the Company's stewardship, over expenses incurred. The former is most sensitive to the net accretion of funds under management as a function of new business and lapse and timing of death. The accounting impact of the latter is dependent upon the amortisation of acquisition costs in line with the emergence of

margins (for insurance contracts) and amortisation in line with service provision (for the investment management component of investment contracts). By virtue of the design features of most of the contracts which provide low levels of mortality cover, the profits are relatively insensitive to changes in mortality experience.

*iv Shareholder exposure to interest rate risk and other market risk*

By virtue of the fund structure, product features and basis of accounting described in note D2(d) and (f), the policyholder liabilities of the UK insurance operations are, except for pension annuity business, not generally exposed to interest rate risk. For pension annuity business, liabilities are exposed to fair value interest rate risk. However, the net exposure to the PAC WPSF (for PAL) and shareholders (for liabilities of PRIL and the non-profit sub-fund) is very substantially ameliorated by virtue of the close matching of assets with appropriate duration. The level of matching from period to period can vary depending on management actions and economic factors so it is possible for a degree of mis-matching profits or losses to arise.

The close matching by the Prudential Group of assets of appropriate duration to annuity liabilities is based on maintaining economic and regulatory capital. The measurement of liabilities under capital reporting requirements and IFRS is not the same, with contingency reserves and some other margins for prudence within the assumptions required under the FSA regulatory solvency basis not included for IFRS reporting purposes. As a result IFRS equity is higher than regulatory capital and therefore more sensitive to interest rate risk.

The estimated sensitivity of the UK non-linked shareholder-backed business (principally pension annuities business) to a movement in interest rates is as follows.

	2007		2008		2009		2007		2008		2009	
	A decrease of 1%	An increase of 1%	A decrease of 2%	A decrease of 1%	An increase of 1%	An increase of 2%	A decrease of 2%	A decrease of 1%	An increase of 1%	An increase of 2%	A decrease of 2%	A decrease of 1%
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Carrying value of debt												
securities and derivatives . . .	1,930	(1,634)	4,362	1,983	(1,676)	(3,108)	5,372	2,422	(2,020)	(3,731)		
Policyholder liabilities . . . . .	(1,777)	1,467	(3,974)	(1,798)	1,503	2,773	(5,125)	(2,304)	1,905	3,498		
Related deferred tax effects . .	(43)	47	(109)	(52)	48	94	(69)	(33)	32	65		
Net sensitivity of profit after tax and shareholders'												
equity . . . . .	110	(120)	279	133	(125)	241	178	85	(83)	(168)		

In addition the shareholder-backed portfolio of UK non-linked insurance operations covering liabilities and shareholders' equity includes equity securities and investment property. Excluding any second order effects on the measurement of the liabilities for future cash flow to the policyholder, a fall in their value would have given rise to the following effects on pre-tax profit, profit after tax, and shareholders' equity.

	2007	2008		2009	
	A decrease of 10%	A decrease of 40%	A decrease of 20%	A decrease of 10%	A decrease of 20%
	£m	£m	£m	£m	£m
Pre-tax profit . . . . .	(86)	(508)	(254)	(127)	(292)
Related deferred tax assets . . . . .	24	142	71	35	82
Net sensitivity of profit after tax and shareholders' equity . . . . .	(62)	(366)	(183)	(92)	(210)

A 10%, 20% or 40% increase in their value would have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The market risk sensitivities shown above reflect the impact of temporary market movements and, therefore, the primary effect of such movements would, in the Prudential Group's segmental analysis of profits, be included within the short-term fluctuations in investment returns. The disclosure of the effect of a 40% fall for the 2008 year end was included because of the exceptional market conditions at that time. These conditions have now abated and the disclosure is no longer appropriate.

In the equity risk sensitivity analysis given above the Prudential Group has, for 2009, considered the impact of an instantaneous 20% fall in equity markets. If equity markets were to fall by more than 20%, the Prudential Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Prudential Group would be able to put in place mitigating management actions.

j Duration of liabilities

With the exception of most unitised with-profits bonds and other whole of life contracts the majority of the contracts of the UK insurance operations have a contract term. However, in effect, the maturity term of contracts reflects the earlier of death, maturity, or lapsation. In addition, with-profit contract liabilities as noted in note D2(f) include projected future bonuses based on current investment values. The actual amounts payable will vary with future investment performance of SAIF and the WPSF.

The tables below show the carrying value of the policyholder liabilities. Separately, the Prudential Group uses cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing EEV basis results. The tables below also show the maturity profile of the cash flows used for 2007, 2008 and 2009 respectively, for that purpose for insurance contracts, as defined by IFRS, i.e. those containing significant insurance risk, and investment contracts, which do not.

2007 £m									
With-profits business				Annuity business (Insurance contracts)			Other		
Insurance contracts	Investment contracts	Total	PAL	PRIL	Total	Insurance contracts	Investment contracts	Total	Total
Policyholder liabilities . . . . .									
47,915	29,480	77,395	12,564	13,402	25,966	9,057	12,059	21,116	124,477
2007 %									
Expected maturity:									
0 to 5 years . . . . .	47	25	38	32	31	32	32	31	31
5 to 10 years . . . . .	27	23	26	24	23	24	23	22	23
10 to 15 years . . . . .	13	19	16	18	17	17	18	20	19
15 to 20 years . . . . .	7	15	10	12	12	12	12	13	12
20 to 25 years . . . . .	4	11	6	7	8	7	8	6	7
Over 25 years . . . . .	2	7	4	7	9	8	7	8	8
2008 £m									
With-profits business				Annuity business (Insurance contracts)			Other		
Insurance contracts	Investment contracts	Total	PAL	PRIL	Total	Insurance contracts	Investment contracts	Total	Total
Policyholder liabilities . . . . .									
39,010	23,367	62,377	11,477	12,513	23,990	9,756	11,584	21,340	107,707
2008 %									
Expected maturity:									
0 to 5 years . . . . .	47	26	38	30	29	29	31	32	32
5 to 10 years . . . . .	26	23	25	24	23	23	23	22	23
10 to 15 years . . . . .	13	19	15	18	17	18	18	18	18
15 to 20 years . . . . .	7	15	10	12	13	13	12	12	12
20 to 25 years . . . . .	4	11	7	8	8	8	8	7	7
Over 25 years . . . . .	3	6	5	8	10	9	8	9	8

	2009 £m									
	With-profits business				Annuity business (Insurance contracts)			Other		
	Insurance contracts	Investment contracts	Total	PAL	PRIL	Total	Insurance contracts	Investment contracts	Total	Total
Policyholder liabilities	40,780	24,780	65,560	11,969	14,292	26,261	10,614	13,794	24,408	116,229
<b>2009%</b>										
Expected maturity:										
0 to 5 years . . . . .	50	29	41	32	31	32	34	35	35	
5 to 10 years . . . . .	26	25	26	25	23	24	25	22	23	
10 to 15 years . . . . .	13	19	15	18	17	17	18	19	18	
15 to 20 years . . . . .	6	14	9	11	12	12	11	11	11	
20 to 25 years . . . . .	3	9	6	7	8	7	7	6	6	
Over 25 years . . . . .	2	4	3	7	9	8	5	7	7	

**Notes**

- i The cash flow projections of expected benefit payments used in the maturity profile tables above are from value of in-force business and exclude the value of future new business, including vesting of internal pension contracts.
- ii Benefit payments do not reflect the pattern of bonuses and shareholder transfers in respect of the with-profits business.
- iii Investment contracts under Other comprise certain unit-linked and similar contracts accounted for under IAS 39 and IAS 18.
- iv For business with no maturity term included within the contracts, for example with-profits investment bonds such as Prudence Bond, an assumption is made as to likely duration based on prior experience.
- v The maturity tables shown above have been prepared on a discounted basis. Details of undiscounted cash flow for investment contracts are shown in note G2.

**D3: US insurance operations**

*a Summary results and statement of financial position*

*i Results and movements on shareholders' equity*

	<u>2007</u> £m	<u>2008</u> £m	<u>2009</u> £m
Operating profit based on longer-term investment returns . . . . .	444	406	459
Short-term fluctuations in investment returns . . . . .	(18)	(1,058)	27
Profit (loss) before shareholder tax . . . . .	426	(652)	486
Tax . . . . .	(126)	72	102
Profit (loss) for the year . . . . .	<u>300</u>	<u>(580)</u>	<u>588</u>
	<u>2007</u> £m	<u>2008</u> £m	<u>2009</u> £m
Profit (loss) for the year . . . . .	300	(580)	588
Items recognised in other comprehensive income:			
Exchange movements . . . . .	(42)	545	(231)
Unrealised valuation movements on securities classified as available-for-sale:			
Unrealised holding (losses) gains arising during the year . . . . .	(231)	(2,482)	2,249
Less (gains) losses included in the income statement . . . . .	(13)	378	420
Total unrealised valuation movements . . . . .	(244)	(2,104)	2,669
Related change in amortisation of deferred income and acquisition costs . . . . .	88	831	(1,069)
Related tax . . . . .	54	442	(557)
Total other comprehensive income (loss) . . . . .	(144)	(286)	812
Total comprehensive income (loss) for the year . . . . .	156	(866)	1,400
Dividends and interest payments to Central companies . . . . .	(122)	(126)	(87)
Net increase (decrease) in equity . . . . .	34	(992)	1,313
Shareholders' equity at beginning of year . . . . .	<u>2,656</u>	<u>2,690</u>	<u>1,698</u>
Shareholders' equity at end of year . . . . .	<u>2,690</u>	<u>1,698</u>	<u>3,011</u>

Included within the movements in shareholders' equity is a net reduction in value of Jackson's debt securities classified as 'available-for-sale' under IAS 39 of £244 million, and £2,104 million for 2007 and 2008 respectively, and a net increase in value of £2,669 million for 2009.

With the exception of debt securities for US insurance operations classified as 'available-for-sale' under IAS 39, unrealised value movements on the Prudential Group's investments are booked within the income statement. However, for debt securities classified as "available-for-sale", unless impaired, fair value movements are recognised in other comprehensive income. Realised gains and losses, including impairments, are recorded in the income statement. This classification is applied for most of the debt securities of the Prudential Group's US operations. Jackson recorded £35 million, £497 million and £630 million, for 2007, 2008 and 2009 respectively, of impairment losses arising from:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Residential mortgage-backed securities . . . . .	—	167	509
Public fixed income . . . . .	21	311	91
Other . . . . .	<u>14</u>	<u>19</u>	<u>30</u>
	<u>35</u>	<u>497</u>	<u>630</u>

Further details on the impairment losses recognised in the year are shown in note B1. Jackson's portfolio of debt securities is managed proactively with credit analysts closely monitoring and reporting on the credit quality of its holdings. Jackson continues to review its investments on a case-by-case basis to determine whether any decline in fair value represents an impairment. In addition, investment in structured securities where market prices are depressed are subject to a rigorous review of their future estimated cash flows, including expected and stress case scenarios, to identify potential shortfalls in contractual payments (both interest and principal). Impairment charges are recorded on structured securities when Prudential forecasts a contractual payment shortfall. Situations where such a short fall would not lead to recognition of a loss are rare. However, some structured securities do not have a single determined set of future cash flows and instead, there can be a reasonable range of estimates that could potentially emerge. With this variability, there could be instance where the projected cash flow shortfall under management's base case set of assumptions is so minor that relatively small and justifiable changes to the base case assumptions would eliminate the need for an impairment loss to be recognised. The impairment loss reflects the difference between the fair value and book value.

There was a movement in the statement of financial position value for debt securities classified as available-for-sale from a net unrealised gain of £110 million to a net unrealised loss of £136 million in 2007, a net unrealised loss of £136 million to a net unrealised loss of £2,897 million in 2008, and a net unrealised loss of £2,897 million to a net unrealised gain of £4 million, in 2009. The gross unrealised gain in the statement of financial position decreased from £303 million at 31 December 2007 to £281 million at 31 December 2008 then increased to £970 million at 31 December 2009 while the gross unrealised loss increased from £439 million at 31 December 2007 to £3,178 million at 31 December 2008 then decreased to £966 million at 31 December 2009. Details of the securities in an unrealised loss position are shown in D3(c) below.

These features are included in the table shown below of the movements in the values of available-for-sale securities:

	As at 31 December								
	2006	2007		2008			2009		
		Changes in unrealised appreciation†		Changes in unrealised appreciation†	Foreign exchange translation		Changes in unrealised appreciation†	Foreign exchange translation	
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets fair valued at below book value									
Book value*	11,258		10,730			20,600			8,220
Unrealised loss	(256)	(183)	(439)	(1,997)	(742)	(3,178)	1,925	287	(966)
Fair value (as included in statement of financial position)	<u>11,002</u>	<u>—</u>	<u>10,291</u>	<u>—</u>	<u>—</u>	<u>17,422</u>	<u>—</u>	<u>—</u>	<u>7,254</u>
Assets fair valued at or above book value									
Book value*	8,208		8,041			6,296			14,444
Unrealised gain	366	(63)	303	(107)	85	281	744	(55)	970
Fair value (as included in statement of financial position)	<u>8,574</u>	<u>—</u>	<u>8,344</u>	<u>—</u>	<u>—</u>	<u>6,577</u>	<u>—</u>	<u>—</u>	<u>15,414</u>
Total									
Book value*	19,466		18,771			26,896			22,664
Net unrealised (loss) gain	110	(246)	(136)	(2,104)	(657)	(2,897)	2,669	232	4
Fair value (as included in statement of financial position)**	<u>19,576</u>	<u>—</u>	<u>18,635</u>	<u>—</u>	<u>—</u>	<u>23,999</u>	<u>—</u>	<u>—</u>	<u>22,668</u>
Reflected as part of movement in other comprehensive income									
Movement in unrealised appreciation			(244)			(2,104)			2,669
Exchange movements			(2)			(657)			232
			(246)			(2,761)			2,901

\* Book value represents cost/amortised cost of the debt securities.

\*\* Debt securities for US operations as included in the statement of financial position of £19,002 million, £24,249 million and £22,831 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, comprise £18,635 million, £23,999 million and £22,668 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, in respect of securities classified as 'available-for-sale' and £367 million, £250 million, £163 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, for securities of consolidated investment funds classified as 'fair value through profit and loss'.

† Translated at closing rate of US\$2.00: £1 for 2007, the difference arising on exchange translation at 31 December 2007 between average and closing rate was not material. Translated at the average rate of US\$1.85: £1 and US\$1.57: £1, for 2008 and 2009 respectively.

Included within the movement in gross unrealised losses for the debt securities of Jackson of £183 million, £1,997 million and £1,925 million, for 2007, 2008 and 2009 respectively, as shown above was a value reduction of £55 million, £105 million and £72 million, for 2007, 2008 and 2009 respectively, relating to the sub-prime and Alt-A securities as referred to in section B6.

ii *Statement of financial position*

Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type.

**US insurance operations at 31 December:**

	<u>2007 Total</u> £m	<u>2008 Total</u> £m	Variable annuity separate account assets and liabilities note i £m	Fixed annuity, GIC and other business note i £m	<u>2009 Total</u> £m
<b>Assets</b>					
Intangible assets attributable to shareholders:					
Deferred acquisition costs and other intangible assets . . .	1,928	3,962	—	3,092	3,092
Total . . . . .	<u>1,928</u>	<u>3,962</u>	—	<u>3,092</u>	<u>3,092</u>
Deferred tax assets . . . . .	657	1,969	—	1,944	1,944
Other non-investment and non-cash assets . . . . .	994	1,819	—	1,404	1,404
Investments of long-term business and other operations:					
Investment properties . . . . .	8	13	—	33	33
Financial investments:					
Loans(note ii) . . . . .	3,258	5,121	—	4,319	4,319
Equity securities and portfolio holdings in unit trusts . . . . .	15,507	15,142	20,639	345	20,984
Debt securities(note D3c) . . . . .	19,002	24,249	—	22,831	22,831
Other investments(note iii) . . . . .	762	1,256	—	955	955
Deposits . . . . .	258	390	—	454	454
Total investments . . . . .	<u>38,795</u>	<u>46,171</u>	<u>20,639</u>	<u>28,937</u>	<u>49,576</u>
Properties held for sale . . . . .	—	—	—	3	3
Cash and cash equivalents . . . . .	169	246	—	340	340
Total assets . . . . .	<u>42,543</u>	<u>54,167</u>	<u>20,639</u>	<u>35,720</u>	<u>56,359</u>
<b>Equity and liabilities</b>					
<i>Equity</i>					
Shareholders' equity . . . . .	2,690	1,698	—	3,011	3,011
Minority interests . . . . .	1	—	—	—	—
Total equity . . . . .	<u>2,691</u>	<u>1,698</u>	—	<u>3,011</u>	<u>3,011</u>
<i>Liabilities</i>					
Policyholder liabilities:(note iv)					
Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) . . . . .					
	34,848	45,361	20,639	27,672	48,311
Total . . . . .	<u>34,848</u>	<u>45,361</u>	<u>20,639</u>	<u>27,672</u>	<u>48,311</u>
Core structural borrowings of shareholder-financed operations . . . . .					
	125	173	—	154	154
Operational borrowings attributable to shareholder-financed operations . . . . .					
	591	511	—	203	203
Deferred tax liabilities . . . . .	639	1,337	—	1,858	1,858
Other non-insurance liabilities . . . . .	3,649	5,087	—	2,822	2,822
Total liabilities . . . . .	<u>39,852</u>	<u>52,469</u>	<u>20,639</u>	<u>32,709</u>	<u>53,348</u>
Total equity and liabilities . . . . .	<u>42,543</u>	<u>54,167</u>	<u>20,639</u>	<u>35,720</u>	<u>56,359</u>

**Notes**

i Assets and liabilities attaching to variable annuity business that are not held in the separate account are shown within other business.

ii Loans

The loans of the Prudential Group's US insurance operations of £3,258 million, £5,121 million and £4,319 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, comprise mortgage loans of £2,841 million, £4,534 million and £3,774 million and policy loans of £417 million, £587 million and £530 million and other loans of nil, nil, and £15 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. All of the mortgage loans are commercial mortgage loans which are collateralised by properties. The

property types are mainly industrial, multi-family residential, suburban office, retail and hotel. The breakdown by property type as at 31 December is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	%	%	%
Industrial . . . . .	28	29	32
Multi-family . . . . .	23	21	18
Office . . . . .	22	21	20
Retail . . . . .	18	17	19
Hotels . . . . .	8	10	10
Other . . . . .	<u>1</u>	<u>2</u>	<u>1</u>
	<u>100</u>	<u>100</u>	<u>100</u>

The US insurance operations' commercial mortgage loan portfolio does not include any single-family residential mortgage loans and is therefore not exposed to the risk of defaults associated with residential sub-prime mortgage loans. The average loan size as at 31 December 2009 is £6.3 million. The portfolio has a current estimated average loan to value of 74% which provides significant cushion to withstand substantial declines in value.

The policy loans are fully secured by individual life insurance policies or annuity policies. These loans are accounted for at amortised cost, less any impairment.

iii Other investments as at 31 December comprise:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Derivative assets (note G3*) . . . . .	390	675	519
Partnerships in investment pools and other** . . . . .	<u>372</u>	<u>581</u>	<u>436</u>
	<u>762</u>	<u>1,256</u>	<u>955</u>

\* In the US, Prudential uses derivatives to reduce interest rate risk, to facilitate efficient portfolio management to match liabilities under annuity policies, and for certain equity-based product management activities. After taking account of the derivative liability of £158 million, £863 million and £461 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, which is also included in the statement of financial position, the derivative position for US operations is a net asset of £232 million, net liability of £188 million and a net asset of £58 million for as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

\*\* Partnerships in investment pools and other comprise primarily investments in limited partnerships. These include interest in the PPM America Private Equity Fund and diversified investments in 164, 157 and 159 other partnerships by independent money managers that generally invest in various equities and fixed income loans and securities as at 31 December 2007, 31 December 2008 and 31 December 2009, respectively.

iv Summary policyholder liabilities (net of reinsurance) and reserves at 31 December 2007, 31 December 2008 and 31 December 2009  
The policyholder liabilities, net of reinsurers' share of £436 million, £800 million and £667 million, reflect balances in respect of the following as at 31 December:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Policy reserves and liabilities on non-linked business:			
Reserves for future policyholder benefits and claims payable . . . . .	916	2,518	1,645
Deposits on investment contracts (as defined under US GAAP) . . . . .	16,784	24,962	23,706
Guaranteed investment contracts . . . . .	1,685	2,543	1,654
Unit-linked (variable annuity) business . . . . .	<u>15,027</u>	<u>14,538</u>	<u>20,639</u>
	<u>34,412</u>	<u>44,561</u>	<u>47,644</u>

In addition to the policyholder liabilities above, Jackson has entered into a programme of funding arrangements under contracts which, in substance, are almost identical to GICs. The liabilities under these funding arrangements totalled £2,607 million, £3,233 million and £1,444 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively and are included in 'other non-insurance liabilities' in the statement of financial position above.

*b Reconciliation of movement in policyholder liabilities*

A reconciliation of the total policyholder liabilities of US insurance operations from the beginning of the year to the end of the year is as follows:

	<b>Variable annuity separate account liabilities</b>	<b>Fixed annuity, GIC and other business</b>	<b>US insurance operations Total</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
At 1 January 2007 . . . . .	11,367	20,379	31,746
Premiums . . . . .	3,970	2,382	6,352
Surrenders . . . . .	(960)	(2,516)	(3,476)
Maturities/Deaths . . . . .	(92)	(398)	(490)
Net cash flows <sup>(note b)</sup> . . . . .	2,918	(532)	2,386
Investment-related items and other movements . . . . .	914	311	1,225
Foreign exchange translation differences <sup>(note a)</sup> . . . . .	(172)	(337)	(509)
At 31 December 2007/1 January 2008 . . . . .	15,027	19,821	34,848
Premiums . . . . .	2,637	4,091	6,728
Surrenders . . . . .	(1,053)	(2,799)	(3,852)
Maturities/Deaths . . . . .	(161)	(403)	(564)
Net cash flows <sup>(note b)</sup> . . . . .	1,423	889	2,312
Investment-related items and other movements . . . . .	(6,288)	1,736	(4,552)
Foreign exchange translation differences <sup>(note a)</sup> . . . . .	4,376	8,377	12,753
At 31 December 2008/1 January 2009 . . . . .	14,538	30,823	45,361
Premiums . . . . .	4,667	4,510	9,177
Surrenders . . . . .	(882)	(2,373)	(3,255)
Maturities/Deaths . . . . .	(199)	(534)	(733)
Net cash flows <sup>(note b)</sup> . . . . .	3,586	1,603	5,189
Transfers from general to separate account . . . . .	984	(984)	—
Investment-related items and other movements <sup>(note c)</sup> . . . . .	3,368	(382)	2,986
Foreign exchange translation differences <sup>(note a)</sup> . . . . .	(1,837)	(3,388)	(5,225)
At 31 December 2009 . . . . .	20,639	27,672	48,311

Notes

- (a) Movements in the year have been translated at an average rate of 1.99, 1.85 and 1.57, for 2007, 2008 and 2009 respectively. The closing balance has been translated at closing rate of 1.96, 1.44 and 1.61, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. Differences upon retranslation are included in foreign exchange translation differences.
- (b) Net cash flows for the year were £5,189 million compared with £2,312 million in 2008, driven largely by increased new business volumes for the variable annuity business.
- (c) Positive investment-related items and other movements in variable annuity separate account liabilities were impacted by the recovery of US equity markets during 2009. Negative movements in fixed annuity, GIC and other business of £382 million primarily represents a reduction in the liabilities for variable annuity guarantees following improvements in equity markets and increases in interest rates offset by interest credited to policyholder accounts.

**As at 31 December:**

	2007 Carrying value	2008 Carrying value	2009 Carrying value
	£m	£m	£m
Corporate security and commercial loans:			
Publicly traded and SEC Rule 144A traded . . . . .	10,345	13,198	13,338
Non-SEC Rule 144A traded . . . . .	<u>2,613</u>	<u>3,273</u>	<u>3,117</u>
Total . . . . .	12,958	16,471	16,455
Residential mortgage-backed securities . . . . .	3,177	4,509	3,316
Commercial mortgage-backed securities . . . . .	1,532	1,869	2,104
Other debt securities . . . . .	<u>1,335</u>	<u>1,400</u>	<u>956</u>
Total debt securities . . . . .	<u><u>19,002</u></u>	<u><u>24,249</u></u>	<u><u>22,831</u></u>

*i Credit quality*

For statutory reporting in the US, debt securities are classified into six quality categories specified by the Securities Valuation Office of the National Association of Insurance Commissioners (“NAIC”). The categories range from Class 1 (the highest) to Class 6 (the lowest). Performing securities are designated as Classes 1 to 5. Securities in or near default are designated Class 6. Securities designated as Class 3, 4, 5 and 6 are non-investment grade securities. Generally, securities rated AAA to A by nationally recognised statistical ratings organisations are reflected in Class 1, BBB in Class 2, BB in Class 3 and B and below in Classes 4 to 6. If a designation is not currently available from the NAIC, Jackson’s investment adviser, PPM America, provides the designation for the purposes of disclosure below.

The following table shows the quality of the SEC Rule 144A publicly traded placement portfolio by NAIC classifications at 31 December:

	2007		2008		2009	
	£m	Carrying value % of total	£m	Carrying value % of total	£m	Carrying value % of total
NAIC designation:						
1 . . . . .	4,338	42	5,380	41	5,067	38
2 . . . . .	5,194	50	6,849	52	7,508	56
3 . . . . .	542	5	690	5	598	5
4 . . . . .	231	2	200	1	122	1
5 . . . . .	40	1	75	1	40	—
6 . . . . .	—	—	4	—	3	—
	<u>10,345</u>	<u>100</u>	<u>13,198</u>	<u>100</u>	<u>13,338</u>	<u>100</u>

The following table shows the quality of the non-SEC Rule 144A traded private placement portfolio by NAIC classifications at 31 December:

	2007		2008		2009	
	£m	Carrying value % of total	£m	Carrying value % of total	£m	Carrying value % of total
NAIC designation:						
1 . . . . .	1,011	39	1,268	39	1,084	35
2 . . . . .	1,351	52	1,655	50	1,792	57
3 . . . . .	206	8	285	9	162	5
4 . . . . .	45	1	54	2	54	2
5 . . . . .	—	—	11	0	20	1
6 . . . . .	—	—	—	—	5	—
	<u>2,613</u>	<u>100</u>	<u>3,273</u>	<u>100</u>	<u>3,117</u>	<u>100</u>

Included within other debt securities of £1,335 million, £1,400 million and £956 million in the summary shown above are £706 million, £893 million and £652 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, of asset-backed securities held directly by Jackson. Of this balance £579 million, £663 million and £447 million were NAIC designation 1 and a further £127 million, £159 million and £152 million were NAIC designation 2 as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. In

addition, other debt securities includes £316 million, £257 million and £172 million in respect of securities held by the Piedmont trust entity and £313 million, £250 million and £131 million from the consolidation of investment funds managed by PPM America as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

In addition to the ratings disclosed above, the following table summarises by rating the debt securities, as at 31 December using Standard and Poor's ("S&P"), Moody's, Fitch and implicit ratings of RMBS based on NAIC valuations:

	2007 Carrying value	2008 Carrying value	2009 Carrying Value
	£m	£m	£m
S&P — AAA	3,896	5,321	3,287
S&P — AA+ to AA-	1,187	853	846
S&P — A+ to A-	3,657	5,244	5,192
S&P — BBB+ to BBB-	5,415	7,077	7,659
S&P — Other	1,113	1,321	895
	<u>15,268</u>	<u>19,816</u>	<u>17,879</u>
Moody's — Aaa	549	458	273
Moody's — Aa1 to Aa3	118	100	43
Moody's — A1 to A3	47	111	32
Moody's — Baa1 to Baa3	79	100	64
Moody's — Other	78	95	57
	<u>871</u>	<u>864</u>	<u>469</u>
Implicit ratings of RMBS based on NAIC valuations (see below)			
NAIC 1	—	—	747
NAIC 2	—	—	105
NAIC 3-6	—	—	473
	—	—	1,325
Fitch	380	464	281
Other	2,483	3,105	2,877
Total debt securities	<u>19,002</u>	<u>24,249</u>	<u>22,831</u>

In the table above, with the exception of residential mortgage-backed securities for 2009, S&P ratings have been used where available. For securities where S&P ratings are not immediately available, those produced by Moody's and then Fitch have been used as an alternative.

During 2009, the National Association of Insurance Commissioners ("NAIC") in the US revised the regulatory ratings process for more than 20,000 residential mortgage-backed securities. The table above includes these securities, where held by Jackson, using the regulatory rating levels established by an external third party (PIMCO).

The amounts within Other which are not rated by S&P, Moody's, Fitch nor are RMBS securities using the revised regulatory ratings have the following NAIC classifications as at 31 December:

	2007 £m	2008 £m	2009 £m
NAIC 1	1,079	1,334	1,102
NAIC 2	1,311	1,650	1,623
NAIC 3-6	93	121	152
	<u>2,483</u>	<u>3,105</u>	<u>2,877</u>

## ii Determining the fair value of debt securities when the markets are not active

Under IAS 39, unless categorised as 'held to maturity' or 'loans and receivables' debt securities are required to be fair valued. Where available, quoted market prices are used. However, where securities are in inactive markets, IAS 39 requires that valuation techniques be applied. Note G1 sets out further details of the Prudential Group's approach to determining fair value and classifies these fair values into a three level hierarchy as required by IFRS 7. As at 31 December 2008 and 2009, respectively, 15% and 3% of Jackson's debt securities were classified as level 3 being fair values where there are significant inputs which are not based on observable market data. The higher proportion at 31 December 2008 arises from the illiquidity of the market at that time and hence a greater use of internal valuation techniques.

In 2008, due to inactive and illiquid markets, beginning at the end of the third quarter of 2008 the external prices obtained for certain asset-backed securities were deemed not to reflect fair value in the dislocated market conditions at that time. For the valuations at 31 December 2008, Jackson had therefore utilised internal valuation models, provided by PPM America, as best estimate of fair values of all non-agency Residential Mortgage-backed Securities (“RMBS”) and Asset backed Securities (“ABS”) and certain Commercial Mortgage-backed securities (“CMBS”).

During 2009, improvements were observed in the level of liquidity for these sectors of structured securities and this increased liquidity in the markets for certain tranches of non-agency RMBS and ABS resulted in Jackson being able to rely on external prices for the securities as the most appropriate measure of fair value.

Accordingly, at 30 June 2009 and 31 December 2009, nearly all of the non-agency RMBS, ABS and certain CMBS which at 31 December 2008 were valued using internal valuation models due to the dislocated market conditions in 2008, have now been valued using external prices.

### iii Asset-backed securities funds exposures

Included within the debt securities of Jackson at 31 December 2007, 31 December 2008 and 31 December 2009 are exposures to asset-backed securities as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
RMBS Sub-prime (2007: 100% S&P AAA; 2008: 91% S&P AAA, 3% AA; 2009 76% S&P AAA, 1% AA) † . . . . .	237	291	194
Alt-A (2007: 77% AAA, 17% AA; 2008: 60% AAA, 15% AA; 2009 24% AAA, 5% AA) . . . . .	660	646	443
Prime (2007: 87% AAA; 2008: 87% AAA, 5% AA; 2009 82% AAA, 4% AA) . . . . .	2,280	3,572	2,679
CMBS (2007: 83% AAA; 2008: 85% AAA, 9% AA; 2009 46% AAA, 14% AA) . . . . .	1,532	1,869	2,104
CDO funds (2007: 65% AAA, 8% AA; 2008: 34% AAA, 14% AA; 2009: 29% AAA, 10% AA)* including £3m exposure to sub-prime . . . . .	260	320	79
ABS (2007: 37% AAA, 12% AA; 2008: 31% AAA, 16% AA; 2009: 25% AAA, 18% AA)* including nil exposure to sub-prime . . . . .	<u>706</u>	<u>766</u>	<u>877</u>
	<u>5,675</u>	<u>7,464</u>	<u>6,376</u>

\* Including Prudential Group’s economic interest in Piedmont and other consolidated CDO funds.

† RMBS ratings refer to the rating implicit within NAIC risk-based capital valuation.

Jackson defines its exposure to sub-prime mortgages as investments in residential mortgage-backed securities in which the underlying borrowers have a US Fair Isaac Credit Organisation (“FICO”) credit score of 680 or lower.

### iv Debt securities classified as available-for-sale in an unrealised loss position

#### a) Fair value of securities as a percentage of book value

The unrealised losses in Jackson’s statement of financial position on unimpaired securities are £439 million, £3,178 million and £966 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. This relates to assets with fair market value of £10,291 million, £17,422 million, and £7,254 million as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively and a book value of £10,730 million £20,600 million and £8,220 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

The following table shows the fair value of the debt securities in a gross unrealised loss position for various percentages of book value at 31 December:

Fair value of securities as a percentage of book value	2007		2008		2009	
	Fair value	Unrealised loss	Fair value	Unrealised loss	Fair value	Unrealised loss
	£m		£m		£m	
Between 90% and 100% . . . . .	9,370	(274)	8,757	(431)	5,127	(169)
Between 80% and 90% . . . . .	784	(122)	4,581	(809)	1,201	(203)
Below 80% . . . . .	<u>137</u>	<u>(43)</u>	<u>4,084</u>	<u>(1,938)</u>	<u>926</u>	<u>(594)</u>
	<u>10,291</u>	<u>(439)</u>	<u>17,422</u>	<u>(3,178)</u>	<u>7,254</u>	<u>(966)</u>

Included within the table above are amounts relating to sub-prime and Alt-A securities of:

<u>Fair value of securities as a percentage of book value</u>	<u>2007</u>		<u>2008</u>		<u>2009</u>	
	<u>Fair value</u>	<u>Unrealised loss</u>	<u>Fair value</u>	<u>Unrealised loss</u>	<u>Fair value</u>	<u>Unrealised loss</u>
		<u>£m</u>		<u>£m</u>		<u>£m</u>
Between 90% and 100% . . . . .	572	(24)	479	(27)	102	(3)
Between 80% and 90% . . . . .	132	(22)	120	(19)	160	(28)
Below 80% . . . . .	<u>28</u>	<u>(10)</u>	<u>192</u>	<u>(166)</u>	<u>159</u>	<u>(88)</u>
	<u>732</u>	<u>(56)</u>	<u>791</u>	<u>(212)</u>	<u>421</u>	<u>(119)</u>

b) *Unrealised losses by maturity of security*

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>Unrealised loss</u>	<u>Unrealised loss</u>	<u>Unrealised loss</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Less than 1 year . . . . .	(1)	(21)	—
1 to 5 years . . . . .	(54)	(537)	(29)
5 to 10 years . . . . .	(164)	(1,236)	(127)
More than 10 years . . . . .	(60)	(395)	(92)
Mortgage-backed and other debt securities . . . . .	<u>(160)</u>	<u>(989)</u>	<u>(718)</u>
Total . . . . .	<u>(439)</u>	<u>(3,178)</u>	<u>(966)</u>

c) *Age analysis of unrealised losses for the periods indicated*

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

<u>Aged analysis of unrealised losses for the periods indicated</u>	<u>2007</u>			<u>2008</u>			<u>2009</u>		
	<u>Non-investment grade</u>	<u>Investment grade</u>	<u>Total</u>	<u>Non-investment grade</u>	<u>Investment grade</u>	<u>Total</u>	<u>Non-investment grade</u>	<u>Investment grade</u>	<u>Total</u>
	<u>£m</u>			<u>£m</u>			<u>£m</u>		
Less than 6 months . . .	(9)	(58)	(67)	(108)	(362)	(470)	(7)	(51)	(58)
6 months to 1 year . . .	(21)	(115)	(136)	(125)	(1,164)	(1,289)	(25)	(59)	(84)
1 year to 2 years . . . .	(2)	(21)	(23)	(154)	(622)	(776)	(59)	(234)	(293)
2 years to 3 years . . . .	(34)	(140)	(174)	(15)	(91)	(106)	(125)	(199)	(324)
More than 3 years . . . .	<u>(2)</u>	<u>(37)</u>	<u>(39)</u>	<u>(61)</u>	<u>(476)</u>	<u>(537)</u>	<u>(35)</u>	<u>(172)</u>	<u>(207)</u>
	<u>(68)</u>	<u>(371)</u>	<u>(439)</u>	<u>(463)</u>	<u>(2,715)</u>	<u>(3,178)</u>	<u>(251)</u>	<u>(715)</u>	<u>(966)</u>

As at 31 December 2007, 2008 and 2009, the gross unrealised losses in the statement of financial position for the sub-prime and Alt-A securities in an unrealised loss position were £56 million, £212 million and £119 million, respectively. Of these losses, £37 million, £91 million and £21 million at 31 December 2007, 31 December 2008 and 31 December 2009 respectively have been in an unrealised loss position for less than one year with the remaining securities with unrealised losses of £19 million, £121 million, and £98 million respectively being in an unrealised loss position for more than one year.

d) *Securities whose fair value were below 80% of the book value*

As shown in table (a) above, £43 million, £1,938 million and £594 million of the £439 million, £3,178 million and £966 million of gross unrealised losses at 31 December 2007, 31 December 2008, and 31 December 2009 respectively related to securities whose fair values were below 80% of the book value. The analysis of the £43 million, £1,938 million and £594 million, for 2007, 2008 and 2009 respectively, by category of debt securities

and by age analysis indicating the length of time for which their fair value was below 80% of the book value, are as follows:

<u>Category analysis</u>	<u>2007</u>		<u>2008</u>		<u>2009</u>	
	<u>Fair value</u>	<u>Unrealised loss</u>	<u>Fair value</u>	<u>Unrealised loss</u>	<u>Fair value</u>	<u>Unrealised loss</u>
		£m		£m		£m
Residential mortgage-backed securities						
Prime . . . . .	2	(1)	287	(115)	322	(153)
Alt-A . . . . .	27	(10)	144	(127)	77	(33)
Sub-prime . . . . .	—	—	48	(39)	82	(55)
	29	(11)	479	(281)	481	(241)
Commercial mortgage-backed securities . . . . .	4	(1)	811	(375)	87	(86)
Other asset-backed securities . . . . .	4	(1)	198	(86)	183	(188)
Total structured securities . . . . .	37	(13)	1,488	(742)	751	(515)
Corporates . . . . .	100	(30)	2,596	(1,196)	175	(79)
Total . . . . .	<u>137</u>	<u>(43)</u>	<u>4,084</u>	<u>(1,938)</u>	<u>926</u>	<u>(594)</u>

Age analysis of fair value being below 80% for the period indicated:

<u>Age analysis</u>	<u>2007</u>		<u>2008</u>		<u>2009</u>	
	<u>Fair value</u>	<u>Unrealised loss</u>	<u>Fair value</u>	<u>Unrealised loss</u>	<u>Fair value</u>	<u>Unrealised loss</u>
		£m		£m		£m
Less than 3 months . . . . .	137	(43)	3,118	(1,364)	153	(45)
3 months to 6 months . . . . .	—	—	696	(403)	5	(3)
More than 6 months . . . . .	—	—	270	(171)	768	(546)
	<u>137</u>	<u>(43)</u>	<u>4,084</u>	<u>(1,938)</u>	<u>926</u>	<u>(594)</u>

*d Products and guarantees*

Jackson provides long-term savings and retirement products to retail and institutional customers throughout the US. Jackson offers fixed annuities (interest-sensitive, fixed indexed and immediate annuities), variable annuities (VA), life insurance and institutional products.

*i Fixed annuities*

**Interest-sensitive annuities**

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, interest-sensitive fixed annuities accounted for 25%, 29% and 24% of policy and contract liabilities of Jackson. Interest-sensitive fixed annuities are primarily deferred annuity products that are used for retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The policyholder of an interest-sensitive fixed annuity pays Jackson a premium, which is credited to the policyholder's account. Periodically, interest is credited to the policyholder's account and in some cases administrative charges are deducted from the policyholder's account. Jackson makes benefit payments at a future date as specified in the policy based on the value of the policyholder's account at that date.

The policy provides that at Jackson's discretion it may reset the interest rate, subject to a guaranteed minimum. The minimum guarantee varied from 1.5% to 5.5%, 1.5% to 5.5% and 1.5% to 5.5%, for 2007, 2008 and 2009 respectively, depending on the jurisdiction of issue and the date of issue, with 80%, 83% and 82%, for 2007, 2008 and 2009 respectively, of the fund at 3% or less. The average guarantee rate was 3.1%, 3.1% and 3.1%, for 2007, 2008 and 2009 respectively.

Approximately 30%, 34% and 61% of the interest-sensitive fixed annuities Jackson wrote in 2007, 2008 and 2009 respectively, provide for a market value adjustment, that could be positive or negative, on surrenders in the surrender period of the policy. This formula-based adjustment approximates the change in value that assets supporting the product would realise as interest rates move up or down. The minimum guaranteed rate is not affected by this adjustment.

## **Fixed indexed annuities**

Fixed indexed annuities accounted for 7%, 8% and 10%, for 2007, 2008 and 2009 respectively, of Jackson's policy and contract liabilities at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. Fixed indexed annuities vary in structure, but generally are deferred annuities that enable policyholders to obtain a portion of an equity-linked return (based on participation rates and caps) but provide a guaranteed minimum return. These guaranteed minimum rates are generally set at 1.25% to 3%.

Jackson hedges the equity return risk on fixed indexed products using futures and options linked to the relevant index. The cost of these hedges is taken into account in setting the index participation rates or caps. Jackson bears the investment and surrender risk on these products.

## **Immediate annuities**

At 31 December 2007, 31 December 2008 and 31 December 2009, immediate annuities accounted for 2% of Jackson's policy and contract liabilities. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years and/or the life of the policyholder. If the term is for the life of the policyholder, then Jackson's primary risk is mortality risk. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

### **ii Variable annuities**

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, VAs accounted for 45%, 39% and 49% of Jackson's policy and contract liabilities. VAs are deferred annuities that have the same tax advantages and payout options as interest-sensitive and fixed indexed annuities.

The primary differences between VAs and interest-sensitive or fixed indexed annuities are investment risk and return. If a policyholder chooses a VA, the rate of return depends upon the performance of the selected fund portfolio. Policyholders may allocate their investment to either the fixed or variable account. Investment risk on the variable account is borne by the policyholder, while investment risk on the fixed account is borne by Jackson through guaranteed minimum fixed rates of return. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, approximately 9%, 18% and 14% of VA funds were in fixed accounts.

Jackson issues VA contracts where it contractually guarantees to the contractholder 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 contract anniversary. These guarantees include benefits that are payable in the event of death (guaranteed minimum death benefit (GMDB)), annuitisation (guaranteed minimum income benefit (GMIB)), or at specified dates during the accumulation period (guaranteed minimum withdrawal benefit (GMWB)) and guaranteed minimum accumulation benefit (GMAB). Jackson hedges these risks using equity options and futures contracts as described in note D3(e). The GMIB is no longer offered, with existing coverage being reinsured.

### **iii Life insurance**

Jackson's life insurance products accounted for 9%, 10% and 9% of Jackson's policy and contract liabilities at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. The products offered include variable universal life insurance, term life insurance and interest-sensitive life insurance.

### **iv Institutional products**

Jackson's institutional products consist of GICs, funding agreements (including agreements issued in conjunction with Jackson's participation in the US Federal Home Loan Bank programme) and medium-term note funding agreements. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, institutional products accounted for 12%, 12% and 6% of policy and contract liabilities. Under a traditional GIC, the policyholder makes a lump sum deposit. The interest rate paid is fixed and established when the contract is issued. If deposited funds are withdrawn earlier than the specified term of the contract, an adjustment is made that approximates a market value adjustment.

Under a funding agreement, the policyholder either makes a lump sum deposit or makes specified periodic deposits. Jackson agrees to pay a rate of interest, which may be fixed but which is usually a floating short-term interest rate linked to an external index. The average term of the funding arrangements is one to two years. Funding agreements

terminable by the policyholder with less than 90 days' notice account for less than 1%, 1% and less than 1% for 2007, 2008 and 2009 respectively, of total policyholder reserves.

Medium-term note funding agreements are generally issued to support trust instruments issued on non-US exchanges or to qualified investors (as defined by SEC Rule 144A). Through the funding agreements, Jackson agrees to pay a rate of interest, which may be fixed or floating, to the holders of the trust instruments.

*e Exposure to market risk and risk management*

Jackson's main exposures are to market risk through its exposure to interest rate risk and equity risk. Approximately 90%, 90% and 95%, for 2007, 2008 and 2009 respectively, of its general account investments support interest-sensitive and fixed indexed annuities, life business and surplus and 10%, 10% and 5%, for 2007, 2008 and 2009 respectively, support institutional business. All of these types of business contain considerable interest rate guarantee features and, consequently, require that the assets that support them are primarily fixed income or fixed maturity.

Prudential is exposed primarily to the following risks in the US arising from fluctuations in interest rates:

- The risk of loss related to meeting guaranteed rates of accumulation following a sharp and sustained fall in interest rates;
- the risk of loss related to policyholder withdrawals following a sharp and sustained increase in interest rates; and
- the risk of mismatch between the expected duration of certain annuity liabilities and prepayment risk and extension risk inherent in mortgage-backed securities.

Prudential is also exposed to the following risks in the US arising from equity market movements:

- The risk of loss related to the incidence of benefits related to guarantees issued in conjunction with its VA contracts; and
- the risk of loss related to meeting contractual accumulation requirements in FIA contracts.

Jackson enters into financial derivative transactions, including those noted below to reduce and manage business risks. These transactions manage the risk of a change in the value, yield, price, cash flows, or quantity of, or a degree of exposure with respect to assets, liabilities or future cash flows, which Jackson has acquired or incurred.

Jackson uses free-standing derivative instruments for hedging purposes. Additionally, certain liabilities, primarily trust instruments supported by funding agreements, fixed indexed annuities, certain GMWB variable annuity features and reinsured GMIB variable annuity features contain embedded derivatives as defined by IAS 39, 'Financial Instruments: Recognition and Measurement'. Jackson does not account for such derivatives as either fair value or cash flow hedges as might be permitted if the specific hedge documentation requirements of IAS 39 were followed. Financial derivatives, including derivatives embedded in certain host liabilities that have been separated for accounting and financial reporting purposes are carried at fair value.

Value movements on the derivatives are reported within the income statement. In preparing Jackson's segment profit as shown in note B1, value movements on Jackson's derivative contracts, other than for certain equity-based product management activities, are included within short-term fluctuations in investment returns and excluded from operating results based on longer-term investment returns (defined as segment profit). Value movements on derivative instruments used for certain equity-based product management activities, which for 2008 and 2009 is based on a static long-term volatility assumption and, for embedded liabilities, average Corporate AA interest rates, are included within operating results based on longer-term investment returns, as the value movements broadly offset the economic impact of changed levels of benefit payments and reserves as equity markets fluctuate, (subject to some limitations for GMDB where US GAAP does not fully reflect the economic features being hedged). Any differences in value movements on these derivatives between the static long-term volatility assumption and implied volatility or average Corporate AA interest rates and ending Corporate AA interest rates are reflected as a component of short-term fluctuations. The types of derivatives used by Jackson and their purpose are as follows:

- Interest rate swaps generally involve the exchange of fixed and floating payments over the period for when Jackson holds the instrument without an exchange of the underlying principal amount. These agreements are used for hedging purposes;
- put-swaption contracts provide the purchaser with the right, but not the obligation, to require the writer to pay the present value of a long-duration interest rate swap at future exercise dates. Jackson purchases and writes put-swaptions with maturities up to 10 years. On a net basis, put-swaptions hedge against significant upward movements in interest rates;

- equity index futures contracts and equity index call and put options are used to hedge Jackson's obligations associated with its issuance of fixed indexed immediate and deferred annuities and certain VA guarantees. These annuities and guarantees contain embedded options which are fair valued for financial reporting purposes;
- total return swaps in which Jackson receives equity returns or returns based on reference pools of assets in exchange for short-term floating rate payments based on notional amounts, are held for both hedging and investment purposes;
- cross-currency swaps, which embody spot and forward currency swaps and additionally, in some cases, interest rate swaps and equity index swaps, are entered into for the purpose of hedging Jackson's foreign currency denominated funding agreements supporting trust instrument obligations;
- spread cap options are used as a macro-economic hedge against declining interest rates. Jackson receives quarterly settlements based on the spread between the two-year and the 10-year constant maturity swap rates in excess of a specified spread; and
- credit default swaps, represent agreements under which Jackson has purchased default protection on certain underlying corporate bonds held in its portfolio. These contracts allow Jackson to sell the protected bonds at par value to the counterparty in the event of their default in exchange for periodic payments made by Jackson for the life of the agreement.

Note D3(i) parts (iii) and (iv) show the sensitivities of Jackson's results through its exposure to equity risk and interest rate risk.

*f Process for setting assumptions and determining contract liabilities*

Under the MSB of reporting applied under IFRS 4 for insurance contracts, providing the requirements of the Companies Act, UK GAAP standards and the ABI SORP are met, it is permissible to reflect the previously applied UK GAAP basis. Accordingly, and consistent with the basis explained in note A4, in the case of Jackson the carrying values of insurance assets and liabilities are consolidated into the group accounts based on US GAAP.

Under US GAAP, investment contracts (as defined for US GAAP purposes) are accounted for by applying in the first instance a retrospective deposit method to determine the liability for policyholder benefits. This is then augmented by potentially three additional amounts. These amounts are for:

- any amounts that have been assessed to compensate the insurer for services to be performed over future periods (i.e. deferred income);
- any amounts previously assessed against policyholders that are refundable on termination of the contract; and
- any probable future loss on the contract (i.e. premium deficiency).

Capitalised acquisition costs and deferred income for these contracts are amortised over the life of the book of contracts. The present value of the estimated gross profits is generally computed using the rate of interest that accrues to policyholder balances (sometimes referred to as the contract rate). Estimated gross profits include estimates of the following elements, each of which will be determined based on the best estimate of amounts of the following individual elements over the life of the book of contracts without provision for adverse deviation for:

- amounts expected to be assessed for mortality less benefit claims in excess of related policyholder balances;
- amounts expected to be assessed for contract administration less costs incurred for contract administration;
- amounts expected to be earned from the investment of policyholder balances less interest credited to policyholder balances;
- amounts expected to be assessed against policyholder balances upon termination of contracts (sometimes referred to as surrender charges); and
- other expected assessments and credits.

VA contracts written by Jackson may, as described above, provide for GMDB, GMIB, GMWB and GMAB features. In general terms, liabilities for these benefits are accounted for under US GAAP by using estimates of future benefits and fees under best estimate persistency assumptions.

In accordance with SOP03-01 (Accounting and Reporting by Insurance Enterprises for Certain Non-traditional Long Duration Contracts and for Separate Accounts) which specifies how certain guarantee features should be accounted for under US GAAP, the GMDB liability is not fair valued but is instead determined each period end by estimating the expected value of death benefits in excess of the projected account balance and recognising the

excess ratably over the life of the contract based on total expected assessments. At 31 December 2007, 31 December 2008 and 31 December 2009, the GMDB liability was valued using a series of deterministic investment performance scenarios, a mean investment return of 8.4% and assumptions for lapse, mortality and expense that are the same as those used in amortising the capitalised acquisition costs.

The direct GMIB liability is determined by estimating the expected value of the annuitisation benefits in excess of the projected account balance at the date of annuitisation and recognising the excess ratably over the accumulation period based on total expected assessments.

The assumptions used for calculating the direct GMIB liability at 31 December 2007, 2008 and 2009 are consistent with those used for calculating the GMDB liability.

Jackson regularly evaluates estimates used and adjusts the additional GMDB and GMIB liability balances, with a related charge or credit to benefit expense, if actual experience or other evidence suggests that earlier assumptions should be revised.

GMIB benefits are essentially fully reinsured, subject to annual claim limits. As this reinsurance benefit is net settled, it is considered to be a derivative under IAS 39 and is, therefore, recognised at fair value with the change in fair value included as a component of short-term derivative fluctuations.

Most GMWB features are considered to be embedded derivatives under IAS 39. Therefore, provisions for these benefits are recognised at fair value, with the change in fair value included in operating profit based on longer-term investment returns. Certain GMWB features guarantee payments over a lifetime and, therefore, include mortality risk. Provisions for these GMWB amounts are valued consistent with the GMDB valuation method discussed above.

For GMWB and GMIB reinsurance embedded derivatives that are fair valued under IAS 39, Jackson bases its volatility assumptions solely on implied market volatility with no reference to historical volatility levels and explicitly incorporates Jackson's own credit risk in determining discount rates.

For 2008 and 2009, volatility assumptions are based on a weighting of available market data on implied volatility for durations up to ten years, at which point the projected volatility is held constant. Non-performance risk is incorporated into the calculation through the use of discount interest rates sourced from a AA corporate credit curve. Other risk margins, particularly for market illiquidity and policyholder behaviour are also incorporated into the model through the use of explicitly conservative assumptions. On a periodic basis, Jackson rationalises the resulting fair values based on comparisons to other models and market movements.

With the exception of the GMDB, GMIB, GMWB and GMAB features of VA contracts, the financial guarantee features of Jackson's contracts are in most circumstances not explicitly valued, but the impact of any interest guarantees would be reflected as they are earned in the current account value (i.e. the US GAAP liability).

For traditional life insurance contracts, provisions for future policy benefits are determined under US GAAP using the net level premium method and assumptions as of the issue date as to mortality, interest, policy lapses and expenses plus provisions for adverse deviation.

Institutional products are accounted for as investment contracts under IFRS with the liability classified as being in respect of financial instruments rather than insurance contracts, as defined by IFRS 4. In practice, there is no material difference between the IFRS and US GAAP basis of recognition and measurement for these contracts.

Certain institutional products representing obligations issued in currencies other than US dollars have been hedged for changes in exchange rates using cross-currency swaps. The fair value of derivatives embedded in funding agreements, as well as foreign currency transaction gains and losses, are included in the carrying value of the trust instruments supported by funding agreements recorded in other non-insurance liabilities.

#### *g Reinsurance*

The principal reinsurance ceded by Jackson outside the Prudential Group is on term life insurance, direct and assumed accident and health business and GMIB variable annuity guarantees. In 2007, 2008 and 2009 respectively, the premiums for such ceded business amounted to £60 million, £68 million and £82 million. Net commissions received on ceded business and claims incurred ceded to external reinsurers totalled £10 million and £47 million, respectively, during 2007, £10 million and £49 million respectively, during 2008 and £12 million and £66 million respectively, during 2009. There were no deferred gains or losses on reinsurance contracts in 2007, 2008 or 2009. The reinsurance asset for business ceded outside the Prudential Group was £436 million, £800 million and £667 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

*h Effect of changes in assumptions used to measure insurance assets and liabilities*

**a Measurement basis for embedded derivatives of variable annuity business and other policyholder liability**

Certain variable annuity products sold by Jackson include Guaranteed Minimum Withdrawal Benefits (GMWB) which, in accordance with the Prudential Group's accounting policies, are measured within the IFRS balance sheet at fair value. This requires a number of assumptions related to projected future cash flows, including those driven by policyholder behaviours such as lapses, fund selections and withdrawals utilisation. During 2009 the GMWB utilisation assumptions were revised to take account of the more recent experience of policyholder behaviour. Previously policyholder behaviour for the utilisation of GMWB was assumed to be largely driven by the extent to which benefits were 'in the money'. For 2009, the assumption has been altered to take account of recent experience which shows that the attained age of the policyholder is the key factor in determining utilisation levels. This has led to a release in policyholder liabilities of £96 million which is offset by a corresponding DAC amortisation charge of £68 million to give an overall impact on profit before tax of £28 million. This assumption change has been offset by sundry other assumption changes such that the overall impact on operating profit of policyholder liability assumption changes, after taking into account DAC amortisation offsets, is a charge of £4 million.

In 2008 there were no changes of assumptions that had a material effect on the Jackson results. There was a change in estimation technique relating to the measurement of the Guaranteed Minimum Withdrawal Benefit (GMWB) features of Jackson's variable annuity products and the reinsurance of the Guaranteed Minimum Income Benefit (GMIB). In 2008 these features were valued using implied current equity volatility levels rather than historic long-term levels and the use of AA corporate bond rates rather than Libor based swap rates as the reference basis for determining the discount rate. The cumulative effect of these two changes was to reduce the total loss in 2008 by £47 million.

**b Deferred acquisition costs**

**Income statement — amortisation for variable annuity business**

Under IFRS 4, the Prudential Group applies US GAAP to the insurance assets and liabilities of Jackson. Under US GAAP, acquisition costs for Jackson's fixed and variable annuity business are deferred and then amortised in line with the expected emergence of margins. The amortisation profile is dependant on assumptions which, for variable annuity business, the key assumption is the expected level of equity market returns. For 2007, 2008 and 2009 a rate of 8.4% has been applied using, as is industry practice, a mean reversion methodology.

The mean reversion methodology is applied with the objective of adjusting the amortisation of deferred acquisition costs that would otherwise be highly volatile for the fact that the expected level of future gross profits fluctuates for altered variable annuity asset values arising from changes in equity market levels at the end of each reporting period.

The mean reversion methodology achieves this objective by dynamic adjustment to the level of expectations of short-term future investment returns. Under the methodology the projected returns for the next five years are, for the purposes of determining the amortisation profile, set so that normally combined with the actual returns for the current and preceding two years the average rate of return is 8.4%. The mean reversion methodology does, however, include a cap of 15% per annum on the projected return for each of the next five years. Projected returns after the next five years are set at 8.4%. For 2008 following the fall in equity markets in that year, this capping effect applied to restrict the projected returns below the rate of approximately 20% per annum level that would have otherwise applied to the first five years. Although equity markets rose during the year, the return in 2008 was such that the cap remains in place at 31 December 2009, albeit at a lower level.

The DAC amortisation reflected in the 2008 results, after incorporating the mean reversion, increased by some £140 million, of which £40 million arises due to the capping feature. In 2009, following improvements in equity markets, no such DAC acceleration arose during the period and DAC amortisation fell accordingly.

**Statement of changes in equity — 'shadow DAC adjustments'**

Consequent upon the unrealised valuation movement in 2007, 2008 and 2009 respectively, of negative £244 million, negative £2,104 million, and positive £2,669 million, there is a credit of £88 million, a credit of £831 million and a debit of £1,069 million, for 2007, 2008 and 2009 respectively, for altered 'shadow' amortisation booked within other comprehensive income. These adjustments reflect movement from period to period in the changes to the pattern of reported gross profits that would have happened if the assets had been sold, crystallising the gain or loss, and the proceeds reinvested at yields currently available in the market. At 31 December 2008 and 2009, cumulative 'shadow DAC balance' was positive £1,192 million and negative £10 million, respectively.

*i Sensitivity of IFRS basis profit and equity to market and other risks*

***i Currency fluctuations***

Consistent with the Prudential Group's accounting policies, the profits of the Prudential Group's US operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2007, 2008 and 2009 respectively, the rates were US\$2.00, US\$1.85, and US\$1.57 and US\$1.99, US\$1.44 and US\$1.61 to £1 sterling, respectively.

A 10% increase or decrease in these rates would reduce or increase profit (loss) before tax attributable to shareholders, profit (loss) for the year and shareholders' equity attributable to US insurance operations respectively as follows:

	A 10% increase in exchange rates			A 10% decrease in exchange rates		
	2007	2008	2009	2007	2008	2009
	£m	£m	£m	£m	£m	£m
Profit (loss) before tax attributable to shareholders* . . . . .	(39)	59	(44)	48	(72)	54
Profit (loss) for the year . . . . .	(29)	51	(54)	35	(62)	65
Shareholders' equity attributable to US insurance operations . . . . .	<u>(242)</u>	<u>(158)</u>	<u>(274)</u>	<u>296</u>	<u>193</u>	<u>335</u>

\* Sensitivity on profit (loss) before tax i.e. aggregate of the operating profit based on longer-term investment returns and short-term fluctuations, as discussed in note B1.

***ii Other sensitivities***

The principal determinants of variations in operating profit based on longer-term returns are:

- Growth in the size of assets under management covering the liabilities for the contracts in-force;
- variations in fees and other income, offset by variations in market value adjustment payments and, where necessary, strengthening of liabilities;
- incidence of guarantees and the effectiveness of the related hedge programme; and
- spread returns for the difference between investment returns and rates credited to policyholders.

For the purpose of determining longer-term returns, adjustment is necessary for the normalisation of investment returns to remove the effects of short-term volatility in investment returns.

- amortisation of deferred acquisition costs.

For term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity business, acquisition costs are deferred and amortised in line with expected gross profits on the relevant contracts. For interest-sensitive business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders, which is based on an annual spread analysis. In addition, expected gross profits depend on mortality assumptions, assumed unit costs and terminations other than deaths (including the related charges) all of which are based on a combination of actual experience of Jackson, industry experience and future expectations.

A detailed analysis of actual experience is measured by internally developed mortality and persistency studies. For variable annuity business, the key assumption is the expected long-term level of equity market returns, which for 2007, 2008 and 2009 was 8.4% per annum implemented using a mean reversion methodology. These returns affect the level of future expected profits through their effects on the fee income and the required level of provision for guaranteed minimum death benefit claims. The mean reversion methodology dampens the impact of equity market movements during a particular year, but does not fully eliminate the effects of movements in the equity markets.

In addition, the mean reversion methodology includes both a cap and a floor that determine the maximum impact that the methodology may have. Due to the significant market movements during 2008, Jackson exceeded the cap on future equity market returns, resulting in a higher level sensitivity to market movements than would have been recognised had the cap not been met at the end of 2008. Given the low market return in 2008 this cap remained in place at 31 December 2009 and so the higher level of sensitivity remains.

Except to the extent of mortality experience, which primarily affects profits through variations in claim payments and GMDB reserves, the profits of Jackson are relatively insensitive to changes in insurance risk.

*iii Exposure to equity risk*

As noted in note D3(e), Jackson is exposed to equity risk through the options embedded in the fixed indexed liabilities and GMDB and GMWB guarantees included in certain VA benefits. This risk is managed using a comprehensive equity hedging programme to minimise the risk of a significant economic impact as a result of increases or decreases in equity market levels while taking advantage of naturally offsetting exposures in Jackson's operations. Jackson purchases external futures and options that hedge the risks inherent in these products, while also considering the impact of rising and falling separate account fees.

As a result of this hedging programme, if the equity markets were to increase further in the future, Jackson's free-standing derivatives would decrease in value. However, over time, this movement would be broadly offset by increased separate account fees and reserve decreases, net of the related changes to amortisation of deferred acquisition costs. Due to the nature of the free-standing and embedded derivatives, this hedge while effective on an economic basis, may not completely mute the immediate impact of the market movements as the free-standing derivatives reset immediately while the hedged liabilities reset more slowly and fees are recognised prospectively. The opposite impacts would be observed if the equity markets were to decrease.

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, based on the hedges in place at that time, it is estimated that an immediate decrease in the equity markets of 10% would result in an accounting impact, net of related DAC amortisation, before tax of up to, £30 million benefit, £20 million charge and £60 million benefit, excluding the impact on future separate account fees. After related deferred tax there would have been an estimated change in shareholders' equity at 31 December 2007, 31 December 2008 and 31 December 2009, respectively of up to £20 million increase, £15 million decrease and £40 million increase. Jackson extended the range of reasonably possible movements in the value of equity securities, partnerships in investment pools and other financial derivatives at 31 December 2008 and 2009. Consequently an immediate decrease in the equity markets of 20% would result in an accounting charge, net of related DAC amortisation, before tax of up to £40 million at 31 December 2008, and an accounting benefit of £110 million at 31 December 2009, excluding the impact on future separate account fees. After related deferred tax there would have been an estimated reduction in shareholders' equity at 31 December 2008 of up to £30 million and an increase in shareholders' equity of up to £80 million at 31 December 2009.

An immediate increase in the equity markets of 10 and 20% is estimated to result in an approximately equal and opposite estimated effect on profit and shareholders' equity as that disclosed above for a decrease.

The actual impact on financial results would vary contingent upon the volume of new product sales and lapses, changes to the derivative portfolio, correlation of market returns and various other factors including volatility, interest rates and elapsed time.

In addition, Jackson is also exposed to equity risk from its holding of equity securities, partnerships in investment pools and other financial derivatives.

A range of reasonably possible movements in the value of equity securities, partnerships in investment pools and other financial derivatives have been applied to Jackson's holdings at 31 December 2007, 31 December 2008 and 31 December 2009. The table below shows the sensitivity to reasonable per cent falls in value at each year end and the impact that this would have on pre-tax profit, net of related changes in amortisation of DAC, profit after tax and shareholders' equity.

	2007			2008		2009
	A decrease of 10%	A decrease of 40%	A decrease of 20%	A decrease of 10%	A decrease of 20%	A decrease of 10%
	£m			£m		£m
Pre-tax profit, net of related changes in amortisation of DAC . . . . .	(76)	(255)	(141)	(98)	(117)	(58)
Related deferred tax effects . . . . .	<u>26</u>	<u>89</u>	<u>49</u>	<u>34</u>	<u>41</u>	<u>20</u>
Net sensitivity of profit after tax and shareholders' equity . . . . .	<u>(50)</u>	<u>(166)</u>	<u>(92)</u>	<u>(64)</u>	<u>(76)</u>	<u>(38)</u>

The disclosure of the effect of a 40% fall for the 2008 year-end was included because of the exceptional market conditions at that time. These conditions have now abated and the disclosure is no longer appropriate.

In the equity risk sensitivity analysis given above the Prudential Group has, for 2009, considered the impact of an instantaneous 20% fall in equity markets. If equity markets were to fall by more than 20%, the Prudential Group

believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Prudential Group would be able to put in place mitigating management actions.

*iv Exposure to interest rate risk*

Notwithstanding the market risk exposure described in note D3(e), except in the circumstances of interest rate scenarios where the guarantee rates included in contract terms are higher than crediting rates that can be supported from assets held to cover liabilities, the accounting measurement of fixed annuity liabilities of Jackson products is not generally sensitive to interest rate risk. This position derives from the nature of the products and the US GAAP basis of measurement described in notes D3(d) and D3(f). The GMWB features attaching to variable annuity business represents embedded derivatives which are fair valued and so will be sensitive to changes in interest rate.

Debt securities and related derivatives are marked to fair value. Value movements on derivatives, again net of related changes to amortisation of DAC and deferred tax, are recorded within profit and loss. Fair value movements on debt securities, net of related changes to amortisation of DAC and deferred tax, are recorded within other comprehensive income. At 31 December 2008 Jackson extended the range of the movements that were reasonably possible to occur to include both 1% and 2%. This continued at 31 December 2009. The estimated sensitivity of the above items and policyholder liabilities to a 1% and 2% decrease and increase in interest rates at 31 December, where applicable, is as follows:

	2007		2008				2009			
	A 1% decrease	A 1% increase	A 2% decrease	A 1% decrease	A 1% increase	A 2% increase	A 2% decrease	A 1% decrease	A 1% increase	A 2% increase
	£m		£m							
<b>Profit and loss</b>										
Direct effect										
Derivatives value change . . .	(116)	163	(575)	(268)	283	639	(319)	(148)	159	370
Policyholder liabilities . . . .	(38)	29	(517)	(218)	182	350	(418)	(185)	170	334
Related effect on amortisation of DAC . . . . .	<u>52</u>	<u>(58)</u>	<u>498</u>	<u>215</u>	<u>(193)</u>	<u>(395)</u>	<u>364</u>	<u>162</u>	<u>(156)</u>	<u>(328)</u>
<b>Pre-tax profit effect</b>										
Operating profit based on longer-term investment returns . . . . .	(15)	11	(128)	(59)	64	146	(144)	(62)	56	109
Short-term fluctuations in investment returns . . . . .	<u>(87)</u>	<u>123</u>	<u>(466)</u>	<u>(212)</u>	<u>208</u>	<u>448</u>	<u>(229)</u>	<u>(109)</u>	<u>117</u>	<u>267</u>
	(102)	134	(594)	(271)	272	594	(373)	(171)	173	376
Related effect on charge for deferred tax . . . . .	<u>36</u>	<u>(47)</u>	<u>206</u>	<u>94</u>	<u>(95)</u>	<u>(207)</u>	<u>131</u>	<u>60</u>	<u>(60)</u>	<u>(131)</u>
Net profit effect . . . . .	<u>(66)</u>	<u>87</u>	<u>(388)</u>	<u>(177)</u>	<u>177</u>	<u>387</u>	<u>(242)</u>	<u>(111)</u>	<u>113</u>	<u>245</u>
Other comprehensive income										
Direct effect on carrying value of debt securities . . . . .	848	(848)	2,476	1,238	(1,238)	(2,476)	2,183	1,179	(1,179)	(2,183)
Related effect on amortisation of DAC . . . . .	(212)	212	(619)	(310)	310	619	(764)	(413)	413	764
Related effect on movement in deferred tax . . . . .	<u>(223)</u>	<u>223</u>	<u>(650)</u>	<u>(325)</u>	<u>325</u>	<u>650</u>	<u>(497)</u>	<u>(268)</u>	<u>268</u>	<u>497</u>
Net effect . . . . .	<u>413</u>	<u>(413)</u>	<u>1,207</u>	<u>603</u>	<u>(603)</u>	<u>(1,207)</u>	<u>922</u>	<u>498</u>	<u>(498)</u>	<u>(922)</u>
Total net effect on IFRS equity . . . . .	<u>347</u>	<u>(326)</u>	<u>819</u>	<u>426</u>	<u>(426)</u>	<u>(820)</u>	<u>680</u>	<u>387</u>	<u>(385)</u>	<u>(677)</u>

*j Duration of liabilities*

The table below shows the carrying value of policyholder liabilities. Separately, the Prudential Group uses cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing EEV basis results. The table below shows the maturity profile of the cash flows used for that purpose for 2007, 2008 and 2009:

	2007		2008		2009	
	Fixed annuity and other business (including GICs and similar contracts)	Variable annuity	Fixed annuity and other business (including GICs and similar contracts)	Variable annuity	Fixed annuity and other business (including GICs and similar contracts)	Variable annuity
	£m		£m		£m	
Policyholder liabilities . . . . .	<u>19,821</u>	<u>15,027</u>	<u>30,823</u>	<u>14,538</u>	<u>27,672</u>	<u>20,639</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>
Expected maturity:						
0 to 5 years . . . . .	51	48	49	46	52	50
5 to 10 years . . . . .	26	30	26	28	27	28
10 to 15 years . . . . .	11	13	11	14	10	12
15 to 20 years . . . . .	5	6	6	7	5	6
20 to 25 years . . . . .	3	2	3	3	3	2
Over 25 years . . . . .	4	1	5	2	3	2

The maturity tables shown above have been prepared on a discounted basis. Details of undiscounted cash flows for investment contracts are shown in note G2.

**D4: Asian insurance operations**

*a Summary statement of financial position*

Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type as at 31 December.

	Asian insurance operations					
	2007	2008	With-profits	Unit-linked	Other	2009
	Total	Total	business	assets and		Total
£m	£m	note i	liabilities	£m	£m	
<b>Assets</b>						
Intangible assets attributable to shareholders:						
Goodwill <sup>(note iii)</sup>	111	111	—	—	80	80
Deferred acquisition costs and other intangible assets	745	1,247	—	—	822	822
Total	856	1,358	—	—	902	902
Intangible assets attributable to with-profit funds:						
Deferred acquisition costs and other intangible assets	—	113	97	—	—	97
Deferred tax assets	73	101	—	—	132	132
Other non-investment and non-cash assets <sup>(note iii)</sup>	689	1,416	234	83	563	880
Investments of long-term business and other operations:						
Investment properties	14	20	—	—	11	11
Investment accounted for using the equity method	—	—	—	—	2	2
Financial investments:						
Loans <sup>(note ii)</sup>	1,087	1,705	781	27	399	1,207
Equity securities and portfolio holdings in unit trusts	9,804	8,077	3,691	7,224	267	11,182
Debt securities <sup>(note c)</sup>	6,920	11,113	4,988	2,462	2,534	9,984
Other investments	42	144	73	44	141	258
Deposits	377	750	14	196	536	746
Total investments	18,244	21,809	9,547	9,953	3,890	23,390
Cash and cash equivalents	679	1,501	225	235	377	837
<b>Total assets</b>	<b>20,541</b>	<b>26,298</b>	<b>10,103</b>	<b>10,271</b>	<b>5,864</b>	<b>26,238</b>
<b>Equity and liabilities</b>						
<b>Equity</b>						
Shareholders' equity	1,369	2,167	—	—	1,462	1,462
Minority interests	7	7	—	—	1	1
Total equity	1,376	2,174	—	—	1,463	1,463
<b>Liabilities</b>						
Policyholder liabilities and unallocated surplus of with-profits funds:						
Contract liabilities (including amounts in respect of contracts classified as investment contract under IFRS 4)	17,033	20,909	8,808	9,717	3,333	21,858
Unallocated surplus of with-profits funds	146	160	53	—	—	53
Total	17,179	21,069	8,861	9,717	3,333	21,911
Other non-insurance liabilities:						
Operational borrowings attributable to shareholders-financed operations	—	130	—	—	210	210
Deferred tax liabilities	362	441	266	12	106	384
Other non-insurance liabilities	1,624	2,484	976	542	752	2,270
Total liabilities	19,165	24,124	10,103	10,271	4,401	24,775
<b>Total equity and liabilities</b>	<b>20,541</b>	<b>26,298</b>	<b>10,103</b>	<b>10,271</b>	<b>5,864</b>	<b>26,238</b>

## Notes

- i The statement of financial position for with-profits business comprises the with-profits assets and liabilities of the Hong Kong, Malaysia and Singapore with-profits operations. Assets and liabilities of other participating business are included in the column for 'other businesses'.
- ii The loans of the Prudential Group's Asian insurance operations of £1,087 million, £1,705 million and £1,207 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, comprise mortgage loans of £132 million, £238 million and £13 million, policy loans of £430 million, £675 million and £437 million and other loans of £525 million, £792 million and £757 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. The mortgage and policy loans are secured by properties and life insurance policies respectively. The majority of the other loans are commercial loans held by the Malaysian operation and which are all investment graded by two local rating agencies.
- iii Further segmental analysis

No goodwill attributable to any individual country included in the Asia total of £111 million, £111 million and £80 million, exceeds 10% of the Prudential Group goodwill attributable to shareholders of £1,341 million, £1,341 million and £1,310 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. Included within "Other non-investment and non-cash assets" of £689 million, £1,416 million and £880 million, as at 31 December 2007, 31 December 2008 and 31 December 2009, was "Property, plant and equipment" of £98 million, £144 million and £94 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. No individual Country in Asia held property, plant and equipment at the end of the year which exceeds 10% of the Prudential Group total of £1,012 million, £635 million and £367 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

*Summary policyholder liabilities (net of reinsurance) and unallocated surplus*

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the policyholder liabilities (net of reinsurance of £12 million, £24 million and £18 million) and unallocated surplus for Asian operations of £17.2 billion, £21.0 billion and £21.9 billion comprised the following:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Singapore .....	5,462	5,426	6,960
Hong Kong .....	3,901	5,100	5,762
Taiwan .....	2,781	4,024	545
Malaysia .....	1,201	1,587	1,823
Japan .....	695	1,100	1,094
Other countries .....	<u>3,127</u>	<u>3,808</u>	<u>5,709</u>
Total Asian operations .....	<u>17,167</u>	<u>21,045</u>	<u>21,893</u>

*b Reconciliation of movement 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 Asian insurance operations from the beginning of the year to the end of the year is as follows:

	<u>With-profits business</u>	<u>Unit-linked assets and liabilities</u>	<u>Other</u>	<u>Asian insurance operations Total</u>
	£m	£m	£m	£m
At 1 January 2007 .....	5,500	4,134	3,255	12,889
Premiums				
New business .....	372	1,676	160	2,208
In-force .....	<u>488</u>	<u>781</u>	<u>481</u>	<u>1,750</u>
	860	2,457	641	3,958
Surrenders .....	(146)	(689)	(197)	(1,032)
Maturities/Deaths .....	<u>(183)</u>	<u>(52)</u>	<u>(160)</u>	<u>(395)</u>
Net cash flows	531	1,716	284	2,531
Shareholders transfer post tax .....	(21)	—	—	(21)
Investment-related items and other movements .....	441	914	103	1,458
Foreign exchange translation differences <sup>(note (i))</sup> .....	<u>96</u>	<u>207</u>	<u>19</u>	<u>322</u>
At 31 December 2007/1 January 2008 .....	6,547	6,971	3,661	17,179
Premiums				
New business .....	391	1,252	233	1,876
In-force .....	<u>647</u>	<u>1,009</u>	<u>630</u>	<u>2,286</u>
	1,038	2,261	863	4,162
Surrenders .....	(354)	(614)	(223)	(1,191)
Maturities/Deaths .....	<u>(181)</u>	<u>(14)</u>	<u>(159)</u>	<u>(354)</u>
Net cash flows	503	1,633	481	2,617
Shareholders transfer post tax .....	(23)	—	—	(23)
Investment-related items and other movements .....	(1,320)	(3,158)	185	(4,293)
Foreign exchange translation differences <sup>(note (i))</sup> .....	<u>2,387</u>	<u>1,774</u>	<u>1,428</u>	<u>5,589</u>
At 31 December 2008/1 January 2009 .....	8,094	7,220	5,755	21,069
Premiums				
New business (note (ii)) .....	46	643	517	1,206
In-force .....	<u>777</u>	<u>1,223</u>	<u>601</u>	<u>2,601</u>
	823	1,866	1,118	3,807
Surrenders .....	(361)	(666)	(174)	(1,201)
Maturities/Deaths .....	<u>(253)</u>	<u>(19)</u>	<u>(70)</u>	<u>(342)</u>
Net cash flows	209	1,181	874	2,264
Change in other reserving basis .....	—	—	(4)	(4)
Change in reserving basis in Malaysia <sup>(note (iii))</sup> .....	—	(9)	(54)	(63)
Shareholders' transfers post tax .....	(20)	—	—	(20)
Investment-related items and other movements <sup>(note (iv))</sup> .....	1,431	2,661	150	4,242
Foreign exchange translation differences <sup>(note (i))</sup> .....	(853)	(612)	(604)	(2,069)
Disposal of Taiwan agency business <sup>(note (v))</sup> .....	<u>—</u>	<u>(724)</u>	<u>(2,784)</u>	<u>(3,508)</u>
<b>At 31 December 2009 .....</b>	<b>8,861</b>	<b>9,717</b>	<b>3,333</b>	<b>21,911</b>

- i) Movements in the year have been translated at the average exchange rate for the year ended 31 December 2007, 31 December 2008 and 31 December 2009. The closing balance has been translated at the closing spot rates as at 31 December 2007, 31 December 2008 and 31 December 2009. Differences upon retranslation are included in foreign exchange differences.
- ii) In 2009, the increase in policyholder liabilities due to new business premium for the with-profits business fell by £345 million to £46 million. This is predominantly driven by a fall in sales of single premium with-profits policies in Hong Kong following the withdrawal of the PruSaver product in 2009. The increase in policyholder liabilities due to new business premium for Asia unit-linked business was lower by £609 million in 2009, in line with decreases in single premium sales during the year.
- iii) The change in reserving basis in Malaysia of £63 million reflects the change made following the adoption of a risk based capital (RBC) approach to the local regulatory reporting in that country.
- iv) The positive investment related items and other movements for with-profits (£1,431 million) and unit-linked business (£2,661 million) were mainly driven from Asian equity market gains in the period.
- v) The disposal of Taiwan agency business reflects the liabilities transferred at the date of disposal.

*c Information on credit risks of debt securities*

Additional supplementary disclosure has been provided in 2009 to set out the operating segment financial position by business type. The following table summarises the credit quality of the debt securities of the Asian insurance operations as at 31 December by rating agency rating:

	<b>2009</b>					
	<b>2007</b>	<b>2008</b>	<b>With-</b>	<b>Unit-</b>	<b>Other</b>	<b>Total</b>
	<b>Total</b>	<b>Total</b>	<b>profits</b>	<b>linked</b>	<b>business</b>	<b>Total</b>
	<b>£m</b>	<b>£m</b>	<b>business</b>	<b>business</b>	<b>business</b>	<b>£m</b>
S&P — AAA . . . . .	2,284	2,632	1,778	295	186	2,259
S&P — AA+ to AA- . . . . .	1,994	3,746	657	345	592	1,594
S&P — A+ to A- . . . . .	675	808	749	463	284	1,496
S&P — BBB+ to BBB- . . . . .	193	902	472	103	107	682
S&P — Other . . . . .	149	253	397	3	517	917
	<u>5,295</u>	<u>8,341</u>	<u>4,053</u>	<u>1,209</u>	<u>1,686</u>	<u>6,948</u>
Moody's — Aaa . . . . .	201	494	86	33	15	134
Moody's — Aa1 to Aa3 . . . . .	45	108	38	32	279	349
Moody's — A1 to A3 . . . . .	28	398	12	283	14	309
Moody's — Baa1 to Baa3 . . . . .	19	60	17	16	7	40
Moody's — Other . . . . .	58	50	—	—	15	15
	<u>351</u>	<u>1,110</u>	<u>153</u>	<u>364</u>	<u>330</u>	<u>847</u>
Fitch . . . . .	1	41	—	38	1	39
Other . . . . .	<u>1,273</u>	<u>1,621</u>	<u>782</u>	<u>851</u>	<u>517</u>	<u>2,150</u>
Total debt securities . . . . .	<u>6,920</u>	<u>11,113</u>	<u>4,988</u>	<u>2,462</u>	<u>2,534</u>	<u>9,984</u>

Of the £598 million, £555 million and £517 million of debt securities for other business that are not rated in the table above, £317 million, £231 million and £225 million are in respect of government bonds, £83 million, £221 million and £265 million are in respect of corporate bonds rated as investment grade by local external ratings agencies and £71 million, nil and £22 million of structured deposits issued by banks which are themselves rated but where the specific deposits have not been, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

*d Products and guarantees*

The life insurance products offered by the Prudential Group's Asian operations include a range of with-profits and non-participating term, whole life, endowment and unit-linked policies. The Asian operations also offer health, disability, critical illness and accident coverage to supplement its core life products.

The terms and conditions of the contracts written by the Asian operations and, in particular, the products' options and guarantees, vary from territory to territory depending upon local market circumstances.

In general terms, the Asian participating products provide savings and protection where the basic sum assured can be enhanced by a profit share (or bonus) from the underlying fund as determined at the discretion of the insurers. The Asian operations' non-participating term, whole life and endowment products offer savings and/or protection where the benefits are guaranteed or determined by a set of defined market-related parameters. Unit-linked products combine savings with protection, the cash value of the policy depends on the value of the underlying unitised funds. Health and protection policies provide mortality or morbidity benefits and include health, disability, critical illness

and accident coverage. Health and protection products are commonly offered as supplements to main life policies but can be sold separately.

Subject to local market circumstances and regulatory requirements, the guarantee features described in note D2(d) in respect of UK business broadly apply to similar types of participating contracts written in the Hong Kong branch, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

Non-participating long-term products are the only ones where the insurer is contractually obliged to provide guarantees on all benefits. Investment-linked products have the lowest level of guarantee, if any.

Product guarantees in Asia can be broadly classified into four main categories, namely premium rate, cash value and interest rate guarantees, policy renewability, and convertibility options.

The risks on death coverage through premium rate guarantees are low due to appropriate product pricing.

Cash value and interest rate guarantees are of three types:

- Maturity values

Maturity values are guaranteed for non-participating products and on the guaranteed portion of participating products. Declared annual bonuses are also guaranteed once vested. Future bonus rates and cash dividends are not guaranteed on participating products.

- Surrender values

Surrender values are guaranteed for non-participating products and on the guaranteed portion of participating products. The surrender value of declared reversionary bonuses are also guaranteed once vested. Market value adjustments and surrender penalties are used where the law permits such adjustments in cash values.

- Interest rate guarantees

It is common in Asia for regulations or market-driven demand and competition to provide some form of capital value protection and minimum crediting interest rate guarantees. This would be reflected within the guaranteed maturity and surrender values.

The guarantees are borne by shareholders for non-participating and investment-linked (non-investment guarantees only) products. Participating product guarantees are predominantly supported by the segregated life funds and their estates.

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 are written in the Korean life operations. This is to a much lesser extent than the policies written by the Taiwan agency business which was sold in the first half of 2009, as Korea has a much higher proportion of linked and health business. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the Korean business had non-linked liabilities of £261 million, £312 million and £349 million, and linked liabilities of £728 million, £742 million and £1,173 million respectively.

The other area of note in respect of guarantees is the Japanese business, where pricing rates are higher than current bond yields. Lapse risk is a feature in that policyholders could potentially surrender their policies on guaranteed terms if interest rates significantly increased leaving the potential for losses if bond values had depreciated significantly. However, the business is matched to a relatively short realistic liability duration.

The method for determining liabilities of insurance contracts for UK GAAP, and hence IFRS, purposes for some Asian operations is based on US GAAP principles and this method applies to contracts with cash value and interest rate guarantees. Following standard US GAAP procedure, premium deficiency reserve calculations are performed each year to establish whether the carrying values of the liabilities are sufficient.

On the US GAAP basis the calculations are deterministic, that is to say based on a single set of projections, and expected long-term rates of return are applied.

*e Exposure to market risk*

The Asian operations sell with-profits and unit-linked policies and, although the with-profits business generally has a lower terminal bonus element than in the UK, the investment portfolio still contains a proportion of equities and, to a lesser extent, property. Non-participating business is largely backed by debt securities or deposits. The exposure to market risk of the Prudential Group arising from its Asian operations is therefore at modest levels. This arises from the fact that the Asian operations have a balanced portfolio of with-profits, unit-linked and other types of business.

*f Process for setting assumptions and determining liabilities*

The future policyholder benefit provisions for Asian businesses in the Prudential Group's IFRS accounts and previously under the MSB, are determined in accordance with methods prescribed by local GAAP adjusted to comply, where necessary, with UK GAAP.

For Asian operations in countries where local GAAP is not well established and in which the business written is primarily non-participating and linked business, US GAAP is used as the most appropriate reporting basis. This basis is applied in Japan and Vietnam and, materially for 2007 and 2008 but less so for 2009 following the sale of the agency business, in Taiwan. The future policyholder benefit provisions for non-linked business are determined using the net level premium method, with an allowance for surrenders, maintenance and claims expenses. Rates of interest used in establishing the policyholder benefit provisions vary by operation depending on the circumstances attaching to each block of business.

*g Reinsurance*

The Asian businesses cede only minor amounts of business outside the Prudential Group with immaterial effects on reported profit. During 2007, 2008 and 2009 respectively, reinsurance premiums for externally ceded business were £52 million, £76 million and £119 million and the reinsurance assets as at 31 December 2007, 31 December 2008 and 31 December 2009 were £12 million, £24 million and £18 million in aggregate.

*h Effect of changes in bases, estimates and assumptions used to measure insurance assets and liabilities*

*a Exceptional credit of £63 million regarding the liability measurement for Malaysia long-term business*

For the Malaysia life business, under the basis applied previously, 2008 IFRS basis liabilities were determined on the local regulatory basis using prescribed interest rates such that a high degree of prudence resulted.

As of 1 January 2009, the local regulatory basis has been replaced by the Malaysian authority's risk-based capital (RBC) framework. In the light of this development, Prudential has remeasured the liabilities by reference to the method applied under the new RBC framework, which is more realistic than the previous approach, but with an overlay constraint to the method such that negative reserves derived at an individual policyholder level are not included. This change has resulted in a one-off release from liabilities at 1 January 2009 of £63 million.

*b Changes in key assumptions*

There were no changes of assumptions that had a material impact on the 2007 results for Asian operations. There were a number of individually small assumption changes impacting on the 2008 results by £21 million, in aggregate, for Asian operations. Excluding the change in Malaysia as explained above, the result for Asian operations was impacted in 2009 by the effect of a number of other individually small assumptions changes of, in aggregate, £4 million.

*c Deferral and amortisation of acquisition costs*

Under IFRS, the basis of accounting for insurance assets and liabilities reflects 'grandfathered' GAAP under the Modified Statutory Basis. In general, this requires the deferral and amortisation of acquisition costs in line with the emergence of margins. In 2008, the basis of deferral and amortisation was adjusted for a number of territories to better reflect the MSB requirement as follows:

For the India life operation, reflecting the initial development stage of the business, acquisition costs had previously not been deferred. In 2008, £19 million of deferred acquisition costs, net of amortisation in the year, were established.

For the Korea life business, refinements were made to move to a more appropriate basis which resulted in a credit of £35 million (£9 million of which related to the 1 January 2008 balance).

For Singapore, refinements were made with a £21 million benefit in 2008 (of which £7 million related to the 1 January 2008 position) where the local risk based capital approach does not provide an appropriate basis of implicit allowance for acquisition costs for certain products and in Hong Kong, adjustments were made with a net overall effect of £10 million in 2008.

### Currency translation

Consistent with the Prudential Group's accounting policies, the profits of the Asian insurance operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2009, the rates for the most significant operations are given in note B4.

A 10% increase or decrease in these rates would have reduced or increased profit before tax attributable to shareholders, profit for the year and shareholders' equity, excluding goodwill, attributable to Asian operations respectively as follows:

	A 10% increase in exchange rates			A 10% decrease in exchange rates		
	2007	2008	2009	2007	2008	2009
	£m	£m	£m	£m	£m	£m
Profit before tax attributable to shareholders* . . . . .	(16)	(14)	(40)	20	18	49
Profit for the year . . . . .	(10)	(6)	(35)	13	8	43
Shareholders' equity, excluding goodwill, attributable to Asian operations . . . . .	(124)	(202)	(129)	151	246	158

\* Sensitivity on profit before tax i.e. aggregate of the operating profit based on longer-term investment returns, short-term fluctuations in investment returns, and actuarial gains and losses on defined benefit pension schemes but excluding for 2009 the loss on sale and results for Taiwan agency business, as discussed in note B1.

### Other risks

#### i With-profits business

Similar principles to those explained for UK with-profits business apply to profit emergence for the Asian with-profits business. Correspondingly, the profit emergence reflects bonus declaration and is relatively insensitive to period by period fluctuations in insurance risk or interest rate movements.

#### ii Unit-linked business

As for the UK insurance operations, the profits and shareholders' equity related to the Asian operations is primarily driven by charges related to invested funds. For the Asian operations, substantially all of the contracts are classified as insurance contracts under IFRS 4, i.e. containing significant insurance risk. The sensitivity of profits and equity to changes in insurance risk is minor and, to interest rate risk, not material.

#### iii Other business

##### a) *Interest rate risk for Taiwan*

For 2008 the principal other business of Asian operations that was most sensitive to movements in interest rates was the whole of life business written in Taiwan. In June 2009 Prudential completed the sale of its agency distribution business and associated liabilities and its agency force in Taiwan to China Life Insurance Company Ltd. as explained in note I1. For 2009 the assets and liabilities of the element of Taiwan business retained by Prudential are relatively less sensitive to variances in interest rates, with a reasonably possible decrease in interest rates of 0.5% leading to an increase in IFRS pre-tax profits of £24 million. After adjusting these results for deferred tax the reasonably possible effect on shareholders' equity is £19 million. A 0.5% increase in interest rates is estimated to have an approximately equal and opposite effect on profit and shareholders equity.

##### b) *Interest rate risk for other business excluding Taiwan*

Asian operations offer a range of insurance and investment products, predominately with-profits and non-participating term, whole life, endowment and unit-linked. Excluding with-profit and unit-linked business along with Taiwan, the results of the Asian business are sensitive to the vagaries of routine movements in interest rates.

For the purposes of analysing sensitivity to variations in interest rates, it has been determined for the majority of territories that a movement of 1% in the 10 year government bond rate can be considered reasonably possible. At 31 December 2009, 10 year government bond rates vary from territory to territory and range from 1.3% to 11.45% (2008: 1.17% to 10.18% and 2007: 1.5% to 9.1%). An exception to this arises in Japan where reasonably possible

interest rate movements have been determined as 0.5% respectively. (2008: Japan 0.5%, Vietnam 1.5% and 2007: Japan 0.25%, Vietnam 1.5%). These reasonably possible changes would have the following impact:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	A decrease of 1%*	A decrease of 1%*	A decrease of 1%*
	£m		
Pre-tax . . . . .	30	56	67
Related deferred tax (where applicable). . . . .	<u>(8)</u>	<u>(11)</u>	<u>(17)</u>
Net effect on profit and equity . . . . .	<u>22</u>	<u>45</u>	<u>50</u>

\* 1% sensitivity has been used in all territories except (2007: Japan 0.25% and Singapore 0.5%), (2008: Japan 0.5%, Vietnam 1.5%) and (2009: Japan 0.5%)

The pre-tax impacts, if they arose, would mostly be recorded within the category short-term fluctuations in investment returns in the Prudential Group's supplementary analysis of profit before tax.

At 31 December 2009, an increase in the rates of 1% (Japan (0.5%)) is estimated to have the effect of decreasing pre-tax profit by £87 million. After adjusting these results for deferred tax the reasonable possible effect on shareholders' equity is a decrease of £65 million.

c) *Equity price risk*

The non-linked shareholder business has limited exposure to equity and property investment (£278 million at 31 December 2009.) Generally changes in equity and property investment values are not automatically matched by investments in policyholder liabilities.

However for the Vietnam business, to the extent that equity investment appreciation is realised through sales of securities then policyholders liabilities are adjusted to the extent that policyholders participate.

The estimated sensitivity to a 10% and 20% (2008: 10, 20 and 40% and 2007: 10%) change in equity and property prices for shareholder-backed Asian other business, which would be reflected in the short-term fluctuation component of the Prudential Group's segmental analysis of profit before tax at 31 December 2007, 2008 and 2009 would be as follows:

	<u>2007</u>	<u>2008</u>			<u>2009</u>	
	A decrease of 10%	A decrease of 40%	A decrease of 20%	A decrease of 10%	A decrease of 20%	A decrease of 10%
	£m			£m		
Pre-tax . . . . .	(73)	(176)	(88)	(44)	(58)	(29)
Related deferred tax (where applicable). . . . .	<u>5</u>	<u>5</u>	<u>3</u>	<u>1</u>	<u>8</u>	<u>4</u>
Net effect on profit and equity . . . . .	<u>(68)</u>	<u>(171)</u>	<u>(85)</u>	<u>(43)</u>	<u>(50)</u>	<u>(25)</u>

A 10% or 20% (2008: 10%, 20%, or 40% and 2007: 10%) increase in their value is estimated to have an approximately equal and opposite effect on profit and shareholders' equity to the sensitivities shown above. The low tax rate effect, which is particularly evident in 2008, relates to the availability of losses in some of the territories.

The disclosure of the effect of a 40% fall for the 2008 year-end was included because of the exceptional market conditions at that time. These conditions have now abated and the disclosure is no longer appropriate.

In the equity risk sensitivity analysis given above the Prudential Group has, for 2009, considered the impact of an instantaneous 20% fall in equity markets. If equity markets were to fall by more than 20%, the Prudential Group believes that this would not be an instantaneous fall but rather this would be expected to occur over a period of time during which the Prudential Group would be able to put in place mitigating management actions.

d) *Insurance risk*

Many of the territories in Asia are exposed to mortality/morbidity risk and provision is made within IFRS policyholder liabilities on a prudent regulatory basis to cover the potential exposure. If these prudent assumptions were strengthened by 5% (estimated at one in ten year shock) then it is estimated that post tax IFRS profit would be impacted by approximately £9 million (with a corresponding change to IFRS shareholders' equity) in 2009. Mortality/morbidity has a symmetrical effect on portfolio and so a weakening of mortality/morbidity assumptions would have an approximately equal and opposite similar impact.

*j*      *Duration of liabilities*

The table below shows the carrying value of policyholder liabilities. Separately the Prudential Group uses cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing EEV basis results. The table below shows the maturity profile of the cash flows, taking account of expected future premiums and investment returns, is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Policyholder liabilities . . . . .	17,033	20,909	21,858
	<u>%</u>	<u>%</u>	<u>%</u>
Expected maturity:			
0 to 5 years . . . . .	22	23	24
5 to 10 years . . . . .	22	21	21
10 to 15 years . . . . .	16	15	15
15 to 20 years . . . . .	13	13	12
20 to 25 years . . . . .	9	10	9
Over 25 years . . . . .	18	18	19

**D5: Capital position statement for life assurance businesses**

*a Summary statement*

The Prudential Group's estimated capital position for life assurance businesses with reconciliations to shareholders' equity is shown below. Available capital for each fund or group of companies is determined by reference to local regulation at 31 December 2007, 2008 and 2009.

	2007									
31 December 2007	SAIF	WPSF note i	Total PAC with- profits fund	Other UK life assurance subsidi- aries and funds note ii	Jackson	Asian life assurance subsidi- aries	Total life assurance opera- tions	M&G (including Prudential Capital)	Parent company and share- holders' equity of other subsidi- aries and funds	Group total  £m
<b>Group shareholders' equity</b>										
Held outside long-term funds:										
Net assets . . . . .	—	—	—	550	2,690	1,258	4,498	271	(862)	3,907
Goodwill . . . . .	—	—	—	—	—	111	111	1,153	77	1,341
Total . . . . .	—	—	—	550	2,690	1,369	4,609	1,424	(785)	5,248
Held in long-term funds <sup>(note iii)</sup> . . . . .	—	—	—	814	—	—	814	—	—	814
Total Group shareholders' equity . . . . .	—	—	—	1,364	2,690	1,369	5,423	1,424	(785)	6,062
<b>Adjustments to regulatory basis</b>										
Unallocated surplus of with- profits funds <sup>(note v)</sup> . . . . .	—	13,813	13,813	—	—	146	13,959	—	—	—
Shareholders' share of realistic liabilities . . . . .	—	(4,178)	(4,178)	—	—	—	(4,178)	—	—	—
Deferred acquisition costs of non- participating business not recognised for regulatory reporting purposes . . . . .	(4)	(15)	(19)	(143)	(1,928)	(790)	(2,880)	—	—	—
Jackson surplus notes <sup>(note iv)</sup> . . . . .	—	—	—	—	125	—	125	—	—	—
Investment and policyholder liabilities valuation differences between IFRS and regulatory basis for Jackson <sup>(note viii)</sup> . . . . .	—	—	—	—	—	—	—	—	—	—
Adjustment from IAS 19 basis pension deficit attributable to WPSF to pension liability for regulatory purposes <sup>(note vii)</sup> . . . . .	—	(138)	(138)	—	—	—	(138)	—	—	—
Valuation difference on PAL between IFRS basis and regulatory basis . . . . .	—	(1,117)	(1,117)	—	—	—	(1,117)	—	—	—
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) <sup>(note v)</sup> . . . . .	4	355	359	(239)	1,364	149	1,633	—	—	—
Total adjustments . . . . .	—	8,720	8,720	(382)	(439)	(495)	7,404	—	—	—
<b>Total available capital resources of life assurance businesses on local regulatory bases . . . . .</b>	<u>—</u>	<u>8,720</u>	<u>8,720</u>	<u>982</u>	<u>2,251</u>	<u>874</u>	<u>12,827</u>	<u>—</u>	<u>—</u>	<u>—</u>

<u>31 December 2007</u>	<u>SAIF</u>	<u>WPSF note i</u>	<u>Total PAC with- profits fund</u>	<u>Other UK life assurance subsidiaries and funds note ii</u>	<u>Jackson</u>	<u>Asian life assurance subsidiaries</u>	<u>Total life assurance operations £m</u>
<b>Policyholder liabilities</b>							
With-profits liabilities of UK regulated with-profits funds:							
Insurance contracts . . . . .	12,672	34,029	46,701	—	—	3,307	50,008
Investment contracts (with discretionary participating features) . . . . .	693	28,773	29,466	—	—	84	29,550
Total . . . . .	<u>13,365</u>	<u>62,802</u>	<u>76,167</u>	<u>—</u>	<u>—</u>	<u>3,391</u>	<u>79,558</u>
Other liabilities:							
Insurance contracts:							
With-profits liabilities of non-UK regulated funds . . . . .							
Unit-linked, including variable annuity . . . . .	—	—	—	—	—	2,973	2,973
Other life assurance business . . . . .	255	11,494	11,749	14,121	17,899	3,661	47,430
Investment contracts without discretionary participation features (principally unit-linked and similar contracts in the UK and GIC liabilities of Jackson) <sup>(note vi)</sup> . . . . .							
Total . . . . .	<u>—</u>	<u>14</u>	<u>14</u>	<u>12,059</u>	<u>1,922</u>	<u>37</u>	<u>14,032</u>
Total . . . . .	<u>255</u>	<u>13,537</u>	<u>13,792</u>	<u>34,518</u>	<u>34,848</u>	<u>13,642</u>	<u>96,800</u>
<b>Total policyholder liabilities shown in the consolidated statement of financial position . . . . .</b>							
	<u>13,620</u>	<u>76,339</u>	<u>89,959</u>	<u>34,518</u>	<u>34,848</u>	<u>17,033</u>	<u>176,358</u>

<u>31 December 2008</u>	<u>SAIF</u>	<u>WPSF note i</u>	<u>Total PAC with- profits fund</u>	<u>Other UK life assurance subsidi- aries and funds note ii</u>	<u>Jackson</u>	<u>Asian life assurance subsidi- aries</u>	<u>Total life assurance opera- tion</u>	<u>M&amp;G (including Prudential Capital)</u>	<u>Parent company and share- holders' equity of other subsidi- aries and funds</u>	<u>Group total £m</u>
<b>Group shareholders' equity</b>										
Held outside long-term funds:										
Net assets . . . . .	—	—	—	735	1,698	2,056	4,489	147	(1,839)	2,797
Goodwill . . . . .	—	—	—	—	—	111	111	1,153	77	1,341
Total . . . . .	—	—	—	735	1,698	2,167	4,600	1,300	(1,762)	4,138
Held in long-term funds <sup>(note iii)</sup> . . . . .										
Total Group shareholders' equity . . . . .	—	—	—	920	—	—	920	—	—	920
Total Group shareholders' equity . . . . .	—	—	—	1,655	1,698	2,167	5,520	1,300	(1,762)	5,058
<b>Adjustments to regulatory basis</b>										
Unallocated surplus of with-profits funds <sup>(note v)</sup> . . . . .	—	8,254	8,254	—	—	160	8,414	—	—	—
Shareholders' share of realistic liabilities . . . . .	—	(2,028)	(2,028)	—	—	—	(2,028)	—	—	—
Deferred acquisition costs of non-participating business not recognised for regulatory reporting purposes . . . . .	(3)	(10)	(13)	(128)	(3,962)	(876)	(4,979)	—	—	—
Jackson surplus notes <sup>(note iv)</sup> . . . . .	—	—	—	—	173	—	173	—	—	—
Investment and policyholder liabilities valuation differences between IFRS and regulatory basis for Jackson <sup>(note vii)</sup> . . . . .	—	—	—	—	4,819	—	4,819	—	—	—
Adjustment from IAS 19 basis pension deficit attributable to WPSF to pension liability for regulatory purposes <sup>(note vii)</sup> . . . . .	—	(147)	(147)	—	—	—	(147)	—	—	—
Valuation difference on PAL between IFRS basis and regulatory basis . . . . .	—	(1,350)	(1,350)	—	—	—	(1,350)	—	—	—
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis) <sup>(note v)</sup> . . . . .	3	643	646	(474)	30	(41)	161	—	—	—
Total adjustments . . . . .	—	5,362	5,362	(602)	1,060	(757)	5,063	—	—	—
<b>Total available capital resources of life assurance businesses on local regulatory bases . . . . .</b>	<u>—</u>	<u>5,362</u>	<u>5,362</u>	<u>1,053</u>	<u>2,758</u>	<u>1,410</u>	<u>10,583</u>	<u>—</u>	<u>—</u>	<u>—</u>

<b>31 December 2008</b>	<b>SAIF</b>	<b>WPSF note i</b>	<b>Total PAC with- profits fund</b>	<b>Other UK life assurance subsidiaries and funds note ii</b>	<b>Jackson</b>	<b>Asian life assurance subsidiaries</b>	<b>Total life assurance operations £m</b>
<b>Policyholder liabilities</b>							
With-profits liabilities of UK regulated with-profits funds:							
Insurance contracts . . . . .	9,260	26,466	35,726	—	—	4,416	40,142
Investment contracts (with discretionary participating features) . . . . .	494	22,873	23,367	—	—	79	23,446
Total . . . . .	<u>9,754</u>	<u>49,339</u>	<u>59,093</u>	<u>—</u>	<u>—</u>	<u>4,495</u>	<u>63,588</u>
Other liabilities:							
Insurance contracts:							
With-profits liabilities of non-UK regulated funds . . . . .							
Unit-linked, including variable annuity . . . . .	—	1,872	1,872	6,041	14,538	7,220	29,671
Other life assurance business . . . . .	264	12,625	12,889	16,228	27,938	5,755	62,810
Investment contracts without discretionary participation features (principally unit-linked and similar contracts in the UK and GIC liabilities of Jackson) <sup>(note vi)</sup> . . . . .	—	—	—	11,584	2,885	32	14,501
Total . . . . .	<u>264</u>	<u>14,497</u>	<u>14,761</u>	<u>33,853</u>	<u>45,361</u>	<u>16,414</u>	<u>110,389</u>
<b>Total policyholder liabilities shown in the consolidated statement of financial position . . . . .</b>	<u><u>10,018</u></u>	<u><u>63,836</u></u>	<u><u>73,854</u></u>	<u><u>33,853</u></u>	<u><u>45,361</u></u>	<u><u>20,909</u></u>	<u><u>173,977</u></u>

<b>31 December 2009</b>	<b>SAIF</b>	<b>WPSF note i</b>	<b>Total PAC with- profits fund</b>	<b>Other UK life assurance subsidi- aries and funds note ii</b>	<b>Jackson</b>	<b>Asian life assurance subsidi- aries</b>	<b>Total life assurance opera- tions</b>	<b>M&amp;G (including Prudential Capital)</b>	<b>Parent company and share- holders' equity of other subsidi- aries and funds</b>	<b>Group total  £m</b>
<b>Group shareholders' equity . . . . .</b>										
Held outside long-term funds:										
Net assets . . . . .	—	—	—	788	3,011	1,382	5,181	173	(1,507)	3,847
Goodwill . . . . .	—	—	—	—	—	80	80	1,153	77	1,310
Total . . . . .	—	—	—	788	3,011	1,462	5,261	1,326	(1,430)	5,157
Held in long-term funds (note iii) . . . . .	—	—	—	1,114	—	—	1,114	—	—	1,114
Total Group shareholders' equity . . . . .	—	—	—	1,902	3,011	1,462	6,375	1,326	(1,430)	6,271
<b>Adjustments to regulatory basis . . . . .</b>										
Unallocated surplus of with-profits funds(note v) . . . . .	—	9,966	9,966	—	—	53	10,019			
Shareholders' share of realistic liabilities . . . . .	—	(3,001)	(3,001)	—	—	—	(3,001)			
Deferred acquisition costs of non- participating business not recognised for regulatory reporting purposes . . . . .	(2)	(7)	(9)	(124)	(3,092)	(786)	(4,011)			
Jackson surplus notes(note iv) . . . . .	—	—	—	—	154	—	154			
Investment and policyholder liabilities valuation differences between IFRS and regulatory basis for Jackson (note viii) . . . . .	—	—	—	—	2,221	—	2,221			
Adjustment from IAS 19 basis pension deficit attributable to WPSF to pension liability for regulatory purposes(note vii) . . . . .	—	65	65	—	—	—	65			
Valuation difference on PAL between IFRS basis and regulatory basis . . . . .	—	(1,294)	(1,294)	—	—	—	(1,294)			
Other adjustments to restate these amounts to a regulatory basis (with SAIF and the WPSF on a Peak 2 realistic basis)(note v) . . . . .	2	703	705	(171)	194	400	1,128			
Total adjustments . . . . .	—	6,432	6,432	(295)	(523)	(333)	5,281			
<b>Total available capital resources of life assurance businesses on local regulatory bases . . . . .</b>	<u>—</u>	<u>6,432</u>	<u>6,432</u>	<u>1,607</u>	<u>2,488</u>	<u>1,129</u>	<u>11,656</u>			

<u>31 December 2009</u>	<u>SAIF</u>	<u>WPSF note i</u>	<u>Total PAC with- profits fund</u>	<u>Other UK life assurance subsidiaries and funds note ii</u>	<u>Jackson</u>	<u>Asian life assurance subsidiaries</u>	<u>Total life assurance operations</u> £m
<b>Policyholder liabilities</b> . . . . .							
With-profits liabilities of UK regulated with- profits funds:							
Insurance contracts . . . . .	9,285	28,449	37,734	—	—	4,766	42,500
Investment contracts (with discretionary participating features) . . . . .	<u>396</u>	<u>24,384</u>	<u>24,780</u>	<u>—</u>	<u>—</u>	<u>100</u>	<u>24,880</u>
Total . . . . .	<u>9,681</u>	<u>52,833</u>	<u>62,514</u>	<u>—</u>	<u>—</u>	<u>4,866</u>	<u>67,380</u>
Other liabilities:							
Insurance contracts:							
With-profits liabilities of non-UK regulated funds . . . . .	—	—	—	—	—	3,942	3,942
Unit-linked, including variable annuity . . . . .	—	1,998	1,998	6,793	20,639	9,717	39,147
Other life assurance business . . . . .	291	12,726	13,017	18,113	25,707	3,287	60,124
Investment contracts without discretionary participation features (principally unit- linked and similar contracts in the UK and GIC liabilities of Jackson)(note vi) . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>13,794</u>	<u>1,965</u>	<u>46</u>	<u>15,805</u>
Total . . . . .	<u>291</u>	<u>14,724</u>	<u>15,015</u>	<u>38,700</u>	<u>48,311</u>	<u>16,992</u>	<u>119,018</u>
<b>Total policyholder liabilities shown in the consolidated statement of financial position</b> . . . . .	<u><u>9,972</u></u>	<u><u>67,557</u></u>	<u><u>77,529</u></u>	<u><u>38,700</u></u>	<u><u>48,311</u></u>	<u><u>21,858</u></u>	<u><u>186,398</u></u>

## Notes

- i WPSF unallocated surplus includes amounts related to the Hong Kong branch. Policyholder liabilities of the Hong Kong branch are included in the amounts of Asian life assurance subsidiaries.
- ii Excluding PAC shareholders' equity that is included in 'parent company and shareholders' equity of other subsidiaries and funds'.
- iii The term shareholders' equity held in long-term funds refers to the excess of assets over liabilities attributable to shareholders of funds which are required by law to be maintained with segregated assets and liabilities.
- iv For regulatory purposes the Jackson surplus notes are accounted for as capital.
- v Other adjustments to shareholders' equity and unallocated surplus include amounts for the value of non-participating business for UK regulated with-profits funds, deferred tax, admissibility and other items measured differently on the regulatory basis. For Jackson the principal reconciling item is deferred tax related to the differences between IFRS and regulatory basis as shown in the table above and other methodology differences.
- vi Insurance business accounted for as financial instruments under IAS 39.
- vii In determining the IAS 19 adjustment for the purposes of this table the deficit in the Prudential Group's main pension scheme used for the calculation includes amounts for investments in Prudential insurance policies (see note I2).
- viii The investment and policyholder liabilities valuation difference between IFRS and regulatory bases for Jackson is mainly due to not all investments being carried at fair value under the regulatory basis and also for the valuation difference on annuity reserves.

*b Basis of preparation, capital requirements and management*

Each of the Prudential Group's long-term business operations is capitalised to a sufficiently strong level for its individual circumstances. Details by the Prudential Group's major operations are shown below.

*i UK insurance operations*

The FSA rules which govern the Prudential regulation of insurance form part of the Prudential Sourcebook for Insurers, the General Prudential Sourcebook and Interim Prudential Sourcebook for Insurers. Overall, the net requirements of the General Prudential Sourcebook are intended to align the capital adequacy requirements for insurance business more closely with those of banking and investment firms and building societies, for example, by addressing tiers of capital, rather than looking at net admissible assets. An insurer must hold capital resources equal at least to the Minimum Capital Requirement (MCR).

The Prudential Sourcebook for Insurers also contains rules on Individual Capital Assessments. Under these rules and the rules of the General Prudential Sourcebook all insurers must assess for themselves the amount of capital needed to back their business. If the FSA views the results of this assessment as insufficient, it may draw up its own Individual Capital Guidance for a firm, which can be superimposed as a requirement.

## **PAC WPSF and SAIF**

Under FSA rules, insurers with with-profits liabilities of more than £500 million must hold capital equal to the higher of the MCR and the Enhanced Capital Requirement (ECR). The ECR is intended to provide a more risk responsive and 'realistic' measure of a with-profit insurer's capital requirements, whereas the MCR is broadly speaking equivalent to the previous required minimum margin under the Interim Prudential Sourcebook and satisfies the minimum EU Standards.

Determination of the ECR involves the comparison of two separate measurements of the firm's resources requirement, which the FSA refers to as the 'twin peaks' approach.

The two separate peaks are:

- i The requirement comprised by the mathematical reserves plus the 'Long-Term Insurance Capital Requirement' (LTICR), together known as the 'regulatory peak'; and
- ii a calculation of the 'realistic' present value of the insurer's expected future contractual liabilities together with projected 'fair' discretionary bonuses to policyholders, plus a risk capital margin, together known as the 'realistic peak'.

Available capital of the WPSF and SAIF of £8.7 billion, £5.4 billion and £6.4 billion, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, represents the excess of assets over liabilities on the FSA realistic basis. Unlike the previously discussed FRS 27 basis, realistic liabilities on the regulatory basis include the shareholders' share of future bonuses. These amounts are shown before deduction of the risk capital margin (RCM) which is estimated to be £2.0 billion, £2.1 billion and £1.4 billion, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

The FSA's basis of setting the RCM is to target a level broadly equivalent to a Standard & Poor's credit rating of BBB and to judge this by ensuring there are sufficient assets to absorb a one in 200 year event. The RCM calculation achieves this by setting rules for the determination of margins to cover defined stress changes in asset values and yields for market risk, credit risk and termination risk for with-profits policies.

As noted in section D2(f)(ii), PAC has discretion in its management actions in the case of adverse investment conditions. Management actions encompass, but are not confined to, investment allocation decisions, levels of reversionary bonuses, crediting rates and total claim values. To illustrate the flexibility of management actions, rates of regular bonus are determined for each type of policy primarily by targeting them at a prudent proportion of the long-term expected future investment return on the underlying assets. The expected future investment return is reduced as appropriate for each type of policy to allow for items such as expenses, charges, tax and shareholders' transfers. However, the rates declared may differ by product type, or by date of payment of the premiums or date of issue of the policy, if the accumulated annual bonuses are particularly high or low relative to a prudent proportion of the achieved investment return.

When target bonus levels change, the PAC board has regard to the overall financial strength of the long-term fund when determining the length of time over which it will seek to achieve the amended product target bonus level.

In normal investment conditions, PAC expects changes to regular bonus rates to be gradual over time and changes are not expected to exceed 1% per annum over any year. However, discretion is retained as to whether or not a regular bonus is declared each year, and there is no limit on the amount by which regular bonus rates can be changed.

As regards smoothing of maturity and death benefits, in normal circumstances PAC does not expect most pay-out values on policies of the same duration to change by more than 10% up or down from one year to the next, although some larger changes may occur to balance pay-out values between different policies. Greater flexibility may be required in certain circumstances, for example following a significant rise or fall in market values (either sudden or over a period of years) and in such situations the PAC board may decide to vary the standard bonus smoothing limits to protect the overall interests of policyholders.

For surrender benefits, any substantial fall in the market value of the assets of the with-profits sub-fund would lead to changes in the application of MVRs for accumulating with-profits policies, firstly to increase the size of MVRs already being applied and, secondly, to extend the range of policies for which an MVR is applied.

## **Other UK life assurance subsidiaries and funds**

The available capital of £982 million, £1,053 million and £1,607 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, reflects the excess of regulatory basis assets over liabilities of the

subsidiaries and funds, before deduction of the capital resources requirement of £841 million, £884 million and £952 million as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

The capital resources requirement for these companies broadly reflects a formula which, for active funds, equates to a percentage of regulatory reserves plus a percentage of death strains. Death strains represent payments made to policyholders upon death in excess of amount explicitly allocated to fund the provisions for policyholders claims and maturities.

## *ii Jackson*

The regulatory framework for Jackson is governed by the requirements of the US NAIC approved risk-based capital standards. Under these requirements life insurance companies report on a formula-based capital standard that they calculate by applying factors to various asset, premium and reserve items. The formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk and business risk.

The available capital of Jackson shown above of £2,251 million, £2,758 million and £2,488 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, reflects US regulatory basis assets less liabilities including asset valuation reserves. The asset valuation reserve is designed to provide for future credit-related losses on debt securities and losses on equity investments. Available capital includes a reduction for the effect of the interest maintenance reserve, which is designed by state regulators to defer recognition of non-credit related realised capital gains and losses and to recognise them rateably in the future.

Jackson's risk-based capital ratio is significantly in excess of regulatory requirements. Effective for 2008 reporting, the local regulator granted Jackson three permitted practices, which expired on 1 October 2009, unless extended by the local regulator. One permitted practice allows Jackson to carry interest rate swaps at book value, as if statutory hedge accounting were in place, instead of at fair value as would have been otherwise required. Jackson is also required to demonstrate the effectiveness of its interest rate swap programme pursuant to the Michigan Insurance Code. The local regulator also granted a permitted practice to allow Jackson to recognise book to tax differences that will reverse within the next three years (instead of one year as required by the NAIC) in determining the admissible tax asset (subject to a limitation of 15% of capital and surplus versus the 10% limitation imposed by the NAIC guidance). Finally, the local regulator granted a permitted practice to allow Jackson to use an average interest rate in calculating certain regulatory requirements. In 2009, the permitted practice with respect to the interest rate swaps was renewed until 1 October 2010 with the other two expired on 1 October 2009. The permitted practice requires that Jackson maintain certain minimum capital levels excluding the effect of the permitted practices. The total effect of these permitted practices was to increase statutory surplus by £117 million and £588 million at 31 December 2009 and 2008, respectively, and reduce authorised control level required capital by £57 million at 31 December 2008.

## *iii Asian operations*

The available capital shown above of £874 million, £1,410 million and £1,129 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, represents the excess of local regulatory basis assets over liabilities before deduction of required capital of £265 million, £407 million and £438 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. These amounts have been determined applying the local regulations in each of the operations.

The businesses in Asia are subject to local capital requirements in the jurisdictions in which they operate. The Hong Kong business branch of PAC and its capital requirements are subsumed within those of the PAC long-term fund. For the other material Asian operations, the details of the basis of determining regulatory capital and regulatory capital requirements are as follows:

### **Singapore**

In Singapore a risk-based regulatory framework applies rather than one based on a net premium approach.

For participating business, a gross premium reserve, determined using prudent best estimate assumptions and which makes allowance for future bonus, is held. The amount held is subject to a minimum of the higher of the assets attributed to participating business and a gross premium reserve calculated on specified assumptions, but without allowance for future bonus, that include prescribed provisions for adverse deviations (PADs).

For non-participating business, gross premium reserves are held. For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology.

## **Indonesia**

Policy reserves for traditional business are determined on a modified net premium basis. The valuation interest rates are capped at 9% for local currency products and 5% for foreign currency products.

For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology. Solvency capital is determined using risk-based capital approach. Insurance companies in Indonesia are expected to maintain the level of net assets above 120% of solvency capital. Due to the 2008 financial crisis, the local regulator provided relief in solvency capital through 2008 and 2009 and the measure continues until further notice.

## **Japan**

Mathematical reserves for traditional business are determined on a net premium basis using prescribed mortality and interest rates. Interest rates reflect the original pricing assumptions.

For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology.

With regard to solvency, the adjusted solvency capital assets of Prudential must exceed 200% of the risk related capital requirement value at risk. It is thus a risk-based capital approach.

## **Malaysia**

For 2007 and 2008 the mathematical reserves for traditional business were determined on a modified net premium basis using prescribed mortality and interest rates (no higher than 4%).

For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology.

The capital requirement is determined as 4% of reserves plus a specified percentage of sums at risk. There is an overriding minimum capital requirement of 100 million Malaysian Ringgit.

A new risk-based capital framework was adopted from 1 January 2009 to replace the previous framework that used a net premium approach.

For participating business, a gross premium reserve on the guaranteed and non-guaranteed benefits determined using best estimate assumptions is held. The amount held is subject to a minimum of a gross premium reserve on the guaranteed benefits, determined using best estimate assumptions along with provisions of risk margin for adverse deviations (PRADs) discounted at the risk-free rate.

For non-participating business, gross premium reserves determined using best estimate assumptions along with provisions of risk margin for adverse deviations (PRADs) discounted at the risk-free rate are held. For linked business the value of units is held together with a non-unit reserve calculated in accordance with standard actuarial methodology.

The risk-free rate is derived from a yield curve of zero-coupon spot yields of Malaysian Government Securities.

## **Vietnam**

Mathematical reserves are calculated using a modified net premium approach, using a stable set of assumptions agreed with the regulator.

The capital requirement is determined as 4% of reserves plus a specified percentage of 0.1% of sums at risk for policies with original term less than or equal to five years or 0.3% of sums at risk for policies with original term of more than five years. An additional capital requirement of Vietnamese Dong 200 billion is also required for companies transacting unit-linked business.

## **Korea**

Policy reserves for traditional business are determined on net premium reserve basis using pricing mortality and prescribed standard interest rates.

For linked business, the value of units is held together with the non-unit reserves calculated in accordance with regulatory standard actuarial methodology.

For 2007 and 2008 the capital requirement in Korea were determined as 4% of the policy reserves and expected claims after reinsurance.

Insurance companies in Korea are expected to maintain a level of free surplus in excess of the capital requirements with the usual level of solvency margin being around 200% of the required capital.

The capital requirement in Korea has moved to a risk-based regulatory framework in April 2009 with a two-year transition period where insurers can choose between the prior and new framework. A risk-based regulatory framework is adopted immediately by Prudential. Under the new framework, insurance companies in Korea are expected to maintain a level of free surplus in excess of the capital requirements with the general target level of solvency margin being in excess of 150% of the risk-based capital.

*iv Group capital requirements*

In addition to the requirements at individual company level, FSA requirements under the IGD apply additional prudential requirements for the Prudential Group as a whole.

Discussion of the Prudential Group's estimated IGD position at 31 December 2009, together with market risk sensitivity disclosure provided to key management, is provided in the Risk and capital management section of Part XII of this prospectus and in Section C.

*c Movements in total available capital*

Total available capital for the Prudential Group's life assurance operations has changed during 2007, 2008 and 2009 as follows:

					2007
	WPSF note i	Other UK life assurance subsidiaries and funds note iii	Jackson note ii	Asian life assurance subsidiaries note iv	Group total £m
<b>Available capital at 31 December 2006</b> . . . . .	<b>8,688</b>	<b>903</b>	<b>2,083</b>	<b>745</b>	<b>12,419</b>
Changes in assumptions . . . . .	(335)	(33)	—	4	(364)
Changes in management policy . . . . .	—	—	—	12	12
Changes in regulatory requirements . . . . .	—	—	(7)	—	(7)
New business and other factors . . . . .	<u>367</u>	<u>112</u>	<u>175</u>	<u>113</u>	<u>767</u>
<b>Available capital at 31 December 2007</b> . . . . .	<b><u>8,720</u></b>	<b><u>982</u></b>	<b><u>2,251</u></b>	<b><u>874</u></b>	<b><u>12,827</u></b>
					<b>2008</b>
	WPSF note i	Other UK life assurance subsidiaries and funds note iii	Jackson note ii	Asian life assurance subsidiaries note iv	Group total £m
<b>Available capital at 31 December 2007</b> . . . . .	<b>8,720</b>	<b>982</b>	<b>2,251</b>	<b>874</b>	<b>12,827</b>
Changes in assumptions . . . . .	(149)	(624)	—	(7)	(780)
Changes in management policy . . . . .	—	372	—	60	432
Changes in regulatory requirements . . . . .	—	—	(57)	134	77
New business and other factors . . . . .	<u>(3,209)</u>	<u>323</u>	<u>564</u>	<u>349</u>	<u>(1,973)</u>
<b>Available capital at 31 December 2008</b> . . . . .	<b><u>5,362</u></b>	<b><u>1,053</u></b>	<b><u>2,758</u></b>	<b><u>1,410</u></b>	<b><u>10,583</u></b>

	WPSF note i	Other UK life assurance subsidiaries and funds note iii	Jackson note ii	Asian life assurance subsidiaries note iv	Group total £m
<b>Available capital at 31 December 2008</b> . . . . .	5,362	1,053	2,758	1,410	10,583
Changes in assumptions . . . . .	18	23	—	2	43
Changes in management policy . . . . .	—	26	—	(101)	(75)
Changes in regulatory requirements . . . . .	—	0	128	178	306
New business and other factors . . . . .	<u>1,052</u>	<u>505</u>	<u>(398)</u>	<u>(360)</u>	<u>799</u>
<b>Available capital at 31 December 2009</b> . . . . .	<u><u>6,432</u></u>	<u><u>1,607</u></u>	<u><u>2,488</u></u>	<u><u>1,129</u></u>	<u><u>11,656</u></u>

#### Notes

##### i WPSF

The increase in 2007 reflects investment return earned on the opening available capital partially offset by the £335 million effect of assumption changes and a £214 million impact from a change in the risk-free yield curve which affects the outlook for future investment returns. The £335 million effect of assumption changes on a regulatory basis compares to the £392 million effect of change in assumption on an IFRS basis as shown in note D2(i)

The decrease in 2008 reflects primarily the negative investment returns earned on the opening available capital and £149 million negative effect of changes in assumptions on a regulatory basis compared to the £83 million effect of change in assumptions on an IFRS basis as shown in note D2(i).

The increase in 2009 reflects primarily the positive investment returns earned on the opening available capital and £18 million positive effect of changes in assumptions on a regulatory basis compared to the £65 million effect of change in assumptions on the IFRS basis as shown in note D2(i).

##### ii Jackson

The increase of £168 million in 2007 reflects an underlying increase of £203 million (applying the 2007 year end exchange rate of \$1.99:£1) and £35 million of exchange translation losses.

The increase of £507 million in 2008 reflects an underlying decrease of £358 million (applying the 2008 year end exchange rate of \$1.44:£1) and £865 million of exchange translation gain.

The decrease of £270 million in 2009 reflects an underlying increase of £33 million (applying the 2009 year end exchange rate of \$1.61:£1) and £303 million of exchange translation loss.

The underlying increase/decrease of the available capital of Jackson in 2007, 2008 and 2009 includes the effects of capital contributions, dividends paid to the parent company, impairment losses and also the effects of hedging transactions.

##### iii Other UK life assurance subsidiaries and funds

The effect from the changes in assumptions of valuation interest rates on insurance liabilities is broadly matched by the corresponding effect on assets leaving no significant impact on the available capital.

##### iv Asian life assurance subsidiaries

The decrease of £281 million in 2009 reflects an underlying decrease of £152 million (applying the relevant 2009 year end exchange rates) and £129 million of exchange translation loss. This underlying decrease of available capital includes the effects of the change to a risk-based capital framework in Malaysia from 1 January 2009 as explained in section b above and also the sale of the Taiwan agency business in June 2009 as described in note I1.

#### d *Transferability of available capital*

For PAC and all other UK long-term insurers, long-term business assets and liabilities must, by law, be maintained in funds separate from those for the assets and liabilities attributable to non-life insurance business or to shareholders. Only the 'established surplus' — the excess of assets over liabilities in the long-term fund determined through a formal valuation — may be transferred so as to be available for other purposes. Distributions from the with-profits sub-fund to shareholders reflect the shareholders' one-ninth share of the cost of declared policyholders' bonuses.

Accordingly, the excess of assets over liabilities of the PAC long-term fund is retained within that company. The retention of the capital enables it to support with-profits and other business of the fund by, for example, providing the benefits associated with smoothing and guarantees. It also provides investment flexibility for the fund's assets by meeting the regulatory capital requirements that demonstrate solvency and by absorbing the costs of significant events or fundamental changes in its long-term business without affecting the bonus and investment policies.

For other UK long-term business subsidiaries, the amounts retained within the companies are at levels which provide an appropriate level of capital strength in excess of the regulatory minimum.

For Jackson, capital retention is maintained at a level consistent with an appropriate rating by Standard & Poor's. Jackson can pay dividends on its capital stock only out of earned surplus unless prior regulatory approval is obtained. Furthermore, dividends which exceed the greater of 10% of Jackson's statutory surplus or statutory net gain from operations for the prior year require prior regulatory approval.

For Asian subsidiaries, the amounts retained within the companies are at levels that provide an appropriate level of capital strength in excess of the local regulatory minimum. For ring-fenced with-profits funds, the excess of assets over liabilities is retained with distribution tied to the shareholders' share of bonuses through declaration of actuarially determined surplus. The Singapore and Malaysian businesses may, in general, remit dividends to the UK, provided the statutory insurance fund meets the capital adequacy standard required under local statutory regulations.

Available capital of the non-insurance business units is transferable to the life assurance businesses after taking account of an appropriate level of operating capital, based on local regulatory solvency targets, over and above basis liabilities. The economic capital model described in section D1 (concentration of risks) takes into account restrictions on mobility of capital across the Prudential Group with capital transfers to and from business units triggered at a solvency level consistent with these targets. The model takes into account restrictions on the availability to the Prudential Group of the estate of the various with-profits funds throughout the group.

*e Sensitivity of liabilities and total capital to changed market conditions and capital management policies*

Prudential manages its assets, liabilities and capital locally, in accordance with local regulatory requirements and reflecting the different types of liabilities Prudential has in each business. As a result of the diversity of products offered by the Prudential Group and the different regulatory requirements in which it operates, Prudential employs differing methods of asset/liability and capital management, depending on the business concerned.

Stochastic modelling of assets and liabilities is undertaken in the UK, Jackson and Asia to assess the economic capital requirements under different confidence intervals and time horizons. In addition, reserve adequacy testing under a range of scenarios and dynamic solvency testing is carried out, including under certain scenarios mandated by the UK, the US and Asian regulators.

A stochastic approach models the inter-relationship between asset and liability movements, taking into account asset correlation, management actions and policyholder behaviour under a large number of alternative economic scenarios. These scenarios are projected forward over a period of time, typically 25 years or longer, and the liabilities and solvency position of the fund are calculated in each scenario in each future year. The fund's policy on management actions, including bonus and investment policy, continue to be set in order that they are consistent with the available capital and the targeted risk of default.

The sensitivity of liabilities and other components of total capital vary depending upon the type of business concerned and this conditions the approach to asset/liability management.

For example, for businesses that are most sensitive to interest rate changes, such as immediate annuity business, Prudential uses cash flow analysis to create a portfolio of debt securities whose value changes in line with the value of liabilities when interest rates change. This type of analysis helps protect profits from changing interest rates. This type of analysis is used in the UK for annuity business and by Jackson for its interest-sensitive and fixed indexed annuities and stable value products.

For businesses that are most sensitive to equity price changes, Prudential uses stochastic modelling and scenario testing to look at the future returns on its investments under different scenarios which best reflect the large diversity in returns that equities can produce. This allows Prudential to devise an investment and with-profits policyholder bonus strategy that, on the model assumptions, allows it to optimise returns to its policyholders and shareholders over time while maintaining appropriate financial strength. Prudential uses this methodology extensively in connection with its UK with-profits business.

*f Intra-group arrangements in respect of SAIF*

Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency.

Due to the quality and diversity of the assets in SAIF and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the directors believe that the probability of either the PAC long-term fund or the Prudential Group's shareholders' funds, under their obligation to maintain the capital position of long-term funds generally, having to contribute to SAIF is remote.

## E: ASSET MANAGEMENT (INCLUDING US BROKER-DEALER) AND OTHER OPERATIONS

The Prudential Group's asset management operations are based in the UK, Asia and the US where they operate different models and under different brands tailored to their markets.

Asset management in the UK is undertaken through M&G which is made up of three distinct businesses, being Retail, Wholesale and Finance, and whose operations include retail asset management, institutional fixed income, pooled life and pension funds, property and private finance.

Asset management in Asia serves both the life companies in Asia by managing the life funds and funds underlying the investment linked products and third-party customers through mutual fund business. Asia offers mutual fund investment products in a number of countries within the region, allowing customers to participate in debt, equity and money market investments.

Asset management in the US is undertaken through PPM America which manages assets for the Prudential Group's US, UK and Asian affiliates plus also provides investment services to other affiliated and unaffiliated institutional clients including CDOs, private investment funds, institutional accounts and mutual funds. In addition, broker-dealer activities are undertaken in the US where trades in securities are carried out for both third-party customers and for its own account.

Other operations covers unallocated corporate activities and includes the head office functions.

### E1: Income statement for asset management operations

- a) The profit included in the income statement in respect of asset management operations for the year is as follows:

	Asset management operations			
	2007			
	M&G	US	Asia	Total
	£m			
Revenue*	810	386	201	1,397
Charges	(547)	(377)	(129)	(1,053)
<b>Profit before tax</b>	<b>263</b>	<b>9</b>	<b>72</b>	<b>344</b>
Profit before tax for asset management operations comprise:				
Operating profit based on longer-term investment returns†	254	8	72	334
Short-term fluctuations in investment returns‡	4	1	—	5
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	5	—	—	5
<b>Profit before tax</b>	<b>263</b>	<b>9</b>	<b>72</b>	<b>344</b>
	Asset management operations			
	2008			
	M&G	US	Asia	Total
	£m			
Revenue*	53	409	202	664
Charges	28	(402)	(150)	(524)
<b>Profit before tax</b>	<b>81</b>	<b>7</b>	<b>52</b>	<b>140</b>
Profit before tax for asset management operations comprise:				
Operating profit based on longer-term investment returns†	286	7	52	345
Short-term fluctuations in investment returns‡	(195)	—	—	(195)
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	(10)	—	—	(10)
<b>Profit before tax</b>	<b>81</b>	<b>7</b>	<b>52</b>	<b>140</b>

	Asset management operations			
	2009			
	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>	<u>Total</u>
	£m			
Revenue*	799	500	217	1,516
Charges	(505)	(496)	(162)	(1,163)
<b>Profit before tax</b>	<u>294</u>	<u>4</u>	<u>55</u>	<u>353</u>
Profit before tax for asset management operations comprise:				
Operating profit based on longer-term investment returns†	238	4	55	297
Short-term fluctuations in investment returns‡	70	—	—	70
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	(14)	—	—	(14)
<b>Profit before tax</b>	<u>294</u>	<u>4</u>	<u>55</u>	<u>353</u>

\* Included within revenue for M&G are realised and unrealised net losses of £26 million, £673 million and £176 million, for 2007, 2008 and 2009 respectively, in respect of consolidated investment funds and Prudential Capital. The investment funds are managed on behalf of third-parties and are consolidated under IFRS in recognition of the control arrangements for the funds. The investment losses in respect of the investment funds are non-recourse to M&G and the Prudential Group and are added back through charges and consequently there is no impact on the profit before tax. Excluding the anomaly in respect of the consolidated investment funds the revenue for M&G would be £686 million, £494 million, and £697 million and the charges, £423 million, £413 million and £403 million, for 2007, 2008 and 2009 respectively.

† In 2008 Operating profit based on longer-term investment returns includes a £28 million charge for an impairment loss on a holding in Lehman Brothers. There were no impairment losses in 2007 and 2009.

‡ Short-term fluctuations for M&G are primarily in respect of unrealised value movements on Prudential Capital's bond portfolio.

b) M&G operating profit based on longer-term investment returns

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Asset management fee income	482	455	457
Other income	30	25	13
Staff costs	(224)	(184)	(205)
Other costs	(113)	(111)	(100)
Underlying profit before performance-related fees	175	185	165
Performance-related fees	<u>28</u>	<u>43</u>	<u>12</u>
Operating profit from asset management operations	203	228	177
Operating profit from Prudential Capital	<u>51</u>	<u>58</u>	<u>61</u>
Total M&G operating profit based on longer-term investment returns	<u>254</u>	<u>286</u>	<u>238</u>

The difference between the fees and other income shown above in respect of asset management operations, and the revenue figure for M&G shown in the main table primarily relates to income and investment gains (losses) earned by Prudential Capital and by investment funds controlled by the asset management operations which are consolidated under IFRS.

**E2: Statement of financial position for asset management operations**

Assets, liabilities and shareholders' funds included in the Prudential Group's consolidated statement of financial position in respect of asset management operations are as follows as at 31 December:

	Asset management operations 2007			
	M&G	US	Asia	Total £m
<b>Assets</b>				
Intangible assets:				
Goodwill . . . . .	1,153	16	61	1,230
Deferred acquisition costs . . . . .	<u>6</u>	<u>—</u>	<u>—</u>	<u>6</u>
Total . . . . .	<u>1,159</u>	<u>16</u>	<u>61</u>	<u>1,236</u>
Other non-investment and non-cash assets . . . . .	304	132	85	521
Financial investments:				
Loans <sup>(note i)</sup> . . . . .	2,334	—	—	2,334
Equity securities and portfolio holdings in unit trusts . . . . .	11	—	6	17
Debt securities <sup>(note ii)</sup> . . . . .	857	—	25	882
Other investments <sup>(note v)</sup> . . . . .	132	19	4	155
Deposits . . . . .	<u>—</u>	<u>15</u>	<u>11</u>	<u>26</u>
Total investments . . . . .	3,334	34	46	3,414
Cash and cash equivalents <sup>(note v)</sup> . . . . .	<u>1,751</u>	<u>33</u>	<u>56</u>	<u>1,840</u>
<b>Total assets</b> . . . . .	<b><u>6,548</u></b>	<b><u>215</u></b>	<b><u>248</u></b>	<b><u>7,011</u></b>
<b>Equity and liabilities</b>				
<b>Equity</b>				
Shareholders' equity <sup>(note iii)</sup> . . . . .	1,424	81	172	1,677
Minority interests . . . . .	<u>52</u>	<u>—</u>	<u>—</u>	<u>52</u>
Total equity . . . . .	<u>1,476</u>	<u>81</u>	<u>172</u>	<u>1,729</u>
<b>Liabilities</b>				
Intra Group debt represented by operational borrowings at Group level <sup>(note iv)</sup> . . . . .	2,477	—	—	2,477
Net asset value attributable to external holders of consolidated funds <sup>(note v)</sup> . . . . .	1,234	—	—	1,234
Other non-insurance liabilities . . . . .	<u>1,361</u>	<u>134</u>	<u>76</u>	<u>1,571</u>
Total liabilities . . . . .	<u>5,072</u>	<u>134</u>	<u>76</u>	<u>5,282</u>
<b>Total equity and liabilities</b> . . . . .	<b><u>6,548</u></b>	<b><u>215</u></b>	<b><u>248</u></b>	<b><u>7,011</u></b>

	Asset management operations			Total £m
	2008			
	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>	
<b>Assets</b>				
Intangible assets:				
Goodwill . . . . .	1,153	16	61	1,230
Deferred acquisition costs . . . . .	6	—	—	6
<b>Total</b> . . . . .	<u>1,159</u>	<u>16</u>	<u>61</u>	<u>1,236</u>
Other non-investment and non-cash assets . . . . .	27	169	99	295
Financial investments:				
Loans <sup>(note i)</sup> . . . . .	1,763	—	—	1,763
Equity securities and portfolio holdings in unit trusts . . . . .	11	—	12	23
Debt securities <sup>(note ii)</sup> . . . . .	975	—	16	991
Other investments <sup>(note v)</sup> . . . . .	432	24	6	462
Deposits . . . . .	35	16	13	64
<b>Total investments</b> . . . . .	<u>3,216</u>	<u>40</u>	<u>47</u>	<u>3,303</u>
Cash and cash equivalents <sup>(note v)</sup> . . . . .	1,329	39	104	1,472
<b>Total assets</b> . . . . .	<u><b>5,731</b></u>	<u><b>264</b></u>	<u><b>311</b></u>	<u><b>6,306</b></u>
<b>Equity and liabilities</b>				
<b>Equity</b>				
Shareholders' equity <sup>(note iii)</sup> . . . . .	1,300	114	228	1,642
Minority interests . . . . .	1	—	—	1
<b>Total equity</b> . . . . .	<u>1,301</u>	<u>114</u>	<u>228</u>	<u>1,643</u>
<b>Liabilities</b>				
Intra Group debt represented by operational borrowings at Group level <sup>(note iv)</sup> . . . . .	1,278	—	—	1,278
Net asset value attributable to external holders of consolidated funds <sup>(note v)</sup> . . . . .	1,065	—	—	1,065
Other non-insurance liabilities . . . . .	2,087	150	83	2,320
<b>Total liabilities</b> . . . . .	<u>4,430</u>	<u>150</u>	<u>83</u>	<u>4,663</u>
<b>Total equity and liabilities</b> . . . . .	<u><b>5,731</b></u>	<u><b>264</b></u>	<u><b>311</b></u>	<u><b>6,306</b></u>

	Asset management operations			
	2009			
	M&G	US	Asia	Total
	£m			
<b>Assets</b>				
Intangible assets:				
Goodwill . . . . .	1,153	16	61	1,230
Deferred acquisition costs . . . . .	8	—	—	8
<b>Total</b> . . . . .	<b>1,161</b>	<b>16</b>	<b>61</b>	<b>1,238</b>
Other non-investment and non-cash assets . . . . . 607 161 82 850				
Financial investments:				
Loans <sup>(note i)</sup> . . . . .	1,413	—	—	1,413
Equity securities and portfolio holdings in unit trusts . . . . .	129	—	8	137
Debt securities <sup>(note ii)</sup> . . . . .	1,149	—	15	1,164
Other investments <sup>(note v)</sup> . . . . .	106	2	5	113
Deposits . . . . .	38	13	12	63
<b>Total investments</b> . . . . .	<b>2,835</b>	<b>15</b>	<b>40</b>	<b>2,890</b>
Cash and cash equivalents <sup>(note v)</sup> . . . . .	820	40	110	970
<b>Total assets</b> . . . . .	<b>5,423</b>	<b>232</b>	<b>293</b>	<b>5,948</b>
<b>Equity and liabilities</b>				
<b>Equity</b>				
Shareholders' equity <sup>(note iii)</sup> . . . . .	1,326	111	222	1,659
Minority interests . . . . .	3	—	—	3
<b>Total equity</b> . . . . .	<b>1,329</b>	<b>111</b>	<b>222</b>	<b>1,662</b>
<b>Liabilities</b>				
Intra Group debt represented by operational borrowings at Group level <sup>(note iv)</sup> . . . . .	2,038	—	—	2,038
Net asset value attributable to external holders of consolidated funds <sup>(note v)</sup> . . . . .	410	—	—	410
Other non-insurance liabilities . . . . .	1,646	121	71	1,838
<b>Total liabilities</b> . . . . .	<b>4,094</b>	<b>121</b>	<b>71</b>	<b>4,286</b>
<b>Total equity and liabilities</b> . . . . .	<b>5,423</b>	<b>232</b>	<b>293</b>	<b>5,948</b>

**Notes**

i Loans

The M&G loans of £2,334 million, £1,763 million and £1,413 million, at 31 December 2007, 2008 and 2009 respectively, relate to loans and receivables managed by Prudential Capital. These assets are generally secured but have no external credit ratings. Internal ratings prepared by the Prudential Group's asset management operations as part of the risk management process rating are; £951 million, nil and £92 million as A+ to A-; £738 million, £1,100 million and £835 million as BBB+ to BBB-; £645 million, £663 million, and £330 million, as BB+ to BB-; and nil, nil and £156 million as B+ to B-, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

ii Debt securities

Of the total debt securities of £882 million, £991 million and £1,164 million for M&G £841 million, £959 million and £1,072 million were rated AAA to A- by Standard and Poor's or Aaa rated by Moody's, at 31 December 2007, 31 December 2008, and 31 December 2009.

iii M&G includes those assets and liabilities in respect of Prudential Capital.

iv Intra Group debt represented by operational borrowings at Group level

Operational borrowings for M&G are in respect of Prudential Capital's short-term fixed income security programme and comprise £2,422 million, £1,269 million and £2,031 million, at 31 December 2007, 2008 and 2009 respectively, of commercial paper and £55 million, £9 million, £7 million, at 31 December 2007, 2008 and 2009 respectively, of medium-term notes.

v Consolidated investment funds

The M&G statement of financial position shown above includes investment funds which are managed on behalf of third-parties. In respect of these funds, the statement of financial position includes cash and cash equivalents, other investments, other net assets and liabilities and the net asset value attributable to external unit holders which are non-recourse to M&G and the Prudential Group at 31 December as presented in the table below.

	2007	2008	2009
	£m	£m	£m
Cash and cash equivalents . . . . .	1,253	835	269
Other investments . . . . .	—	345	158
Other net assets and liabilities . . . . .	(19)	(115)	(17)
<b>Net assets attributable to external unit holders*</b> . . . . .	<b>1,234</b>	<b>1,065</b>	<b>410</b>

\* The net asset value attributable to external unit holders in respect of these funds, which are non-recourse to M&G and the Prudential Group.

### **E3: Regulatory capital positions**

Asset management operations in the UK, Hong Kong, Singapore, Vietnam and China are subject to regulatory requirements based on fixed operating expenses and other operating considerations. The movement in the year of the surplus regulatory capital position of these operations, combined with the movement in the IFRS basis shareholders' funds for other asset management operations, is as follows:

	<u>Asset management operations</u>			
	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>	<u>Total</u> <u>£m</u>
<b>Capital surplus position — 2007</b>				
Beginning of year . . . . .	114	57	72	243
Exchange movement . . . . .	—	(1)	—	(1)
Movement in capital requirement . . . . .	(6)	—	(3)	(9)
Gains during the year . . . . .	105	25	59	189
Distributions made . . . . .	<u>(114)</u>	<u>—</u>	<u>(36)</u>	<u>(150)</u>
End of year . . . . .	99	81	92	272
<b>Capital surplus position — 2008</b>				
Beginning of year . . . . .	99	81	92	272
Exchange movement . . . . .	(3)	39	31	67
Movement in capital requirement . . . . .	(28)	—	25	(3)
Gains during the year . . . . .	89	1	46	136
Distributions made . . . . .	<u>—</u>	<u>(8)</u>	<u>(34)</u>	<u>(42)</u>
End of year . . . . .	157	113	160	430
<b>Capital surplus position — 2009</b>				
Beginning of year . . . . .	157	113	160	430
Exchange movement . . . . .	(1)	(4)	(11)	(16)
Movement in capital requirement . . . . .	73	—	(6)	67
Gains during the year . . . . .	(8)	5	41	38
Capital injection . . . . .	—	—	1	1
Distributions made . . . . .	<u>—</u>	<u>(5)</u>	<u>(31)</u>	<u>(36)</u>
End of year . . . . .	<u>221</u>	<u>109</u>	<u>154</u>	<u>484</u>

The movement in the year reflects changes in regulatory requirements whilst gains are driven by profits generated during the year. Distributions consist of dividends paid up to the parent company.

The M&G figures include those for Prudential Capital.

### **E4: Sensitivity of profit and equity to market and other financial risk**

#### *i Currency translation*

Consistent with the Prudential Group's accounting policies, the profits of the Asia and PPM America asset management operations are translated at average exchange rates and shareholders' equity at the closing rate for the reporting period. For 2007, 2008 and 2009 the rates for the most significant operations are given in note B4. A 10% increase in the relevant Asian exchange rates would have reduced reported profit before tax attributable to shareholders and shareholders' equity, excluding goodwill attributable to Asia asset management operations, by £7 million, £5 million, and £5 million and PPM America asset management operations, by £18 million, £26 million, and £23 million for 2007, 2008 and 2009 respectively.

#### *ii. Other sensitivities to other financial risks for asset management operations*

The principal sensitivities to other financial risk of asset management operations are credit risk on the bridging loan portfolio (as described in note E2) of M&G's Prudential Capital operation and the indirect effect of changes to market values of funds under management. Due to the nature of the asset management operations there is limited direct sensitivity to movements in interest rates. Total debt securities held at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, by asset management operations were £882 million, £991 million and £1,164 million, the majority of which are held by the Prudential Capital operation of M&G. Debt securities held by M&G are in general variable rate bonds and so market value is limited in sensitivity to interest rate movements and consequently any change in interest rates would not have a material impact on profit or shareholder's equity. Asset management operations do not hold significant investments in property or equities.

**E5: Other operations**

Other operations consist of unallocated corporate activities relating to Prudential Group Head Office and the Asia regional head office, with net charge (net of income and expenditure) for the year of £260 million, £260 million and £395 million, for 2007, 2008 and 2009 respectively, as detailed in note B1. An analysis of the assets and liabilities of other operations is shown in note B6.

**F: INCOME STATEMENT NOTES**

**F1: Segmental information**

Year ended 31 December 2007

	Insurance operations			Asset management			Total segment	Unallocated corporate	Group total
	UK	US	Asia	M&G	US	Asia			
Gross premiums earned . . . . .	7,477	5,860	5,022	—	—	—	18,359	—	18,359
Outward reinsurance premiums . . .	(59)	(59)	(53)	—	—	—	(171)	—	(171)
Earned premiums, net of reinsurance . . . . .	7,418	5,801	4,969	—	—	—	18,188	—	18,188
Investment return <sup>(note ii)</sup> . . . . .	7,952	2,097	1,758	444	43	60	12,354	(129)	12,225
Other income . . . . .	1,524	(13)	49	366	343	141	2,410	47	2,457
Total revenue, net of reinsurance . .	16,894	7,885	6,776	810	386	201	32,952	(82)	32,870
Benefits and claims . . . . .	(13,606)	(7,161)	(5,457)	—	—	—	(26,224)	—	(26,224)
Outward reinsurers' share of benefits and claims . . . . .	(109)	65	24	—	—	—	(20)	—	(20)
Movement in unallocated surplus of with-profits funds . . . . .	(252)	—	(289)	—	—	—	(541)	—	(541)
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance . . . . .	(13,967)	(7,096)	(5,722)	—	—	—	(26,785)	—	(26,785)
Acquisition costs and other operating expenditure . . . . .	(2,454)	(353)	(948)	(547)	(377)	(129)	(4,808)	(51)	(4,859)
Finance costs: interest on core structural borrowings of shareholder-financed operations . . . . .	—	(10)	—	—	—	—	(10)	(158)	(168)
Total charges, net of reinsurance . .	(16,421)	(7,459)	(6,670)	(547)	(377)	(129)	(31,603)	(209)	(31,812)
Profit (loss) before tax ( <i>being tax attributable to shareholders' and policyholders' returns</i> ) <sup>(note i)</sup> . . . . .	473	426	106	263	9	72	1,349	(291)	1,058
Tax credit attributable to policyholders' returns . . . . .	8	—	(3)	—	—	—	5	—	5
Profit (loss) from continuing operations before tax attributable to shareholders . . . . .	481	426	103	263	9	72	1,354	(291)	1,063

This is represented in the segmental analysis of profit from continuing operations before tax attributable to shareholders in note B1 as follows:

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Group Total</u> £m
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Operating profit based on longer-term investment returns . . . . .	528	444	125	254	8	72	1,431	(279)	1,152
Short-term fluctuations in investment returns on shareholder-backed business . . .	(47)	(18)	15	4	1	—	(45)	(6)	(51)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	5	—	—	5	(6)	(1)
Loss on sale and results for Taiwan agency business . . . . .	—	—	(37)	—	—	—	(37)	—	(37)
Profit (loss) from continuing operations before tax attributable to shareholders . . . .	<u>481</u>	<u>426</u>	<u>103</u>	<u>263</u>	<u>9</u>	<u>72</u>	<u>1,354</u>	<u>(291)</u>	<u>1,063</u>

Year ended 31 December 2008

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Group Total</u> £m
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Gross premiums earned . . . . .	7,628	6,032	5,333	—	—	—	18,993	—	18,993
Outward reinsurance premiums . . .	(61)	(67)	(76)	—	—	—	(204)	—	(204)
Earned premiums, net of reinsurance . . . . .	7,567	5,965	5,257	—	—	—	18,789	—	18,789
Investment return <sup>(note ii)</sup> . . . . .	(20,134)	(5,449)	(4,229)	(301)	40	73	(30,000)	(202)	(30,202)
Other income . . . . .	141	1	93	353	369	129	1,086	60	1,146
Total revenue, net of reinsurance <sup>(note iii)</sup> . . . . .	<u>(12,426)</u>	<u>517</u>	<u>1,121</u>	<u>52</u>	<u>409</u>	<u>202</u>	<u>(10,125)</u>	<u>(142)</u>	<u>(10,267)</u>
Benefits and claims . . . . .	7,048	(1,152)	(1,276)	—	—	—	4,620	—	4,620
Outward reinsurers' share of benefits and claims . . . . .	146	205	38	—	—	—	389	—	389
Movement in unallocated surplus of with-profits funds . . . . .	<u>4,769</u>	<u>—</u>	<u>1,046</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>5,815</u>	<u>—</u>	<u>5,815</u>
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance . . . . .	<u>11,963</u>	<u>(947)</u>	<u>(192)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>10,824</u>	<u>—</u>	<u>10,824</u>
Acquisition costs and other operating expenditure . . . . .	(739)	(211)	(882)	29	(402)	(150)	(2,355)	(104)	(2,459)
Finance costs: interest on core structural borrowings of shareholder-financed operations . . . . .	—	(11)	—	—	—	—	(11)	(161)	(172)
Total charges, net of reinsurance <sup>(note iii)</sup> . . . . .	<u>11,224</u>	<u>(1,169)</u>	<u>(1,074)</u>	<u>29</u>	<u>(402)</u>	<u>(150)</u>	<u>8,458</u>	<u>(265)</u>	<u>8,193</u>
(Loss) profit before tax ( <i>being tax attributable to shareholders' and policyholders' returns</i> ) <sup>(note 1)</sup> . . . . .	(1,202)	(652)	47	81	7	52	(1,667)	(407)	(2,074)
Tax credit attributable to policyholders' returns . . . . .	<u>1,579</u>	<u>—</u>	<u>45</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,624</u>	<u>—</u>	<u>1,624</u>
(Loss) profit before tax attributable to shareholders . . . .	<u>377</u>	<u>(652)</u>	<u>92</u>	<u>81</u>	<u>7</u>	<u>52</u>	<u>(43)</u>	<u>(407)</u>	<u>(450)</u>

This is represented in the segmental analysis of profit from continuing operations before tax attributable to shareholders in note B1 as follows:

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Group total</u> £m
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Operating profit based on longer-term investment returns . . . . .	589	406	231	286	7	52	1,571	(288)	1,283
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	(212)	(1,058)	(138)	(195)	—	—	(1,603)	(118)	(1,721)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . .	—	—	(2)	(10)	—	—	(12)	(1)	(13)
Results for the sold Taiwan agency business . . . . .	—	—	1	—	—	—	1	—	1
(Loss) profit before tax attributable to shareholders . . . . .	<u>377</u>	<u>(652)</u>	<u>92</u>	<u>81</u>	<u>7</u>	<u>52</u>	<u>(43)</u>	<u>(407)</u>	<u>(450)</u>

Year ended 31 December 2009

	Insurance operations			Asset management			Total segment	Unallocated corporate	Group total
	UK	US	Asia	M&G	US	Asia			
									£m
Gross premiums earned . . . . .	5,757	9,197	5,345	—	—	—	20,299	—	20,299
Outward reinsurance premiums . . . . .	(122)	(82)	(119)	—	—	—	(323)	—	(323)
Earned premiums, net of reinsurance . . . . .	5,635	9,115	5,226	—	—	—	19,976	—	19,976
Investment return(note ii) . . . . .	17,366	5,070	4,357	420	68	74	27,355	(466)	26,889
Other income . . . . .	176	(18)	110	379	432	143	1,222	12	1,234
Total revenue, net of reinsurance . . . . .	23,177	14,167	9,693	799	500	217	48,533	(454)	48,099
Benefits and claims . . . . .	(18,521)	(13,297)	(8,083)	—	—	—	(39,901)	—	(39,901)
Outward reinsurers' share of benefits and claims . . . . .	214	12	39	—	—	—	265	—	265
Movement in unallocated surplus of with-profits funds . . . . .	(1,893)	—	334	—	—	—	(1,559)	—	(1,559)
Benefits and claims and movements in unallocated surplus of with-profits funds, net of reinsurance . . . . .	(20,200)	(13,285)	(7,710)	—	—	—	(41,195)	—	(41,195)
Acquisition costs and other operating expenditure . . . . .	(1,508)	(383)	(1,536)	(505)	(496)	(162)	(4,590)	18	(4,572)
Finance costs: interest on core structural borrowings of shareholder-financed operations . . . . .	—	(13)	—	—	—	—	(13)	(196)	(209)
Loss on sale of Taiwan agency business . . . . .	—	—	(559)	—	—	—	(559)	—	(559)
Total charges, net of reinsurance . . . . .	(21,708)	(13,681)	(9,805)	(505)	(496)	(162)	(46,357)	(178)	(46,535)
Profit (loss) before tax ( <i>being tax attributable to shareholders' and policyholders' returns</i> )(note i) . . . . .	1,469	486	(112)	294	4	55	2,196	(632)	1,564
Tax credit attributable to policyholders' returns . . . . .	(750)	—	(68)	—	—	—	(818)	—	(818)
Profit (loss) from continuing operations before tax attributable to shareholders . . . . .	719	486	(180)	294	4	55	1,378	(632)	746

This is represented in the segmental analysis of profit from continuing operations before tax attributable to shareholders in note B1 as follows:

	<u>Insurance operations</u>			<u>Asset management</u>			<u>Total segment</u>	<u>Unallocated corporate</u>	<u>Group total</u> £m
	<u>UK</u>	<u>US</u>	<u>Asia</u>	<u>M&amp;G</u>	<u>US</u>	<u>Asia</u>			
Operating profit based on longer-term investment returns . . . . .	657	459	410	238	4	55	1,823	(418)	1,405
Short-term fluctuations in investment returns on shareholder-backed business . . . . .	108	27	31	70	—	—	236	(200)	36
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(46)	—	—	(14)	—	—	(60)	(14)	(74)
Loss on sale and results for Taiwan agency business . . . . .	—	—	(621)	—	—	—	(621)	—	(621)
Profit (loss) from continuing operations before tax attributable to shareholders . . . . .	<u>719</u>	<u>486</u>	<u>(180)</u>	<u>294</u>	<u>4</u>	<u>55</u>	<u>1,378</u>	<u>(632)</u>	<u>746</u>

**Notes**

- i The measure is the formal (loss) profit before tax measure under IFRS but is not the result attributable to shareholders.
- ii Investment return principally comprises:
  - Interest and dividends;
  - Realised and unrealised gains and losses on securities and derivatives classified as fair value through profit and loss under IAS 39; and
  - Realised gains and losses, including impairment losses, on securities classified as available-for-sale under IAS 39.
- iii Total revenue for 2008 was negative £10,267 million whilst charges were a credit of £8,193 million. These abnormal effects arose from the basis of preparation whereby revenue includes investment appreciation, which is negative in 2008, and charges reflect the allocation, where appropriate, of investment return to policyholder benefits.

**F2: Revenue**

	<u>2007</u> £m	<u>2008</u> £m	<u>2009</u> £m
<b>Long-term business premiums</b>			
Insurance contract premiums . . . . .	17,308	17,575	19,347
Investment contracts with discretionary participation feature premiums . . . . .	874	964	789
Inwards reinsurance premiums . . . . .	177	454	163
Less: reinsurance premiums ceded . . . . .	(171)	(204)	(323)
Earned premiums, net of reinsurance(note iv) . . . . .	<u>18,188</u>	<u>18,789</u>	<u>19,976</u>
Realised and unrealised gains and losses on securities at fair value through profit and loss . . . . .	2,634	(34,157)	18,175
Realised and unrealised gains and losses on derivatives at fair value through profit and loss . . . . .	270	(5,261)	1,164
Realised gains and losses on available-for-sale securities, previously recognised in other comprehensive income . . . . .	13	(487)	(420)
Realised gains and losses on loans . . . . .	47	210	(115)
Interest(notes i,ii) . . . . .	5,857	6,739	5,575
Dividends . . . . .	2,730	2,023	1,755
Other investment income . . . . .	674	731	755
Investment income . . . . .	<u>12,225</u>	<u>(30,202)</u>	<u>26,889</u>
Fee income from investment contract business and asset management (notes iii,iv) . . . . .	1,039	1,109	1,234
Income from venture investments of the PAC with-profits funds . . . . .	1,418	37	—
Other income . . . . .	<u>2,457</u>	<u>1,146</u>	<u>1,234</u>
<b>Total revenue</b> . . . . .	<u>32,870</u>	<u>(10,267)</u>	<u>48,099</u>

## Notes

i The segmental analysis of interest income is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Insurance operations:			
UK . . . . .	3,630	4,802	3,848
US . . . . .	1,493	1,520	1,051
Asia . . . . .	302	49	522
Asset management operations:			
M&G . . . . .	389	310	140
US . . . . .	1	1	2
Asia . . . . .	2	2	2
<b>Total segment</b> . . . . .	<u>5,817</u>	<u>6,684</u>	<u>5,565</u>
Unallocated corporate . . . . .	40	55	10
<b>Total</b> . . . . .	<u>5,857</u>	<u>6,739</u>	<u>5,575</u>

ii Interest income includes £2 million, £11 million and £17 million, for 2007, 2008 and 2009 respectively, accrued in respect of impaired securities.

iii Fee income includes £31 million, £7 million and £1 million, for 2007, 2008 and 2009 respectively, relating to financial instruments that are not held at fair value through profit and loss. These fees primarily related to prepayment fees, late fees and syndication fees.

iv The following table provides additional segmental analysis of revenue from external customers:

	<u>2007</u>				
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Intragroup</u>	<u>Total</u>
	£m	£m	£m	£m	£m
Revenue from external customers:					
Insurance operations . . . . .	5,018	5,788	8,937	(4)	19,739
Asset management . . . . .	199	388	527	(264)	850
Unallocated corporate . . . . .	—	—	47	—	47
Intragroup revenue eliminated on consolidation . . . . .	(58)	(45)	(165)	268	—
Total revenue from external customers . . . . .	<u>5,159</u>	<u>6,131</u>	<u>9,346</u>	<u>—</u>	<u>20,636</u>

	<u>2008</u>				
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Intragroup</u>	<u>Total</u>
	£m	£m	£m	£m	£m
Revenue from external customers:					
Insurance operations . . . . .	5,348	5,955	7,711	(10)	19,004
Asset management . . . . .	202	414	497	(280)	833
Unallocated corporate . . . . .	—	—	61	—	61
Intragroup revenue eliminated on consolidation . . . . .	(73)	(45)	(172)	290	—
Total revenue from external customers . . . . .	<u>5,477</u>	<u>6,324</u>	<u>8,097</u>	<u>—</u>	<u>19,898</u>

	<u>2009</u>				
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Intragroup</u>	<u>Total</u>
	£m	£m	£m	£m	£m
Revenue from external customers:					
Insurance operations . . . . .	5,336	9,097	5,822	(11)	20,244
Asset management . . . . .	213	499	513	(271)	954
Unallocated corporate . . . . .	—	—	12	—	12
Intragroup revenue eliminated on consolidation . . . . .	(70)	(67)	(145)	282	—
Total revenue from external customers . . . . .	<u>5,479</u>	<u>9,529</u>	<u>6,202</u>	<u>—</u>	<u>21,210</u>

Revenue from external customers is made up of the following:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Earned premiums, net of reinsurance . . . . .	18,188	18,789	19,976
Other income . . . . .	2,446	1,109	1,234
Total revenue from external customers . . . . .	<u>20,634</u>	<u>19,898</u>	<u>21,210</u>

In their capacity as fund managers to fellow Prudential Group subsidiaries, M&G, the US and the Asian asset management businesses earn fees for investment management and related services. Intragroup fees, for 2007, 2008 and 2009 respectively, included within asset management revenue were £264 million, £280 million and £271 million earned of which, £161 million, £162 million and £134 million by M&G, £45 million, £45 million and £67 million by the US asset management segment and £58 million, £73 million and £70 million by the Asian asset management segment. In 2007, 2008 and 2009 respectively, the remaining £4 million, £10 million and £11 million of intragroup revenue was recognised by UK insurance operations. These services are charged at appropriate arm's length prices, typically priced as a percentage of funds under management.

In Asia, revenue from external customers from no individual country exceeds 10% of the Prudential Group total. The largest country is Hong Kong with a total revenue from external customers of £1,170 million and £1,013 million, for 2008 and 2009 respectively.

Due to the nature of the business of the Prudential Group, there is no reliance on any major customers.

### F3: Acquisition costs and other operating expenditure

	2007	2008	2009
	£m	£m	£m
Acquisition costs (notes i,ii) . . . . .	1,030	1,185	1,033
Staff and pension costs (I2) . . . . .	1,402	913	1,172
Administrative and operating cost (note iii) . . . . .	2,427	361	2,367
Total acquisition costs and other operating expenditure (notes iv,v) . . . . .	<u>4,859</u>	<u>2,459</u>	<u>4,572</u>

#### Notes

- i Acquisition costs in 2007, 2008 and 2009 respectively, comprise amounts related to insurance contracts of £939 million, £1,048 million, and £871 million and investment contracts and asset management contracts of £91 million, £137 million and £162 million. These costs include amortisation of £410 million, £520 million, and £290 million in respect of insurance contracts for 2007, 2008 and 2009 and £3 million, £15 million, and £15 million for investment contracts for 2007, 2008 and 2009 respectively.
- ii Acquisition costs also include fee expenses relating to financial liabilities held at amortised cost of £1 million, nil and £nil, for 2007, 2008 and 2009 respectively.
- iii Administrative and operating costs include the movement in amounts attributable to external unit holders of the consolidated investment funds of the Prudential Group of a charge of £615 million (2008: a credit of £963 million, 2007: a charge of £122 million).
- iv The total depreciation and amortisation expense is £523 million, £618 million, and £377 million, for 2007, 2008 and 2009 respectively. Of this amount, £413 million, £535 million, and £305 million, for 2007, 2008 and 2009 respectively, relates to amortisation of deferred acquisition costs of insurance contracts and asset management contracts, which is primarily borne by the insurance operations. The segmental analysis of total depreciation and amortisation expense is as follows:

	2007	2008	2009
	£m	£m	£m
Insurance operations:			
UK . . . . .	75	29	25
US . . . . .	315	283	88
Asia . . . . .	122	279	246
Asset management operations:			
M&G . . . . .	4	6	2
US . . . . .	2	1	2
Asia . . . . .	2	4	4
<b>Total segment</b> . . . . .	<u>520</u>	<u>602</u>	<u>367</u>
Unallocated corporate . . . . .	3	16	10
<b>Total</b> . . . . .	<u>523</u>	<u>618</u>	<u>377</u>

- v Interest expense, excluding interest on core structural borrowings of shareholder-financed operations, amounted to £436 million, £278 million, and £89 million, for 2007, 2008 and 2009 respectively, and is included within total acquisition costs and other operating expenditure as part of investment management expenses. The segmental analysis of this interest expense is as follows:

	2007	2008	2009
	£m	£m	£m
Insurance operations:			
UK . . . . .	181	66	28
US . . . . .	148	90	32
Asia . . . . .	—	—	1
Asset management operations:			
M&G . . . . .	—	34	—
US . . . . .	—	—	—
Asia . . . . .	—	—	—
<b>Total segment</b> . . . . .	<u>329</u>	<u>190</u>	<u>61</u>
Unallocated corporate . . . . .	107	88	28
<b>Total</b> . . . . .	<u>436</u>	<u>278</u>	<u>89</u>

### F4: Finance costs: Interest on core structural borrowings of shareholder-financed operations

Finance costs consist of interest on core debt of the parent company of £158 million, £161 million, and £196 million, for 2007, 2008 and 2009 respectively, and interest on US insurance operations' surplus notes of £10 million, £11 million, and £13 million, for 2007, 2008 and 2009 respectively.

## F5: Tax

### a Total tax credit (charge) by nature of expense

An analysis of the total tax benefit (expense) of continuing operations recognised in the income statement by nature of benefit (expense) is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Current tax benefit (expense):			
Corporation tax . . . . .	(806)	(225)	(500)
Adjustments in respect of prior years . . . . .	185	359	(29)
Total current tax . . . . .	<u>(621)</u>	<u>134</u>	<u>(529)</u>
Deferred tax arising from:			
Origination and reversal of temporary differences . . . . .	222	1,629	(340)
(Expense) benefit in respect of a previously unrecognised tax loss, tax credit or temporary difference from a prior period . . . . .	50	(77)	(4)
Write down or reversal of a previous write down of a deferred tax asset . . . . .	—	(3)	—
Total deferred tax credit . . . . .	<u>272</u>	<u>1,549</u>	<u>(344)</u>
Total tax credit (charge) . . . . .	<u>(349)</u>	<u>1,683</u>	<u>(873)</u>

#### Notes

- i Total current tax includes £9 million, £7 million and £6 million, for 2007, 2008 and 2009 respectively, in respect of tax to be paid in Hong Kong. The current tax charge is calculated as either 17.5%, 16.5% and 16.5%, for 2007, 2008 and 2009 respectively, on 5% of the net insurance premium or 17.5%, 16.5% and 16.5%, for 2007, 2008 and 2009 respectively, on the estimated assessable profits depending on the nature of the business written.

The total tax benefit (expense) arises as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Current tax benefit (expense):			
UK . . . . .	(377)	280	(527)
Foreign . . . . .	(244)	(146)	(2)
	<u>(621)</u>	<u>134</u>	<u>(529)</u>
Deferred tax credit:			
UK . . . . .	349	1,478	(368)
Foreign . . . . .	(77)	71	24
	<u>272</u>	<u>1,549</u>	<u>(344)</u>
Total . . . . .	<u>(349)</u>	<u>1,683</u>	<u>(873)</u>

The total tax charge of £349 million for 2007, credit of £1,683 million for 2008 and charge of £873 million for 2009, comprises a charge of £28 million, credit of £1,758 million and charge of £895 million, respectively, for UK tax and a charge of £321 million, a charge of £75 million and a credit of £22 million respectively, for overseas tax. This tax charge and credit comprises tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders. The tax attributable to shareholders of a charge of £354 million for 2007, a credit of £59 million for 2008, and a charge of £55 million for 2009, comprises a charge of £148 million, a credit of £95 million and a charge of £176 million respectively, for UK tax and a charge of £206 million, a charge of £36 million and a credit of £121 million for overseas tax.

The prior year adjustments primarily relate to a change in assumptions regarding available foreign tax credits on overseas dividends and other changes that arose as a result of routine revision of tax returns.

The total deferred tax credit (charge) arises as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Unrealised gains and losses on investments . . . . .	225	1,521	(35)
Balances relating to investment and insurance contracts . . . . .	41	(239)	(12)
Short-term timing differences . . . . .	(10)	(29)	(105)
Capital allowances . . . . .	4	2	1
Unused tax losses . . . . .	<u>12</u>	<u>294</u>	<u>(193)</u>
Deferred tax credit (charge) . . . . .	<u>272</u>	<u>1,549</u>	<u>(344)</u>

In 2007, 2008 and 2009 respectively, a deferred tax credit (charge) of £54 million, £561 million and £(546) million has been taken through other comprehensive income. Other movements in deferred tax totalling an aggregate credit/(charge) of £93 million, £(2) million and £69 million in 2007, 2008 and 2009 respectively is mainly comprised of foreign exchange movements. When these amounts are taken with the deferred tax credit (charge) shown above the result is a (increase) decrease of £0.4 billion, £2.1 billion and £(0.8) billion in the Prudential Group's net deferred tax liability at 31 December 2007, 2008 and 2009 respectively.

### b Reconciliation of effective tax rate

The total tax expense is attributable to shareholders and policyholders as summarised in the income statement.

*i Summary of pre-tax (loss) profit and tax credit (charge)*

The income statement includes the following items:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Profit (loss) before tax . . . . .	1,058	(2,074)	1,564
Tax attributable to policyholders' returns . . . . .	5	1,624	(818)
Profit (loss) before tax attributable to shareholders . . . . .	1,063	(450)	746
Tax attributable to shareholders' (losses) profits:			
Tax credit (charge) . . . . .	(349)	1,683	(873)
Less: tax attributable to policyholders' returns . . . . .	(5)	(1,624)	818
Tax attributable to shareholders' returns . . . . .	(354)	59	(55)
Profit (loss) from continuing operations after tax . . . . .	<u>709</u>	<u>(391)</u>	<u>691</u>

*ii Overview*

For the purposes of explaining the relationship between tax expense and accounting profit, it is appropriate to consider the sources of profit and tax by reference to those that are attributable to shareholders and policyholders, as follows:

	2007			2008			2009		
	Attributable to shareholders	Attributable to policyholders*	Total	Attributable to shareholders	Attributable to policyholders*	Total	Attributable to shareholders	Attributable to policyholders*	Total
	£m			£m			£m		
Profit (loss) before tax . . . . .	1,063	(5)	1,058	(450)	(1,624)	(2,074)	746	818	1,564
Taxation charge:									
Expected tax rate . . . . .	31%	100%	30%	42%	100%	87%	31%	100%	67%
Expected tax charge . . . . .	(327)	5	(322)	188	1,624	1,812	(233)	(818)	(1,051)
Variance from expected tax charge (note v(ii)) . . . . .	(27)	—	(27)	(129)	—	(129)	178	—	178
Actual tax (charge) credit . . . . .	(354)	5	(349)	59	1,624	1,683	(55)	(818)	(873)
Average effective tax rate . . . . .	<u>33%</u>	<u>100%</u>	<u>33%</u>	<u>13%</u>	<u>100%</u>	<u>81%</u>	<u>7%</u>	<u>100%</u>	<u>56%</u>

\* For the column entitled 'Attributable to policyholders', the profit before tax represents income, net of post-tax transfers to unallocated surplus of with-profits funds, before tax attributable to policyholders and unallocated surplus of with-profits funds and unit-linked policies.

Due to the requirements of the financial reporting standards IAS 1 and IAS 12, the profit (loss) before tax and tax charge reflect the aggregate of amounts that are attributable to shareholders and policyholders.

Profit (loss) before tax comprises profit attributable to shareholders and pre-tax profit attributable to policyholders of linked and with-profits funds and unallocated surplus of with-profits funds.

The total tax charge for linked and with-profits business includes tax expense on unit-linked and with-profits funds attributable to policyholders, the unallocated surplus of with-profits funds and the shareholders' profits. This feature arises from the basis of taxation applied to life and pension business, principally in the UK, but with similar bases applying in certain Asian operations, and is explained in note (iii) below.

Furthermore, the basis of preparation of Prudential's financial information incorporates the additional feature that, as permitted under IFRS 4, the residual equity of the Prudential Group's with-profits funds, i.e. unallocated surplus, is recorded as a liability with transfers to and from that liability reflected in pre-tax profits. This gives rise to anomalous effective tax rates for profits attributable to policyholders (as described in note (iv) below).

In meeting the reconciliation requirements set out in paragraph 81(c) of IAS 12, the presentation shown in this disclosure note seeks to ensure that the explanation of the relationship between tax expense and accounting profit draw properly the distinction between the elements of the profit and tax charge that are attributable to policyholders and shareholders as explained below in notes (iv) and (v) respectively. Due to the nature of the basis of taxation of UK life and pension business (as described in note (iii) below), and the significance of the results of the business to the Prudential Group, it is inappropriate to seek to explain the effective tax rate on profit before tax by the traditional approach that would apply for other industries.

The shareholder elements are the components of the profit and tax charge that are of most direct relevance to investors, and it is this aspect that the IAS 12 reconciliation requirement is seeking to explain for companies that do

not need to account for both with-profits and unit-linked funds, where tax is borne by Prudential on the policyholders' behalf and which is not contemplated by the IFRS requirement.

### *iii Basis of taxation for UK life and pension business*

Different rules apply under UK tax law for taxing pension business and life insurance business and there are detailed rules for apportioning the investment return and profits of the fund between the types of business.

The investment return referable to pension business, and some other less significant classes of business, is exempt from taxation, but tax is charged on the profit that shareholders derive from writing such business at the corporate rate of tax. The rules for taxing life insurance business are more complex. Initially, the UK regime seeks to tax the regulatory basis investment return less management expenses (I-E) on this business as it arises. However, in determining the actual tax charge, a calculation of the shareholder profits for taxation purposes from writing life insurance business also has to be made and compared with the I-E profit.

If the shareholder profit is higher than the I-E amount, extra income is attributable to the I-E calculation until the I-E profit equals the shareholder profit. If on the other hand, the I-E profit is the greater, then an amount equal to the shareholder profit is taxed at the corporate rate of tax, with the remainder of the I-E profit being taxed at the lower policyholder rate of tax.

The purpose of this approach is to ensure that Prudential is always at a minimum taxed on the profit, as defined for taxation purposes by reference to Prudential's regulatory returns (rather than IFRS basis results), that it has earned. The shareholders' portion of the long-term business is taxed at the shareholders' rate, with the remaining portion taxed at rates applicable to the policyholders.

It is to be noted that the calculations described are determined using data from the regulatory basis returns rather than the IFRS basis results. The differences between the regulatory and accounting bases are very significant and extremely complex rendering any explanation in general purpose financial information to be of little if any use to users.

### *iv Profits attributable to policyholders and related tax*

As noted above, it is necessary under IFRS requirements to include the total tax charge of Prudential (both policyholder and shareholder elements) in the tax charge disclosed in the income statement.

For with-profits business, total pre-tax profits reflect the aggregate of profits attributable to policyholders and shareholders. However, amounts attributable to the equity of with-profits funds are carried in the liability for unallocated surplus. Also, as described in note (iii), UK with-profits business is taxed on a basis that affects policyholders' unallocated surplus of with-profits funds and shareholders. For the PAC with-profits sub-fund, transfers to and from unallocated surplus are recorded in the income statement, so that after charging the total tax borne by the fund, the net balance reflects the statutory transfer from the fund for the year. The statutory transfer represents 10% of the actuarially determined surplus for the year that is attributable to shareholders.

For SAIF similar transfers are made. However, in the case of SAIF, a net nil balance is derived, reflecting the lack of shareholder interest in the financial performance of the fund (other than through asset management arrangements).

The accounting anomaly that arises under IFRS is that due to the fact that the net of tax profit attributable to with-profits policyholders is zero, Prudential's presentation of pre-tax profit attributable to policyholders reflects an amount that is the mirror image of the tax charge attributable to policyholders.

For unit-linked business, pre-tax profits also reflect the aggregate of profits attributable to policyholders and shareholders. The pre-tax profits attributable to policyholders represent fees earned that are used to pay tax borne by Prudential on policyholders' behalf. The net of tax profit attributable to policyholders for unit-linked business is thus zero.

The combined effect of these features is such that providing a reconciliation of the tax charge attributable to policyholders to an expected charge based on the standard corporate rate of tax on IFRS basis profits attributable to policyholders is not relevant.

In summary, for accounting purposes, in all cases and for all reporting periods, the apparent effective rate for profit attributable to policyholders and unallocated surplus is 100%. However, it is to be noted that the 100% rate does not reflect a rate paid on the profits attributable to policyholders. It instead reflects the basis of accounting for unallocated surplus coupled with the distinction made for performance reporting between sources of profit attributable to shareholders, policyholders and unallocated surplus and IFRS requirements in respect of reporting of all pre-tax profits and all tax charges irrespective of policyholder or shareholder economic interest.

	2007				
	Asian insurance operations	US insurance operations	UK insurance operations	Other operations	Total £m
Profit before tax attributable to shareholders:					
Operating profit based on longer-term investment					
returns(note iii) . . . . .	125	444	528	55	1,152
Short-term fluctuations in investment returns . . . . .	15	(18)	(47)	(1)	(51)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	(1)	(1)
Results for sold Taiwan agency business . . . . .	<u>(37)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(37)</u>
Total . . . . .	<u>103</u>	<u>426</u>	<u>481</u>	<u>53</u>	<u>1,063</u>
Expected tax rate:(note i)					
Operating profit based on longer-term investment					
returns(note iii) . . . . .	19%	35%	30%	28%	31%
Short-term fluctuations in investment returns . . . . .	25%	35%	30%	28%	31%
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	20%	35%	30%	28%	28%
Results for sold Taiwan agency business . . . . .	<u>25%</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>25%</u>
Expected tax credit (charge) based on expected tax rates:					
Operating profit based on longer-term investment					
returns(note iii) . . . . .	(24)	(155)	(158)	(15)	(352)
Short-term fluctuations in investment returns . . . . .	(4)	6	14	—	16
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	—	—
Results for sold Taiwan agency business . . . . .	<u>9</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>9</u>
Total . . . . .	<u>(19)</u>	<u>(149)</u>	<u>(144)</u>	<u>(15)</u>	<u>(327)</u>
Variance from expected tax charge:(note ii)					
Operating profit based on longer-term investment					
returns(note iii) . . . . .	4	22	(25)	(1)	—
Short-term fluctuations in investment returns . . . . .	(1)	1	(2)	6	4
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	1	1
Results for sold Taiwan agency business . . . . .	<u>(32)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(32)</u>
Total . . . . .	<u>(29)</u>	<u>23</u>	<u>(27)</u>	<u>6</u>	<u>(27)</u>
Actual tax credit (charge):					
Operating profit based on longer-term investment					
returns(note iii) . . . . .	(20)	(133)	(183)	(16)	(352)
Short-term fluctuations in investment returns . . . . .	(5)	7	12	6	20
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	1	1
Results for sold Taiwan agency business . . . . .	<u>(23)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(23)</u>
Total . . . . .	<u>(48)</u>	<u>(126)</u>	<u>(171)</u>	<u>(9)</u>	<u>(354)</u>
Actual tax rate: Operating profit based on longer-term investment returns . . . . .					
	16%	30%	35%	29%	31%
Total . . . . .	<u>47%</u>	<u>30%</u>	<u>36%</u>	<u>17%</u>	<u>33%</u>

**Notes**

## i Expected tax rates for profit attributable to shareholders:

Expected tax rates shown in the table above reflect the corporate tax rates generally applied to taxable profits of the relevant country jurisdictions. For Asian operations the expected tax rates reflect the corporate tax rates weighted by reference to the source of profits of the operations contributing to the aggregate business result.

The tax rate of 28% in 2007 for other operations reflects the mix of business between UK and overseas operations, which are taxed at a variety of rates. The rate will fluctuate from year to year dependent on the mix of profits between jurisdictions.

## ii Variances from expected tax charge for results attributable to shareholders:

For 2007, the principal variances arise from differences between the standard corporation tax rate and actual rates due to a number of factors, including:

- a For Asian long-term operations, the tax rate has been adversely impacted by the fact that the Taiwan loss on disposal has no corresponding tax relief. In addition tax losses in several jurisdictions which are not expected to be available for relief against future profits, and losses on investments in jurisdictions which do not provide corresponding tax relief;
- b For Jackson, the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business;
- c For UK insurance operations, disallowed expenses and prior year adjustments arising from the routine revisions of tax returns; and
- d For Other operations, the availability of capital losses brought forward on which no deferred tax had previously been recognised, which have been used against capital gains in the period.
- iii Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses.

	<b>2008</b>				
	<u>Asian insurance operations</u>	<u>US insurance operations</u>	<u>UK insurance operations</u>	<u>Other operations</u>	<u>Total £m</u>
(Loss) Profit before tax attributable to shareholders:					
Operating profit based on longer-term investment returns(note iii) . . . . .	231	406	589	57	1,283
Short-term fluctuations in investment returns . . . . .	(138)	(1,058)	(212)	(313)	(1,721)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(2)	—	—	(11)	(13)
Results for sold Taiwan agency business . . . . .	<u>1</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1</u>
Total. . . . .	<u>92</u>	<u>(652)</u>	<u>377</u>	<u>(267)</u>	<u>(450)</u>
Expected tax rate:(note i)					
Operating profit based on longer-term investment returns(note iii) . . . . .	23%	35%	28%	17%	29%
Short-term fluctuations in investment returns . . . . .	28%	35%	28%	28%	32%
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	25%	—	—	28%	27%
Results for sold Taiwan agency business . . . . .	<u>25%</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>25%</u>
Expected tax credit (charge) based on expected tax rates:					
Operating profit based on longer-term investment returns(note iii) . . . . .	(54)	(142)	(165)	(10)	(371)
Short-term fluctuations in investment returns . . . . .	38	370	59	88	555
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	1	—	—	3	4
Results for sold Taiwan agency business . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total. . . . .	<u>(15)</u>	<u>228</u>	<u>(106)</u>	<u>81</u>	<u>188</u>
Variance from expected tax charge:(note ii)					
Operating profit based on longer-term investment returns(note iii) . . . . .	(51)	17	57	56	79
Short-term fluctuations in investment returns . . . . .	(3)	(173)	(8)	(19)	(203)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	—	(1)	(1)
Results for sold Taiwan agency business . . . . .	<u>(4)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(4)</u>
Total. . . . .	<u>(58)</u>	<u>(156)</u>	<u>49</u>	<u>36</u>	<u>(129)</u>
Actual tax credit (charge):					
Operating profit based on longer-term investment returns(note iii) . . . . .	(105)	(125)	(108)	46	(292)
Short-term fluctuations in investment returns . . . . .	35	197	51	69	352
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	1	—	—	2	3
Results for sold Taiwan agency business . . . . .	<u>(4)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(4)</u>
Total. . . . .	<u>(73)</u>	<u>72</u>	<u>(57)</u>	<u>117</u>	<u>59</u>
Actual tax rate: Operating profit based on longer-term investment returns . . . . .	45%	31%	18%	(81)%	23%
Total. . . . .	<u>79%</u>	<u>11%</u>	<u>15%</u>	<u>44%</u>	<u>13%</u>

## Notes

- i Expected tax rates for profit attributable to shareholders:  
The tax rate of 23% reflects the mix of business between UK and overseas operations which are taxed at a variety of rates.  
The rate will fluctuate from year to year dependent on the mix of profits between jurisdictions.
- ii For 2008, the principal variances arise from differences between the standard corporation tax rate and actual rates due to a number of factors, including:
- a For Asian long-term operations, tax losses in several jurisdictions which are not expected to be available for relief against future profits, and losses on investments in jurisdictions which do not provide corresponding tax relief;
  - b For Jackson, the inability to fully recognise deferred tax assets on losses being carried forward which has partially been offset by the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business;
  - c For UK insurance operations, prior year adjustments arising from the routine revisions of tax returns, the settlement of outstanding issues with HMRC at an amount below that previously provided and the different tax bases of UK life business; and
  - d For Other operations, the settlement of issues with HMRC at amounts below those previously provided and a reduction in amounts previously provided on outstanding issues with HMRC which has been partially offset by the inability to recognise a deferred tax asset on various tax losses.
- iii Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses.

	<b>2009</b>				
	<b>Asian insurance operations</b>	<b>US insurance operations</b>	<b>UK insurance operations</b>	<b>Other operations</b>	<b>Total £m</b>
Profit before tax attributable to shareholders:					
Operating profit based on longer-term investment returns(note iii) . . . . .					
	410	459	657	(121)	1,405
Short-term fluctuations in investment returns . . . . .	31	27	108	(130)	36
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	—	—	(46)	(28)	(74)
Loss on sale and results for Taiwan agency business . . . . .	<u>(621)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(621)</u>
Total . . . . .	<u>(180)</u>	<u>486</u>	<u>719</u>	<u>(279)</u>	<u>746</u>
Expected tax rate:(note i)					
Operating profit based on longer-term investment returns(note iii) . . . . .					
	24%	35%	28%	28%	29%
Short-term fluctuations in investment returns . . . . .	25%	35%	28%	36%	0%
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	—	—	28%	28%	28%
Loss on sale and results for Taiwan agency business . . . . .	<u>25%</u>	<u>—</u>	<u>—</u>	<u>—%</u>	<u>25%</u>
Expected tax credit (charge) based on expected tax rates:					
Operating profit based on longer-term investment returns(note iii) . . . . .					
	(98)	(161)	(184)	34	(409)
Short-term fluctuations in investment returns . . . . .	(8)	(9)	(30)	47	—
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	—	—	13	8	21
Loss on sale and results for Taiwan agency business . . . . .	<u>155</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>155</u>
Total . . . . .	<u>49</u>	<u>(170)</u>	<u>(201)</u>	<u>89</u>	<u>(233)</u>
Variance from expected tax charge:(note ii)					
Operating profit based on longer-term investment returns(note iii) . . . . .					
	35	77	(29)	8	91
Short-term fluctuations in investment returns . . . . .	15	195	—	14	224
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	—	—	—	—	—
Loss on sale and results for Taiwan agency business . . . . .	<u>(137)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(137)</u>
Total . . . . .	<u>(87)</u>	<u>272</u>	<u>(29)</u>	<u>22</u>	<u>178</u>
Actual tax credit (charge):					
Operating profit based on longer-term investment returns(note iii) . . . . .					
	(63)	(84)	(213)	42	(318)
Short-term fluctuations in investment returns . . . . .	7	186	(30)	61	224
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	—	—	13	8	21
Loss on sale and results for Taiwan agency business . . . . .	<u>18</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>18</u>
Total . . . . .	<u>(38)</u>	<u>102</u>	<u>(230)</u>	<u>111</u>	<u>(55)</u>
Actual tax rate: Operating profit based on longer-term investment returns . . . . .					
	15%	18%	32%	35%	23%
Total . . . . .	<u>(21)%</u>	<u>(21)%</u>	<u>32%</u>	<u>40%</u>	<u>7%</u>

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## Notes

i Expected tax rates for profit attributable to shareholders:

The expected tax rates shown in the table above reflect the corporate tax rates generally applied to taxable profits of the relevant country jurisdictions.

For Asian operations the expected tax rates reflect the corporate tax rates weighted by reference to the source of profits of operations contributing to the aggregate business result.

The expected tax rate for Other operations reflects the mix of business between UK and overseas operations, which are taxed at a variety of rates. The rate will fluctuate from year to year dependent on the mix of profits.

ii For 2009, the principal variances arise from differences between the standard corporation tax rate and actual rates due to a number of factors, including:

a For Asian long-term operations, profits in certain countries which are not taxable partly offset by the inability to fully recognise deferred tax assets on losses being carried forward;

b For Jackson, the ability to fully recognise deferred tax assets on losses brought forward which we were previously unable to recognise together with income subject to a lower level of taxation and the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business;

c For UK insurance operations, adjustments in respect of the prior year tax charge and different tax bases of UK life business;

d For Other operations, the ability to now recognise a deferred tax asset on various tax losses which we were previously unable to recognise offset by adjustments in respect of the prior year tax charge; and

e The actual tax rate in relation to Asia excluding the result for the sold Taiwan agency business would have been 13% for the period.

iii Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses.

### ***F6 Allocation of investment return between policyholders and shareholders***

Investment return is attributable to policyholders and shareholders. A key feature of the accounting policies under IFRS is that the investment return included in the income statement relates to all investment assets of the Prudential Group, irrespective of whether the return is attributable to shareholders, or to policyholders or the unallocated surplus of with-profits funds, the latter two of which have no net impact on shareholders' profit. The table below provides a breakdown of the investment return for each regional operation attributable to each type of business.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Asian operations</b>			
Policyholders returns:			
Assets backing unit-linked liabilities . . . . .	753	(2,552)	2,539
With-profits business . . . . .	<u>866</u>	<u>(1,611)</u>	<u>1,519</u>
	1,619	(4,163)	4,058
Shareholder returns . . . . .	<u>199</u>	<u>7</u>	<u>373</u>
Total . . . . .	<u>1,818</u>	<u>(4,156)</u>	<u>4,431</u>
<b>US operations</b>			
Policyholders returns			
Assets held to back (Separate Account) unit-linked liabilities . . . . .	620	(5,925)	3,760
Shareholder returns			
Realised gains and losses (including impairment losses on available-for-sale bonds) . . . . .	(47)	(651)	(529)
Value movements on derivative hedging program for general account business . . . . .	19	(311)	340
Interest/dividend income and value movements on other financial instruments for which fair value movements are booked in the income statement . . . . .	<u>1,548</u>	<u>1,478</u>	<u>1,567</u>
Total . . . . .	<u>1,520</u>	<u>516</u>	<u>1,378</u>
Total . . . . .	<u>2,140</u>	<u>(5,409)</u>	<u>5,138</u>
<b>UK operations</b>			
Policyholder returns			
Scottish Amicable Life Insurance Fund (SAIF) . . . . .	849	(2,095)	1,438
Assets held to back unit-linked liabilities . . . . .	515	(2,971)	2,947
With-profits fund (excluding SAIF) . . . . .	<u>5,881</u>	<u>(14,595)</u>	<u>10,461</u>
	<u>7,245</u>	<u>(19,661)</u>	<u>14,846</u>
Shareholder returns			
Prudential Retirement Income Limited (PRIL) . . . . .	216	(684)	1,827
Other business . . . . .	<u>935</u>	<u>(90)</u>	<u>1,113</u>
	<u>1,151</u>	<u>(774)</u>	<u>2,940</u>
Total . . . . .	<u>8,396</u>	<u>(20,435)</u>	<u>17,786</u>
<b>Unallocated corporate</b>			
Shareholder returns . . . . .	<u>(129)</u>	<u>(202)</u>	<u>(466)</u>
<b>Group Total</b>			
Policyholder returns . . . . .	9,484	(29,749)	22,664
Shareholder returns . . . . .	<u>2,741</u>	<u>(453)</u>	<u>4,225</u>
Total . . . . .	<u>12,225</u>	<u>(30,202)</u>	<u>26,889</u>

The returns as shown in the table above, are delineated between those returns allocated to policyholders and those allocated to shareholders. In making this distinction, returns allocated to policyholders are those from investments in which shareholders have no direct economic interest, namely:

- Unit-linked business in the UK, Asia and SAIF in the UK, for which the investment return is wholly attributable to policyholders,
- Separate account business of US operations, the investment return of which is also wholly attributable to policyholders, and
- With-profits business (excluding SAIF) in the UK and Asia in which the shareholders' economic interest, and the basis of recognising IFRS basis profits, is restricted to a share of the actuarially determined surplus for distribution, in the UK 10%. Except for this surplus the investment return of the with-profit funds is attributable to policy holders (through the asset-share liabilities) or the unallocated surplus, which is accounted for as a liability under IFRS 4.

The investment return related to the types of business above does not impact shareholders' profits directly. However there is an indirect impact for example, investment-related feeds or the effect of investment return on the shareholders' share of the cost of bonuses of with-profits funds.

Investment returns for unit-linked and similar products have reciprocal impact on benefits and claims, with a decrease in market returns on the attached pool of assets affecting policyholder benefits on these products. Similarly for with-profits funds there is a close correlation between increases or decreases in investment returns and the level of combined charge for policyholder benefits and movement on unallocated surplus that arises from such returns.

### Shareholder returns

For shareholder-backed non-participating business of the UK (comprising PRIL and other non-linked non-participating business) and of the Asian operations, the investment return is not directly attributable to policyholders and therefore does impact shareholders' profit directly. However, it should be noted that for UK shareholder-backed annuity business, principally PRIL, where the durations of asset and liability cash flows are closely matched, the discount rate applied to measure liabilities to policyholders (under "grandfathered" UK GAAP under IFRS 4) reflects movements in asset yields (after allowances for the future defaults) of the backing portfolios. Therefore, the net impact on the shareholders' profits of the investment return of the assets backing liabilities of the UK shareholder-backed annuity business is after taking into account the consequential effect on the movement in policyholder liabilities.

Changes in shareholder investment returns for US operations reflect primarily movements in the investment income, movements in the value of the derivative instruments held to manage the general account assets and liability portfolio, and realised gains and losses. However, separately reflecting Jackson's types of business an allocation is made to policyholders through the application of crediting rates. The shareholder investment return for US operations also includes the fair value movement of the derivatives and the movement on the related liabilities of the variable annuity guarantees under Jackson's dynamic hedging program.

The majority of the investments held to back the US non-participating business are debt securities for which the available-for-sale designation is applied for IFRS basis reporting. Under this designation the return included in the income statement reflects the aggregate of investment income and realised gains and losses (including impairment losses). However, movements in unrealised appreciation or depreciation are recognised in other comprehensive income. The return on these assets is attributable to shareholders.

### *F7: Benefits and claims and movements in unallocated surplus of with-profits funds net of reinsurance*

Benefits and claims represent payments, including final bonuses, to policyholders in respect of maturities, surrenders and deaths plus the change in technical provisions (which primarily represents the movement in amounts owed to policyholders). Benefits and claims are amounts attributable to policyholders. The movement in unallocated surplus of with-profits funds represents the transfer to (from) the unallocated surplus each year through a charge (credit) to the income statement of the annual excess (shortfall) of income over expenditure of the with-profits funds, after declaration and attribution of the cost of bonuses to policyholders and shareholders.

Benefits and claims and movements in unallocated surplus of with-profits funds net of reinsurance can be further analysed as follows:

	<u>2007</u>			
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Total</u>
	£m			
Claims incurred . . . . .	(1,429)	(3,032)	(10,266)	(14,727)
(Increase) decrease in policyholder liabilities . . . . .	(4,004)	(4,064)	(3,449)	(11,517)
Movement in unallocated surplus of with-profits funds . . . . .	(289)	—	(252)	(541)
	<u>(5,722)</u>	<u>(7,096)</u>	<u>(13,967)</u>	<u>(26,785)</u>
	<u>2008</u>			
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Total</u>
	£m			
Claims incurred . . . . .	(1,552)	(3,666)	(10,992)	(16,210)
(Increase) decrease in policyholder liabilities . . . . .	314	2,719	18,186	21,219
Movement in unallocated surplus of with-profits funds . . . . .	1,046	—	4,769	5,815
	<u>(192)</u>	<u>(947)</u>	<u>11,963</u>	<u>10,824</u>

	<b>2009</b>			
	<u>Asia</u>	<u>US</u>	<u>UK</u>	<u>Total</u>
	<u>£m</u>			
Claims incurred . . . . .	(1,814)	(4,092)	(9,875)	(15,781)
(Increase) decrease in policyholder liabilities . . . . .	(6,230)	(9,193)	(8,432)	(23,855)
Movement in unallocated surplus of with-profits funds . . . . .	334	—	(1,893)	(1,559)
	<u>(7,710)</u>	<u>(13,285)</u>	<u>(20,200)</u>	<u>(41,195)</u>

**G: FINANCIAL ASSETS AND LIABILITIES**

**G1: Financial instruments — designation and fair values**

The Prudential Group designates all financial assets as either fair value through profit and loss, available-for-sale, or as loans and receivables. Financial liabilities are designated as either fair value through profit and loss, or amortised cost, or as investment contracts with discretionary participating features accounted for under IFRS 4 as described in note A4.

**As at 31 December:**

	<b>2007</b>				
	<u>Fair value through profit and loss</u>	<u>Available-for-sale</u>	<u>Loans and receivables</u>	<u>Total carrying value</u>	<u>Fair value</u>
	<u>£m</u>				
<b>Financial assets</b>					
Cash and cash equivalents . . . . .	—	—	4,951	4,951	4,951
Deposits . . . . .	—	—	7,889	7,889	7,889
Equity securities and portfolio holdings in unit trusts . . . . .	86,157	—	—	86,157	86,157
Debt securities <sup>(note i)</sup> . . . . .	65,349	18,635	—	83,984	83,984
Loans <sup>(note ii)</sup> . . . . .	—	—	7,924	7,924	8,105
Other investments <sup>(note iii)</sup> . . . . .	4,396	—	—	4,396	4,396
Accrued investment income . . . . .	—	—	2,023	2,023	2,023
Other debtors . . . . .	—	—	909	909	909
	<u>155,902</u>	<u>18,635</u>	<u>23,696</u>	<u>198,233</u>	

	<u>Fair value through profit and loss</u>	<u>Amortised cost</u>	<u>IFRS 4 basis value</u>	<u>Total carrying value</u>	<u>Fair value</u> £m
<b>Financial liabilities</b>					
Core structural borrowings of shareholder-financed operations (notes i, H13) . . . . .	—	2,492	—	2,492	2,476
Operational borrowings attributable to shareholder-financed operations (H13) . . . . .	—	3,081	—	3,081	3,081
Borrowings attributable to with-profits funds (H13) . . . . .	204	783	—	987	1,006
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	—	4,081	—	4,081	4,100
Net asset value attributable to unit holders of consolidated unit trust and similar funds . . . . .	3,556	—	—	3,556	3,556
Investment contracts with discretionary participating features (note iv) . . . . .	—	—	29,550	29,550	—
Investment contracts without discretionary participating features . . . . .	12,110	1,922	—	14,032	14,034
Other creditors . . . . .	—	1,020	—	1,020	1,020
Derivative liabilities . . . . .	1,080	—	—	1,080	1,080
Other liabilities . . . . .	1	790	—	791	791
	<u>16,951</u>	<u>14,169</u>	<u>29,550</u>	<u>60,670</u>	

	<u>Fair value through profit and loss</u>	<u>Available- for-sale</u>	<u>Loans and receivables</u>	<u>Total carrying value</u>	<u>Fair value</u> £m
<b>Financial assets</b>					
Cash and cash equivalents . . . . .	—	—	5,955	5,955	5,955
Deposits . . . . .	—	—	7,294	7,294	7,294
Equity securities and portfolio holdings in unit trusts . . . . .	62,122	—	—	62,122	62,122
Debt securities (note i) . . . . .	71,225	23,999	—	95,224	95,224
Loans (note ii) . . . . .	—	—	10,491	10,491	10,043
Other investments (note iii) . . . . .	6,301	—	—	6,301	6,301
Accrued investment income . . . . .	—	—	2,513	2,513	2,513
Other debtors . . . . .	—	—	1,232	1,232	1,232
	<u>139,648</u>	<u>23,999</u>	<u>27,485</u>	<u>191,132</u>	

	<u>Fair value through profit and loss</u>	<u>Amortised cost</u>	<u>IFRS 4 basis value</u>	<u>Total carrying value</u>	<u>Fair value</u> £m
<b>Financial liabilities</b>					
Core structural borrowings of shareholder-financed operations (notes i, H13) . . . . .	—	2,958	—	2,958	2,137
Operational borrowings attributable to shareholder-financed operations (H13) . . . . .	—	1,977	—	1,977	1,977
Borrowings attributable to with-profits funds (H13) . . . . .	158	1,150	—	1,308	1,320
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	—	5,572	—	5,572	5,676
Net asset value attributable to unit holders of consolidated unit trust and similar funds . . . . .	3,843	—	—	3,843	3,843
Investment contracts with discretionary participating features (note iv) . . . . .	—	—	23,446	23,446	—
Investment contracts without discretionary participating features . . . . .	11,616	2,885	—	14,501	14,568
Other creditors . . . . .	—	1,496	—	1,496	1,496
Derivative liabilities . . . . .	4,832	—	—	4,832	4,832
Other liabilities . . . . .	—	890	—	890	890
	<u>20,449</u>	<u>16,928</u>	<u>23,446</u>	<u>60,823</u>	

	<u>Fair value through profit and loss</u>	<u>Available- for-sale</u>	<u>Loans and receivables</u>	<u>Total carrying value</u>	<u>Fair value</u> £m
<b>Financial assets</b>					
Cash and cash equivalents . . . . .	—	—	5,307	5,307	5,307
Deposits . . . . .	—	—	12,820	12,820	12,820
Equity securities and portfolio holdings in unit trusts . . . . .	69,354	—	—	69,354	69,354
Debt securities (note i) . . . . .	79,083	22,668	—	101,751	101,751
Loans (note ii) . . . . .	—	—	8,754	8,754	8,686
Other investments (note iii) . . . . .	5,132	—	—	5,132	5,132
Accrued investment income . . . . .	—	—	2,473	2,473	2,473
Other debtors . . . . .	—	—	762	762	762
	<u>153,569</u>	<u>22,668</u>	<u>30,116</u>	<u>206,353</u>	

	<u>Fair value through profit and loss</u>	<u>Amortised cost</u>	<u>IFRS 4 basis value</u>	<u>Total carrying value</u>	<u>Fair value</u> £m
<b>Financial liabilities</b> . . . . .					
Core structural borrowings of shareholder-financed operations (notes iH13) . . . . .	—	3,394	—	3,394	3,424
Operational borrowings attributable to shareholder-financed operations (H13) . . . . .	—	2,751	—	2,751	2,751
Borrowings attributable to with-profits funds (H13) . . . . .	105	1,179	—	1,284	1,281
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	—	3,482	—	3,482	3,540
Net asset value attributable to unit holders of consolidated unit trust and similar funds . . . . .	3,809	—	—	3,809	3,809
Investment contracts with discretionary participating features (note iv) . . . . .	—	—	24,880	24,880	—
Investment contracts without discretionary participating features . . . . .	13,840	1,965	—	15,805	15,866
Other creditors . . . . .	—	1,612	—	1,612	1,612
Derivative liabilities . . . . .	1,501	—	—	1,501	1,501
Other liabilities . . . . .	—	877	—	877	877
	<u>19,255</u>	<u>15,260</u>	<u>24,880</u>	<u>59,395</u>	

#### Notes

- i As at 31 December 2007, 31 December 2008, and 31 December 2009 respectively, £722 million, £620 million, and £659 million of convertible bonds were included in debt securities and £278 million, £363 million, and £347 million were included in borrowings.
- ii Loans and receivables are reported net of allowance for loan losses of £13 million, £27 million and £44 million, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.
- iii See note G3 for details of the derivative assets included. The balance also contains the PAC with-profits fund's participation in various investment funds and limited liability property partnerships.
- iv It is impractical to determine the fair value of investment contracts with discretionary participation features due to the lack of a reliable basis to measure such features.
- v For financial liabilities designated as fair value through profit and loss there was no impact on profit from movements in credit risk during 2009 and 2008.

#### Determination of fair value

The fair values of the financial assets and liabilities as shown on the table above have been determined on the following bases.

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 quoted investments, or by using quotations from independent third-parties, such as brokers and pricing services or by using appropriate valuation techniques. 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 e.g. 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. These techniques may include a number of assumptions relating to variables such as credit risk and interest rates. Changes in assumptions relating to these variables could positively or negatively impact the reported fair value of these instruments. When determining the inputs into the valuation techniques used priority is given to publicly available prices from independent sources, when available, but overall, the source of pricing is chosen with the objective of arriving at a fair value measurement which reflects the price at which an orderly transaction would take place between market participants on the measurement date.

The fair value estimates are made at a specific point in time, based upon available market information and judgements about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time the Prudential Group's entire holdings of a particular financial instrument, nor do they consider the tax impact of the realisation of unrealised gains or losses from selling the financial

instrument being fair valued. In some cases the fair value estimates cannot be substantiated by comparison to independent markets, nor can the disclosed value be realised in immediate settlement of the financial instrument.

At 31 December 2008 illiquid market conditions resulted in inactive markets for certain of the Prudential Group's financial instruments namely certain asset-backed securities issued by Jackson. As a result, there was generally limited observable market information for these instruments. Fair value estimates for financial instruments deemed to be in an illiquid market are based on judgements regarding current economic conditions, liquidity discounts, currency, credit and interest rate risks, loss experience and other factors. These fair values are estimates and involve considerable uncertainty and variability as a result of the inputs selected and may differ significantly from the values that would have been used had the ready market existed, and the differences could be material. At 31 December 2008 Jackson utilised internal valuation models as best estimate of fair values of all non-agency Residential Mortgage-Backed Securities (RMBS) and Asset-Backed Securities (ABS) and certain Commercial Mortgage-Backed Securities (CMBS). The use of internal models for these securities (which are accounted for on an available-for-sale basis) resulted in a fair value that was higher than those provided from pricing services and brokers of £760 million on a total amortised cost of £3.5 billion. During 2009, improvements were observed in the level of liquidity for these sectors of structured securities with the result that Jackson was able to rely on external prices for these securities as the most appropriate measure of fair value. At 31 December 2009 nearly all of the non-agency RMBS, ABS and certain CMBS which at 31 December 2008 were valued using internal models due to the dislocated market conditions in 2008 have now been valued using external prices.

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 rate of discount used was the market rate of interest.

The estimated fair value of derivative financial instruments reflects the estimated amount the Prudential 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. In accordance with the Prudential Group's risk management framework, all internally generated valuations are subject to assessment against external counterparties' valuations.

The fair value of borrowings is based on quoted market prices, where available.

Section A4 provides details of the determination of fair value for investment contracts without fixed and guaranteed terms (notably UK unit-linked policies). For investment contracts in the US with fixed and guaranteed terms the fair value is determined based on the present value of future cash flows discounted at current interest rates.

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

#### *Level 1, 2 and 3 fair value measurement hierarchy of Prudential Group financial instruments*

In March 2009 IFRS 7 *Financial Instruments: Disclosures* was amended by the IASB to require certain additional disclosures to be included in IFRS financial information. This includes, as is presented below, a table of financial instruments carried at fair value analysed by level of the IFRS 7 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. IFRS 7 does not require comparatives to be provided in the year of adoption but Prudential has chosen to provide the table at both 31 December 2009 and 31 December 2008.

The classification criteria and its application to Prudential can be summarised as follows:

#### *Level 1 — quoted prices (unadjusted) in active markets for identical assets and liabilities*

Level 1 principally includes exchange listed equities, mutual funds with quoted prices, exchange traded derivatives such as futures and options, and national government bonds unless there is evidence that trading in a given instrument is so infrequent that the market could not possibly be considered active. It also includes other financial instruments (including net assets attributable to unit holders of consolidated unit trusts and similar funds) where there is clear evidence that the year end valuation is based on a traded price in an active market.

#### *Level 2 — inputs other than quoted prices included within level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices)*

Level 2 principally includes corporate bonds and other non-national government debt securities which are valued using observable inputs, together with over-the-counter derivatives such as forward exchange contracts and non-

quoted investment funds valued with observable inputs. It also includes net assets attributable to unit holders of consolidated unit trusts and similar funds and investment contract liabilities that are valued using observable inputs.

The nature of Prudential's operations in the US and the UK mean that a significant proportion of the assets backing non-linked shareholder-backed business are held in corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing providers in the US and third party broker quotes in the UK and Asia either directly or via third parties such as IDC or Bloomberg. Such assets have generally been classified as level 2 as the nature of broker quotations means that it does not strictly meet the definition of a level 1 asset. However 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.

In addition level 2 includes debt securities that are valued internally using standard market practices. Of the total level 2 debt securities of £83,301 million at 31 December 2009, £6,426 million are valued internally. The majority of such securities use matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities. 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 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.

*Level 3: Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs)*

Level 3 principally includes investments in private equity funds, investment in property funds which are exposed to bespoke properties or risks, investments which are internally valued or subject to a significant number of unobservable assumptions and certain derivatives which are bespoke or long dated. It also includes debt securities which are rarely traded or traded only in privately negotiated transactions and hence where it is difficult to assert that these have been based on observable market data. The inherent nature of the vast majority of these assets means that, in normal market conditions, there is unlikely to be significant change in the specific underlying assets classified as level 3.

At 31 December 2009 the Prudential Group held £5,190 million, 3% of the fair valued financial instruments, within level 3. Of these amounts £3,510 million was held by the Prudential Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments. Total level 3 assets represented 3.7% of the total assets of the participating funds at 31 December 2009. Total level 3 liabilities were £348 million out of total participating fund liabilities of £104,817 million.

Of the £1,684 million level 3 items net of derivative liabilities which support non-linked shareholder-backed business (3.6% of the total assets net of derivative liabilities backing this business), £1,653 million are externally valued and £31 million are internally valued. Internal valuations, which represent only 0.04% of the total assets net of derivative liabilities supporting non-linked shareholder-backed business, are inherently more subjective than external valuations.

If the value of all level 3 investments backing non-linked shareholder-backed business was varied by 10%, the change in valuation would be £3 million, which would reduce shareholders' equity by this amount before tax. Of this amount a £5 million increase would pass through the income statement substantially as part of short term fluctuations outside of operating profit offset by a £8 million decrease included as part of other comprehensive income, being unrealised movements on assets classified as available-for-sale.

	<b>31 December 2008</b>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>With-profits</b>				
Equity securities and portfolio holdings in unit trusts . . . . .	30,427	885	509	31,821
Debt securities . . . . .	6,765	34,858	1,342	42,965
Other investments (including derivative assets) . . . . .	77	1,569	2,122	3,768
Derivative liabilities . . . . .	<u>(166)</u>	<u>(2,861)</u>	<u>—</u>	<u>(3,027)</u>
Total financial investments, net of derivative liabilities . . . . .	37,103	34,451	3,973	75,527
Borrowing attributable to with-profits fund held at fair value . . . . .	—	(158)	—	(158)
Investment contracts without discretionary participation features held at fair value . . . . .	—	—	—	—
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	<u>(1,010)</u>	<u>(384)</u>	<u>(381)</u>	<u>(1,775)</u>
Total . . . . .	36,093	33,909	3,592	73,594
Percentage of total . . . . .	<u>49%</u>	<u>46%</u>	<u>5%</u>	<u>100%</u>
<b>Unit-linked and variable annuity</b>				
Equity securities and portfolio holdings in unit trusts . . . . .	29,097	114	—	29,211
Debt securities . . . . .	2,650	3,615	33	6,298
Other investments (including derivative assets) . . . . .	117	87	—	204
Derivative liabilities . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total financial investments, net of derivative liabilities . . . . .	31,864	3,816	33	35,713
Borrowing attributable to with-profits fund held at fair value . . . . .	—	—	—	—
Investment contracts without discretionary participation features held at fair value . . . . .	—	(10,309)	—	(10,309)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	<u>(877)</u>	<u>—</u>	<u>—</u>	<u>(877)</u>
Total . . . . .	30,987	(6,493)	33	24,527
Percentage of total . . . . .	<u>126%</u>	<u>(26)%</u>	<u>0%</u>	<u>100%</u>
<b>Non-linked shareholder-backed</b>				
Equity securities and portfolio holdings in unit trusts . . . . .	745	27	318	1,090
Debt securities . . . . .	6,514	35,451	3,996	45,961
Other investments (including derivative assets) . . . . .	427	1,210	692	2,329
Derivative liabilities . . . . .	<u>(38)</u>	<u>(1,521)</u>	<u>(246)</u>	<u>(1,805)</u>
Total financial investments, net of derivative liabilities . . . . .	7,648	35,167	4,760	47,575
Borrowing attributable to with-profits fund held at fair value . . . . .	—	—	—	—
Investment contracts without discretionary participation features held at fair value . . . . .	—	(1,307)	—	(1,307)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	<u>(311)</u>	<u>(815)</u>	<u>(65)</u>	<u>(1,191)</u>
Total . . . . .	7,337	33,045	4,695	45,077
Percentage of total . . . . .	<u>16%</u>	<u>73%</u>	<u>11%</u>	<u>100%</u>
<b>Group total</b>				
Equity securities and portfolio holdings in unit trusts . . . . .	60,269	1,026	827	62,122
Debt securities . . . . .	15,929	73,924	5,371	95,224
Other investments (including derivative assets) . . . . .	621	2,866	2,814	6,301
Derivative liabilities . . . . .	<u>(204)</u>	<u>(4,382)</u>	<u>(246)</u>	<u>(4,832)</u>
Total financial investments net of derivative liabilities . . . . .	76,615	73,434	8,766	158,815
Borrowing attributable to with-profits fund held at fair value . . . . .	—	(158)	—	(158)
Investment contract without discretionary participation held at fair value . . . . .	—	(11,616)	—	(11,616)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	<u>(2,198)</u>	<u>(1,199)</u>	<u>(446)</u>	<u>(3,843)</u>
Total . . . . .	74,417	60,461	8,320	143,198
Percentage of total . . . . .	<u>52%</u>	<u>42%</u>	<u>6%</u>	<u>100%</u>

	31 December 2009			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
<b>With-profits</b>				
Equity securities and portfolio holdings in unit trusts	28,688	799	475	29,962
Debt securities	7,063	39,051	1,213	47,327
Other investments (including derivative assets)	79	1,199	2,170	3,448
Derivative liabilities	(54)	(504)	(25)	(583)
Total financial investments, net of derivative liabilities	35,776	40,545	3,833	80,154
Borrowing attributable to the with-profits fund held at fair value	—	(105)	—	(105)
Investment contract without discretionary participation features held at fair value	—	—	—	—
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(1,354)	(305)	(323)	(1,982)
Total	34,422	40,135	3,510	78,067
Percentage of total	44%	51%	5%	100%
<b>Unit-linked and variable annuity</b>				
Equity securities and portfolio holdings in unit trusts	38,616	4	—	38,620
Debt securities	3,283	5,525	40	8,848
Other investments (including derivative assets)	30	80	—	110
Derivative liabilities	—	—	—	—
Total financial investments net of derivative liabilities	41,929	5,609	40	47,578
Investment contract without discretionary participation features held at fair value	—	(12,242)	—	(12,242)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(1,324)	(7)	(2)	(1,333)
Total	40,605	(6,640)	38	34,003
Percentage of total	119%	(19)%	0%	100%
<b>Non-linked shareholder-backed</b>				
Equity securities and portfolio holdings in unit trusts	557	36	179	772
Debt securities	5,783	38,725	1,068	45,576
Other investments (including derivative assets)	155	787	632	1,574
Derivative liabilities	(20)	(703)	(195)	(918)
Total financial investments, net of derivative liabilities	6,475	38,845	1,684	47,004
Investment contract without discretionary participation features held at fair value	—	(1,598)	—	(1,598)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(110)	(342)	(42)	(494)
Total	6,365	36,905	1,642	44,912
Percentage of total	14%	82%	4%	100%
<b>Group total</b>				
Equity securities and portfolio holdings in unit trusts	67,861	839	654	69,354
Debt securities	16,129	83,301	2,321	101,751
Other investments (including derivative assets)	264	2,066	2,802	5,132
Derivative liabilities	(74)	(1,207)	(220)	(1,501)
Total financial investments, net of derivative liabilities	84,180	84,999	5,557	174,736
Borrowing attributable to the with-profits fund held at fair value	—	(105)	—	(105)
Investment contract without discretionary participation features held at fair value	—	(13,840)	—	(13,840)
Net asset value attributable to unit holders of consolidated unit trusts and similar funds	(2,788)	(654)	(367)	(3,809)
Total	81,392	70,400	5,190	156,982
Percentage of total	52%	45%	3%	100%

### Reconciliation of movements in level 3 financial instruments measured at fair value

The following table reconciles the value of level 3 financial instruments at 1 January 2009 to that presented at 31 December 2009.

Total gains and losses recorded in the income statement in the period represents realised gains and losses, including interest and dividend income, unrealised gains and losses on financial instruments classified at fair value through profit and loss and foreign exchange movements on an individual entity's overseas investments. All these amounts are included within "investment return" within the income statement.

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 Prudential Group's overseas subsidiaries and branches.

As highlighted earlier in this note, at 31 December 2008 Jackson had utilised internal valuations for certain structured securities given the illiquidity of the market at that time. These assets have therefore been classified as level 3 given the unobservable nature of the assumptions within the internal valuation models used. During the first half of 2009 improvements were observed in the level of liquidity for these structured securities such that external prices based on observable inputs from pricing services or brokers were used to value nearly all of the structured securities at 31 December 2009. There is therefore a transfer of £2,072 million from level 3 to level 2 during 2009 in respect of these securities. The remaining transfers in or out of level 3 represent sundry individual asset reclassifications, none of which are materially significant as highlighted in the table below.

	At 1 Jan 2009	Total gains/losses in income statement	Total gains/losses recorded in other comprehensive income	Purchases	Sales	Settled	Transfers into level 3	Transfers out of level 3	At 31 Dec 2009
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>With-profits</b>									
Equity securities and portfolio holdings in unit trusts . . . . .	509	(3)	(1)	26	(56)	—	—	—	475
Debt securities . . . . .	1,342	(14)	(11)	50	(225)	(17)	142	(54)	1,213
Other investments (including derivative assets) . . . . .	2,122	(211)	(89)	403	(55)	—	—	—	2,170
Derivative liabilities . . . . .	—	(2)	—	—	(23)	—	—	—	(25)
Total financial investments, net of derivative liabilities . . . . .	3,973	(230)	(101)	479	(359)	(17)	142	(54)	3,833
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	(381)	9	—	49	—	—	—	—	(323)
Total . . . . .	<u>3,592</u>	<u>(221)</u>	<u>(101)</u>	<u>528</u>	<u>(359)</u>	<u>(17)</u>	<u>142</u>	<u>(54)</u>	<u>3,510</u>
<b>Unit-linked and variable annuity</b>									
Equity securities and portfolio holdings in unit trusts . . . . .	—	—	—	—	—	—	—	—	—
Debt securities . . . . .	33	2	1	16	—	(8)	—	(4)	40
Other investments (including derivative assets) . . . . .	—	—	—	—	—	—	—	—	—
Derivative liabilities . . . . .	—	—	—	—	—	—	—	—	—
Total financial investments, net of derivative liabilities . . . . .	33	2	1	16	—	(8)	—	(4)	40
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	—	—	—	(1)	—	—	(1)	—	(2)
Total . . . . .	<u>33</u>	<u>2</u>	<u>1</u>	<u>15</u>	<u>—</u>	<u>(8)</u>	<u>(1)</u>	<u>(4)</u>	<u>38</u>
<b>Non-linked shareholder-backed</b>									
Equity securities and portfolio holding in unit trusts . . . . .	318	(47)	(34)	21	(55)	—	—	(24)	179
Debt securities . . . . .	3,996	(15)	(565)	104	(473)	(2)	200	(2,177)	1,068
Other investments (including derivative assets) . . . . .	692	130	(76)	153	(308)	—	43	(2)	632
Derivative liabilities . . . . .	(246)	93	—	(64)	23	—	(1)	—	(195)
Total financial investments, net of derivative liabilities . . . . .	4,760	161	(675)	214	(813)	(2)	242	(2,203)	1,684
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	(65)	17	6	—	—	—	—	—	(42)
Total . . . . .	<u>4,695</u>	<u>178</u>	<u>(669)</u>	<u>214</u>	<u>(813)</u>	<u>(2)</u>	<u>242</u>	<u>(2,203)</u>	<u>1,642</u>

	At 1 Jan 2009	Total gains/losses in income statement	Total gains/losses recorded in other comprehensive income	Purchases	Sales	Settled	Transfers into level 3	Transfers out of level 3	At 31 Dec 2009
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Group total</b>									
Equity securities and portfolio holdings in unit trusts . . . . .	827	(50)	(35)	47	(111)	—	—	(24)	654
Debt securities . . . . .	5,371	(27)	(575)	170	(698)	(27)	342	(2,235)	2,321
Other investments (including derivative assets) . . . . .	2,814	(81)	(165)	556	(363)	—	43	(2)	2,802
Derivative liabilities . . . . .	(246)	91	—	(64)	—	—	(1)	—	(220)
Total financial investments net of derivative liabilities . . . . .	8,766	(67)	(775)	709	(1,172)	(27)	384	(2,261)	5,557
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	(446)	26	6	48	—	—	(1)	—	(367)
Total . . . . .	<u>8,320</u>	<u>(41)</u>	<u>(769)</u>	<u>757</u>	<u>(1,172)</u>	<u>(27)</u>	<u>383</u>	<u>(2,261)</u>	<u>5,190</u>

Of the total gains and losses in the income statement of a loss of £(41) million in the period, £(205) million relates to financial instruments still held at the end of the year, which can be analysed as £(41) million for equity securities, £(44) million for debt securities, £(221) million for other investments, £76 million for derivative liabilities and £25 million for net asset value attributable to unit holders of consolidated unit trusts and similar funds.

#### *Transfers between level 1 and level 2*

There have been no significant transfers between level 1 and level 2 during the year.

#### *Interest income and expense*

The interest income on financial assets not at fair value through profit and loss for the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, from continuing operations was £2,016 million, £2,532 million and £1,998 million.

The interest expense on financial liabilities not at fair value through profit and loss for the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, from continuing operations was £699 million, £645 million, and £366 million.

## G2: Market risk

### Interest rate risk

The following table shows an analysis of the classes of financial assets and liabilities and their direct exposure to interest rate risk. Each applicable class of the Prudential Group's financial assets or liabilities is analysed between those exposed to fair value interest rate risk, cash flow interest rate risk and those with no direct interest rate risk exposure:

	<b>2007</b>			
	<u>Fair value interest rate risk</u>	<u>Cash flow interest rate risk</u>	<u>Not directly exposed to interest rate risk</u>	<u>Total £m</u>
<b>Financial assets</b>				
Cash and cash equivalents . . . . .	—	—	4,951	4,951
Deposits . . . . .	678	7,211	—	7,889
Debt securities . . . . .	76,481	7,503	—	83,984
Loans . . . . .	4,319	3,605	—	7,924
Other investments (including derivatives) . . . . .	664	285	3,447	4,396
	<u>82,142</u>	<u>18,604</u>	<u>8,398</u>	<u>109,144</u>
<b>Financial liabilities</b>				
Core structural borrowings of shareholder-financed operations . . . . .	2,492	—	—	2,492
Operational borrowings attributable to shareholder-financed operations . . . . .	2,743	331	7	3,081
Borrowings attributable to with-profits funds . . . . .	451	441	95	987
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	594	3,487	—	4,081
Investment contracts without discretionary participation features . . . . .	1,922	—	12,110	14,032
Derivative liabilities . . . . .	244	145	691	1,080
Other liabilities . . . . .	178	98	515	791
	<u>8,624</u>	<u>4,502</u>	<u>13,418</u>	<u>26,544</u>
	<b>2008</b>			
	<u>Fair value interest rate risk</u>	<u>Cash flow interest rate risk</u>	<u>Not directly exposed to interest rate risk</u>	<u>Total £m</u>
<b>Financial assets</b>				
Cash and cash equivalents . . . . .	—	—	5,955	5,955
Deposits . . . . .	1,126	6,084	84	7,294
Debt securities . . . . .	89,353	5,532	339	95,224
Loans . . . . .	6,979	3,485	27	10,491
Other investments (including derivatives) . . . . .	1,539	686	4,076	6,301
	<u>98,997</u>	<u>15,787</u>	<u>10,481</u>	<u>125,265</u>
<b>Financial liabilities</b>				
Core structural borrowings of shareholder-financed operations . . . . .	2,958	—	—	2,958
Operational borrowings attributable to shareholder-financed operations . . . . .	1,520	454	3	1,977
Borrowings attributable to with-profits funds . . . . .	729	482	97	1,308
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	889	4,683	—	5,572
Investment contracts without discretionary participation features . . . . .	2,885	—	11,616	14,501
Derivative liabilities . . . . .	1,185	785	2,862	4,832
Other liabilities . . . . .	218	105	567	890
	<u>10,384</u>	<u>6,509</u>	<u>15,145</u>	<u>32,038</u>

	<u>Fair value interest rate risk</u>	<u>Cash flow interest rate risk</u>	<u>Not directly exposed to interest rate risk</u>	<u>Total</u> £m
<b>Financial assets</b>				
Cash and cash equivalents . . . . .	—	—	5,307	5,307
Deposits . . . . .	896	11,884	40	12,820
Debt securities . . . . .	95,817	5,550	384	101,751
Loans . . . . .	5,923	2,816	15	8,754
Other investments (including derivatives) . . . . .	<u>1,381</u>	<u>368</u>	<u>3,383</u>	<u>5,132</u>
	<u>104,017</u>	<u>20,618</u>	<u>9,129</u>	<u>133,764</u>
<b>Financial liabilities</b>				
Core structural borrowings of shareholder-financed operations . . . . .	3,394	—	—	3,394
Operational borrowings attributable to shareholder-financed operations . . . . .	2,128	620	3	2,751
Borrowings attributable to with-profits funds . . . . .	804	312	168	1,284
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	611	2,871	—	3,482
Investment contracts without discretionary participation features . . . . .	1,098	867	13,840	15,805
Derivative liabilities . . . . .	647	286	568	1,501
Other liabilities . . . . .	<u>79</u>	<u>92</u>	<u>706</u>	<u>877</u>
	<u>8,761</u>	<u>5,048</u>	<u>15,285</u>	<u>29,094</u>

*Liquidity analysis*

i) Contractual maturities of financial liabilities

The following table sets out the contractual maturities for applicable classes of financial liabilities, excluding derivative liabilities and investment contracts and that are separately presented. The financial liabilities are included in the column relating to the contractual maturities at the undiscounted cash flows (including contractual interest payments) due to be paid assuming conditions are consistent with those of year end.

	2007								
	Total carrying value	1 year or less	After 1 year to 5 years	After 5 years to 10 years	After 10 years to 15 years	After 15 years to 20 years	Over 20 years	No stated maturity	Total £m
<b>Financial liabilities</b>									
Core structural borrowings of shareholder-financed operations(H13) . . . . .	2,492	120	685	525	981	793	821	763	4,688
Operational borrowings attributable to shareholder-financed operations(H13) . . .	3,081	2,625	133	319	19	19	72	—	3,187
Borrowings attributable to with-profits funds(H13) . . . .	987	444	233	250	—	—	83	100	1,110
Obligations under funding, securities lending and sale and repurchase agreements . .	4,081	4,081	—	—	—	—	—	—	4,081
Other liabilities . . . . .	791	630	7	2	—	—	—	152	791
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	3,556	3,556	—	—	—	—	—	—	3,556
Other creditors . . . . .	1,020	1,020	—	—	—	—	—	—	1,020
	<u>16,008</u>	<u>12,476</u>	<u>1,058</u>	<u>1,096</u>	<u>1,000</u>	<u>812</u>	<u>976</u>	<u>1,015</u>	<u>18,433</u>

	2008								
	Total carrying value	1 year or less	After 1 year to 5 years	After 5 years to 10 years	After 10 years to 15 years	After 15 years to 20 years	Over 20 years	No stated maturity	Total £m
<b>Financial liabilities</b>									
Core structural borrowings of shareholder-financed operations(H13) . . . . .	2,958	369	422	525	1,273	437	780	1,059	4,865
Operational borrowings attributable to shareholder-financed operations(H13) . . . . .	1,977	1,590	357	18	18	18	65	—	2,066
Borrowings attributable to with-profits funds(H13) . . . .	1,308	232	807	249	—	—	78	113	1,479
Obligations under funding, securities lending and sale and repurchase agreements . .	5,572	5,572	—	—	—	—	—	—	5,572
Other liabilities . . . . .	890	646	11	5	—	—	—	228	890
Net asset value attributable to unit holders of consolidated unit trusts and similar funds . . . . .	3,843	3,843	—	—	—	—	—	—	3,843
Other creditors . . . . .	1,496	1,496	—	—	—	—	—	—	1,496
	<u>18,044</u>	<u>13,748</u>	<u>1,597</u>	<u>797</u>	<u>1,291</u>	<u>455</u>	<u>923</u>	<u>1,400</u>	<u>20,211</u>

2009

	<u>Total carrying value</u>	<u>1 year or less</u>	<u>After 1 year to 5 years</u>	<u>After 5 years to 10 years</u>	<u>After 10 years to 15 years</u>	<u>After 15 years to 20 years</u>	<u>Over 20 years</u>	<u>No stated maturity</u>	<u>Total</u> £m
<b>Financial liabilities</b> . . . . .									
Core structural borrowings of shareholder-financed operations(H13) . . . . .	3,394	148	588	733	1,394	877	1,343	1,422	6,505
Operational borrowings attributable to shareholder-financed operations(H13) . . . . .	2,751	2,351	435	9	9	9	31	—	2,844
Borrowings attributable to with-profits funds(H13) . . . . .	1,284	228	882	102	—	—	—	205	1,417
Obligations under funding, securities lending and sale and repurchase agreements . . . . .	3,482	3,482	—	—	—	—	—	—	3,482
Other liabilities . . . . .	877	643	11	14	—	—	—	211	879
Net asset value attributable to unit holders of consolidated unit-trusts and similar funds . . . . .	3,809	3,809	—	—	—	—	—	—	3,809
Other creditors . . . . .	<u>1,612</u>	<u>1,612</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,612</u>
	<u>17,209</u>	<u>12,273</u>	<u>1,916</u>	<u>858</u>	<u>1,403</u>	<u>886</u>	<u>1,374</u>	<u>1,838</u>	<u>20,548</u>

ii) *Maturity analysis of derivatives*

The following table provides a maturity analysis of derivative assets and liabilities:

	2007					
	<u>Total carrying value</u>	<u>1 year or less</u>	<u>After 1 year to 3 years</u>	<u>After 3 years to 5 years</u>	<u>After 5 years</u>	<u>Total</u> £m
Net derivative position . . . . .	<u>17</u>	<u>34</u>	<u>5</u>	<u>1</u>	<u>—</u>	<u>40</u>
	2008					
	<u>Total carrying value</u>	<u>1 year or less</u>	<u>After 1 year to 3 years</u>	<u>After 3 years to 5 years</u>	<u>After 5 years</u>	<u>Total</u> £m
Net derivative position . . . . .	<u>(2,462)</u>	<u>(2,464)</u>	<u>12</u>	<u>(1)</u>	<u>—</u>	<u>(2,453)</u>
	2009					
	<u>Total carrying value</u>	<u>1 year or less</u>	<u>After 1 year to 3 years</u>	<u>After 3 years to 5 years</u>	<u>After 5 years</u>	<u>Total</u> £m
Net derivative position . . . . .	<u>279</u>	<u>340</u>	<u>10</u>	<u>(1)</u>	<u>—</u>	<u>349</u>

The net derivative positions as shown in the table above comprise the following derivative assets and liabilities:

	2007	2008	2009
	£m		
Derivative assets . . . . .	1,097	2,370	1,780
Derivative liabilities . . . . .	<u>(1,080)</u>	<u>(4,832)</u>	<u>(1,501)</u>
Net derivative position . . . . .	<u>17</u>	<u>(2,462)</u>	<u>279</u>

The majority of derivative assets and liabilities have been included at fair value within the 1 year or less column representing the basis on which they are managed (i.e. to manage principally asset or liability value exposures). Contractual maturities are not considered essential for an understanding of the timing of the cash flows for these instruments and in particular the Prudential Group has no cash flow hedges. The only exception is certain identified

interest rate swaps which are fully expected to be held until maturity solely for the purposes of matching cash flows on separately held assets and liabilities. For these instruments the undiscounted cash flows (including contractual interest amounts) due to be paid under the swap contract assuming conditions are consistent with those at year end are included in the column relating to the contractual maturity of the derivative.

The table below shows the maturity profile for investment contracts on an undiscounted basis to the nearest billion. This maturity profile has been based on the cash flow projections of expected benefit payments as part of the determination of the value of in-force business when preparing EEV basis results.

								2007
	<u>1 year or less</u>	<u>After 1 year to 5 years</u>	<u>After 5 years to 10 years</u>	<u>After 10 years to 15 years</u>	<u>After 15 years to 20 years</u>	<u>Over 20 years</u>	<u>Total undiscounted value</u>	<u>Carrying value</u>
								£bn
Life assurance investment contracts .....	<u>3</u>	<u>12</u>	<u>16</u>	<u>16</u>	<u>15</u>	<u>25</u>	<u>87</u>	<u>44</u>
								2008
	<u>1 year or less</u>	<u>After 1 year to 5 years</u>	<u>After 5 years to 10 years</u>	<u>After 10 years to 15 years</u>	<u>After 15 years to 20 years</u>	<u>Over 20 years</u>	<u>Total undiscounted value</u>	<u>Carrying value</u>
								£bn
Life assurance investment contracts .....	<u>3</u>	<u>18</u>	<u>12</u>	<u>12</u>	<u>9</u>	<u>13</u>	<u>67</u>	<u>38</u>
								2009
	<u>1 year or less</u>	<u>After 1 year to 5 years</u>	<u>After 5 years to 10 years</u>	<u>After 10 years to 15 years</u>	<u>After 15 years to 20 years</u>	<u>Over 20 years</u>	<u>Total undiscounted value</u>	<u>Carrying value</u>
								£bn
Life assurance investment contracts .....	<u>3</u>	<u>11</u>	<u>13</u>	<u>13</u>	<u>11</u>	<u>17</u>	<u>68</u>	<u>41</u>

Most investment contracts have options to surrender early, albeit these are often subject to surrender or other penalties. It is therefore the case that most contracts could be said to have a contractual maturity of less than one year, but in reality the additional charges and term of the contracts means these are unlikely to be exercised in practice and the more useful information is to present information on expected payment.

The maturity profile above excludes certain corporate unit-linked business with gross policyholder liabilities of £8 billion at 31 December 2007, of £8 billion at 31 December 2008 and of £9 billion at 31 December 2009 respectively, which has no stated maturity but which is repayable on demand.

This table has been prepared on an undiscounted basis and accordingly the amounts shown for life assurance investment contracts differ from those disclosed on the statement of financial position. Durations of long-term business contracts, covering insurance and investment contracts, on a discounted basis are included in section D.

The vast majority of the Prudential Group's financial assets are held to back the Prudential Group's policyholder liabilities. Although asset/liability matching is an important component of managing policyholder liabilities (both those classified as insurance and those classified as investments), this profile is mainly relevant for managing market risk rather than liquidity risk. Within each business unit this asset/liability matching is performed on a portfolio by portfolio basis.

In terms of liquidity risk a large proportion of the policyholder liabilities contain discretionary surrender values or surrender charges, meaning that many of the Prudential Group's liabilities are expected to be held for the long term. Much of the Prudential Group's investment portfolio is in marketable securities, which can therefore be converted quickly to liquid assets.

For the reasons above an analysis of the Prudential Group's assets by contractual maturity is not considered necessary to evaluate the nature and extent of the Prudential Group's liquidity risk.

#### *Credit risk*

The Prudential Group's maximum exposure to credit risk before any allowance for collateral or allocation of losses to policyholders is represented by the carrying value of financial instruments on the balance sheet that have exposures to credit risk. These assets comprise cash and cash equivalents, deposits, debt securities, loans and

derivative assets, the carrying value of which are disclosed at the start of this note and note G3 for derivative assets. The collateral in place in relation to derivatives is described in G4. Notes D2, D3, and D4, describe the security for these loans held by the Prudential Group, as disclosed at the start of this note.

Of the total loans and receivables held £5 million, £21 million and £64 million at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, are past their due date but have not been impaired. Of the total past due but not impaired, £5 million, £21 million and £53 million, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, are less than one year past their due date while £0.2 million, nil and £11 million at 31 December 2007, 31 December 2008 and 31 December 2009 respectively are more than six months but less than one year past their due date. The Prudential Group expects full recovery of these loans and receivables. No further analysis has been provided of the age of financial assets that are past due at the end of the reporting period but not impaired as the amounts are immaterial.

No further analysis has been provided of the element of loans and receivables that was neither past due nor impaired for the total portfolio. This is on the grounds of immateriality of the difference between the neither past due nor impaired elements and the total portfolio.

Financial assets that would have been past due or impaired had the terms not been renegotiated amounted to £55 million (2007: nil; 2008: £1 million).

There was no collateral held against loans that are past due and impaired or that are past due but not impaired at 31 December 2007, 31 December 2008 and 31 December 2009.

In addition, during 2007, 2008 and 2009 respectively, the Prudential Group took possession of £7 million, £66 million and £15 million of other collateral held as security, which mainly consists of assets that could be readily convertible into cash.

#### *Currency risk*

As at 31 December 2007, 31 December 2008 and 31 December 2009, the Prudential Group held 19%, 20%, and 19% and 13%, 13%, and 13% of its financial assets and financial liabilities respectively, in currencies, mainly US dollar and Euro, other than the functional currency of the relevant business unit.

The financial assets, of which 86%, 77%, and 74%, are held by the PAC with-profits fund, allow the PAC with-profits fund to obtain exposure to foreign equity markets, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

The financial liabilities, of which 19%, 38%, and 34%, are held by the PAC with-profits fund, mainly relate to foreign currency borrowings, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

The exchange risks inherent in these exposures are mitigated through the use of derivatives, mainly forward currency contracts (note G3 below).

The amount of exchange gains (losses) recognised in the income statement in 2007, 2008 and 2009 respectively, except for those arising on financial instruments measured at fair value through profit and loss, is £102 million gains, £638 million gains and £201 million losses. This constitutes £109 million gains, £32 million gains and £41 million losses on Medium Term Notes (MTN) liabilities and £7 million of net losses, £606 million net gains and £160 million net losses, mainly arising on investments of the PAC with-profits fund in 2007, 2008 and 2009 respectively. The gains/losses on MTN liabilities are fully offset by value movements on cross-currency swaps, which are measured at fair value through profit and loss, for 2007, 2008 and 2009 respectively.

### **G3: Derivatives and hedging**

#### *Derivatives*

The Prudential Group enters into a variety of exchange traded and over-the-counter derivative financial instruments, including futures, options, forward currency contracts and swaps such as interest rate swaps, cross-currency swaps, swaptions and credit default swaps.

All over-the-counter derivative transactions are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Prudential Group has collateral agreements between the individual Prudential Group entities and relevant counterparties in place under each of these market master agreements.

The total fair value balances of derivative assets and liabilities as at 31 December were as follows:

	<b>2007</b>					
	<u>UK insurance operations</u>	<u>US insurance operations</u>	<u>Asian insurance operations</u>	<u>Asset management</u>	<u>Unallocated to a segment</u>	<u>Group total</u> £m
Derivative assets . . . . .	571	390	15	118	3	1,097
Derivative liabilities . . . . .	<u>(689)</u>	<u>(158)</u>	<u>(2)</u>	<u>(186)</u>	<u>(45)</u>	<u>(1,080)</u>
	<u>(118)</u>	<u>232</u>	<u>13</u>	<u>(68)</u>	<u>(42)</u>	<u>17</u>
	<b>2008</b>					
	<u>UK insurance operations</u>	<u>US insurance operations</u>	<u>Asian insurance operations</u>	<u>Asset management</u>	<u>Unallocated to a segment</u>	<u>Group total</u> £m
Derivative assets . . . . .	1,326	675	15	74	280	2,370
Derivative liabilities . . . . .	<u>(3,401)</u>	<u>(863)</u>	<u>(32)</u>	<u>(292)</u>	<u>(244)</u>	<u>(4,832)</u>
	<u>(2,075)</u>	<u>(188)</u>	<u>(17)</u>	<u>(218)</u>	<u>36</u>	<u>(2,462)</u>
	<b>2009</b>					
	<u>UK insurance operations</u>	<u>US insurance operations</u>	<u>Asian insurance operations</u>	<u>Asset management</u>	<u>Unallocated to a segment</u>	<u>Group total</u> £m
Derivative assets . . . . .	910	519	150	48	153	1,780
Derivative liabilities . . . . .	<u>(709)</u>	<u>(461)</u>	<u>(146)</u>	<u>(49)</u>	<u>(136)</u>	<u>(1,501)</u>
	<u>201</u>	<u>58</u>	<u>4</u>	<u>(1)</u>	<u>17</u>	<u>279</u>

The above derivative assets are included in 'other investments' in the primary statements.

The notional amount of the derivatives, distinguishing between UK insurance and US operations, was as follows:

	<b>2007</b>			
	<u>UK insurance operations</u>		<u>US insurance operations</u>	
	<u>Notional amount on which future payments are based</u>		<u>Notional amount on which future payments are based</u>	
<u>As at 31 December 2007</u>	<u>Asset</u>	<u>Liability</u>	<u>Asset</u>	<u>Liability</u>
	£m			
Cross-currency swaps* . . . . .	658	648	602	—
Equity index call options . . . . .	—	23	—	—
Swaptions . . . . .	1,125	—	25,620	1,005
Futures . . . . .	1,905	2,176	—	371
Forwards* . . . . .	17,243	17,635	—	—
Inflation swaps . . . . .	1,758	1,319	—	—
Credit default swaps . . . . .	4,181	59	—	—
Single stock options . . . . .	—	—	—	—
Credit derivatives . . . . .	—	—	3	20
Put options . . . . .	—	—	3,642	—
Equity options . . . . .	—	—	5,545	11
Total return swaps . . . . .	956	955	226	—
Interest rate swaps* . . . . .	<u>4,335</u>	<u>4,663</u>	<u>1,708</u>	<u>3,587</u>

	<b>2008</b>			
	<b>UK insurance operations</b>		<b>US insurance operations</b>	
	<b>Notional amount on which future payments are based</b>		<b>Notional amount on which future payments are based</b>	
<u>As at 31 December 2008</u>	<u>Asset</u>	<u>Liability</u>	<u>Asset</u>	<u>Liability</u>
	<b>£m</b>			
Cross-currency swaps*	838	1,014	448	218
Equity index call options	17	32	—	—
Swaptions	980	980	28,863	—
Futures	3,286	4,055	—	460
Forwards*	14,315	16,489	—	—
Inflation swaps	2,559	2,482	—	—
Credit default swaps	123	14	—	—
Single stock options	1	1	—	—
Credit derivatives	—	—	31	177
Put options	—	—	6,573	—
Equity options	2	4	3,785	5
Total return swaps	479	514	—	313
Interest rate swaps*	<u>5,074</u>	<u>5,245</u>	<u>1,704</u>	<u>4,514</u>
	<b>2009</b>			
	<b>UK insurance operations</b>		<b>US insurance operations</b>	
	<b>Notional amount on which future payments are based</b>		<b>Notional amount on which future payments are based</b>	
<u>As at 31 December 2009</u>	<u>Asset</u>	<u>Liability</u>	<u>Asset</u>	<u>Liability</u>
	<b>£m</b>			
Cross-currency swaps*	808	881	376	168
Equity index call options	—	—	—	—
Swaptions	900	900	12,694	5,263
Futures	2,267	2,987	—	1,534
Forwards*	20,235	20,184	—	—
Inflation swaps	2,337	2,205	—	—
Credit default swaps	90	12	—	—
Single stock options	—	—	—	—
Credit derivatives	—	—	—	189
Put options	—	—	9,072	—
Equity options	30	552	3,246	562
Total return swaps	420	421	—	—
Interest rate swaps*	<u>5,529</u>	<u>5,710</u>	<u>1,579</u>	<u>3,957</u>

\* In addition, for 2007, 2008 and 2009 respectively, the other operations, including the Group Treasury function and the Asian operations, have cross-currency swap assets and liabilities with notional amounts of £730 million, £1,503 million, and £819 million and £1,401 million, £605 million, and £122 million respectively, forward currency contracts assets and liabilities with notional amounts of £983 million, £1,419 million, and £570 million and £773 million, £2,310 million, and £958 million respectively, interest rate swaps assets and liabilities of £2,799 million, £1,407 million, and £793 million and £1,563 million, £2,316 million, and £522 million, respectively, and cliquet options assets of nil, £1,525 million, and £7 million.

These derivatives are used for efficient portfolio management to obtain cost effective and efficient exposure to various markets in accordance with the Prudential Group's investment strategies and to manage exposure to interest rate, currency, credit and other business risks. See also note D3 for use of derivatives by the Prudential Group's US operations.

The Prudential Group uses various interest rate derivative instruments such as interest rate swaps to reduce exposure to interest rate volatility.

The UK insurance operations use various currency derivatives in order to limit volatility due to foreign currency exchange rate fluctuations arising on securities denominated in currencies other than sterling. See also note G2 above. In addition, total return swaps and interest rate swaps are held for efficient portfolio management.

As part of the efficient portfolio management of the PAC with-profits fund, the fund may, from time to time, invest in cash-settled forward contracts over Prudential plc Shares, which are accounted for consistently with other derivatives. This is in order to avoid a mismatch of the with-profits investment portfolio with the investment benchmarks set for its equity-based investment funds. The contracts will form part of the long-term investments of the with-profits fund. These contracts are subject to a number of limitations for legal and regulatory reasons.

Some of the Prudential Group's products, especially those sold in the US, have certain guarantee features linked to equity indexes. A mismatch between product liabilities and the performance of the underlying assets backing them exposes the Prudential Group to equity index risk. In order to mitigate this risk, the relevant business units purchase swaptions, equity options and futures to match asset performance with liabilities under equity-indexed products.

The US operations and some of the UK operations hold large amounts of interest-rate sensitive investments that contain credit risks on which a certain level of defaults is expected. These entities have purchased some swaptions in order to manage the default risk on certain underlying assets and hence reduce the amount of regulatory capital held to support the assets.

### *Hedging*

The Prudential Group has formally assessed and documented the effectiveness of the following hedges under IAS 39.

#### *Fair value hedges*

The Prudential Group uses interest rate derivatives to hedge the interest exposures on its US\$300 million, 6.5% perpetual subordinated capital securities. In addition, the Prudential Group similarly used interest rate derivatives to hedge the exposure on its US\$1 billion, 6.5% perpetual subordinated capital securities until this hedge was cancelled in March 2009. Where the hedge relationship is de-designated and re-designated, the fair value adjustment to the hedged item up to the point of de-designation continues to be reported as part of the basis of the hedged item and is amortised to the income statement based on a recalculated effective interest rate over the residual period to the first break clause date of the perpetual subordinated capital securities.

The Prudential Group has chosen to designate as a fair value hedge certain fixed to floating rate swaps which hedge the fair value exposure to interest rate movements of certain of the Prudential Group's operational borrowings.

The fair value of the derivatives designated as fair value hedges above at 31 December 2007, 31 December 2008, and 31 December 2009 were an asset of £5 million, £17 million, and £7 million and liabilities of £25 million, £nil, and £1 million. Movements in the fair value of the hedging instruments (net gain of £6 million, a net loss of £4 million, and a net loss of £11 million, for 2007, 2008, and 2009 respectively) and the hedged items (net loss of £4 million, a net gain of £7 million, and a net gain of £11 million, for 2007, 2008, and 2009 respectively) are recorded in the income statement in respect of the fair value hedges above.

#### *Cash flow hedges*

The Prudential Group has no cash flow hedges in place.

#### *Net investment hedges*

The Prudential Group entered into a series of rolling one to three-month period forward currency transactions which together formed a net investment hedge of the currency exposure of the net investments in the US operations. The programme ceased in August 2009. At December 2008 US\$600 million of the forward currency contracts were designated as a partial net investment hedge of the currency exposure of the net investments in the US operations. The fair value of the forward currency contracts at 31 December 2007 and 31 December 2008 was a liability of £44 million and £56 million respectively, of which a liability of £44 million and £17 million respectively was designated as a net investment hedge of the currency exposure of the net investments in the US operations.

In addition, the Prudential Group has designated perpetual subordinated capital securities totalling US\$1.55 billion as a net investment hedge to hedge the currency risks related to the net investment in Jackson. The carrying value of the subordinated capital securities was £763 million, £1,059 million, and £963 million as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. The foreign exchange gain of £13 million, loss of £299 million and of £118 million at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, on translation of the borrowings to pounds sterling at the statement of financial position date is recognised in the translation reserve in shareholders' equity.

The net investment hedges were 100% effective.

#### **G4: Derecognition and collateral**

##### *Securities lending and reverse repurchase agreements*

The Prudential Group has entered into securities lending (including repurchase agreements) whereby blocks of securities are loaned to third-parties, primarily major brokerage firms. The amounts above the fair value of the loaned securities required to be held as collateral by the agreements depend on the quality of the collateral, calculated on a daily basis. The loaned securities are not removed from the Prudential Group's consolidated statement of financial position, rather they are retained within the appropriate investment classification. Collateral typically consists of cash, debt securities, equity securities and letters of credit. At 31 December 2007, 31 December 2008 and 31 December 2009, the Prudential Group had lent £17,172 million, £12,617 million and £10,446 million respectively (of which £11,461 million, £9,701 million, and £7,910 million, respectively was lent by the PAC with-profits fund) of securities and at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, held collateral under such agreements of £18,125 million, £13,497 million and £10,669 million (of which £12,105 million, £9,924 million and £8,086 million, respectively was held by the PAC with-profits fund).

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the Prudential Group had entered into reverse repurchase transactions under which it purchased securities and had taken on the obligation to resell the securities for the purchase price of £1,361 million, £588 million and £1,587 million, together with accrued interest.

##### *Collateral and pledges under derivative transactions*

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the Prudential Group had pledged £260 million, £1,154 million and £644 million for liabilities and held collateral of £292 million, £829 million and £586 million in respect of over-the-counter derivative transactions.

#### **G5: Impairment of financial assets**

In accordance with the Prudential Group's accounting policy set out in note A4, impairment reviews were performed for available-for-sale securities and loans and receivables. In addition, impairment reviews were undertaken for the reinsurers' share of insurance contract liabilities.

During the year ended 31 December 2007, 31 December 2008, and 31 December 2009 respectively, impairment losses of £184 million, £525 million, and £647 million were recognised for available-for-sale securities and loans and receivables. These were £35 million, £497 million and £630 million in respect of available-for-sale securities held by Jackson and a further £149 million, £28 million and £17 million in respect of loans and receivables, for 2007, 2008 and 2009 respectively. The 2007 impairment charge of £149 million related to loans and advances to customers in the discontinued banking operations during the period of ownership. The 2008 impairment charge for loans and receivables of £28 million related primarily to loans held by the UK with-profits fund. The 2009 impairment charge for loans and receivables of £17 million relates to loans held by the UK with-profits fund and mortgage loans held by Jackson.

Impairment losses recognised on available-for-sale securities amounted to £35 million, £497 million and £630 million, for 2007, 2008 and 2009 respectively. Of this amount, 14%, 29% and 86% respectively, has been recorded on structured asset-backed securities, primarily due to reduced cash flow expectations on such securities that are collateralised by diversified pools of primarily below investment grade securities. Of the losses related to the impairment of fixed maturity securities the top five individual corporate issuers made up 57%, 27%, and 11%, for 2007, 2008 and 2009 respectively, reflecting a deteriorating business outlook of the companies concerned.

The impairment losses have been recorded in 'investment return' in the income statement.

In 2007, 2008 and 2009 respectively, the Prudential Group realised gross losses on sales of available-for-sale securities of £86 million, £184 million and £134 million with 46%, 55% and 60% of these losses related to the disposal of fixed maturity securities of six, six and five (2007, 2008 and 2009 respectively) individual issuers, which were disposed off to rebalance the portfolio in the US operations in response to the unstable mortgage lending.

The effect of those reasonably likely changes in the key assumptions underlying the estimates that underpin the assessment of whether impairment has taken place depends on the factors described in note A3. A key indicator of whether such impairment may arise in future, and the potential amounts at risk, is the profile of gross unrealised losses for fixed maturity securities accounted for on an available-for-sale basis by reference to the time periods by which the securities have been held continuously in an unrealised loss position and by reference to the maturity date of the securities concerned.

For 2007, 2008 and 2009 respectively the amounts of gross unrealised losses for fixed maturity securities classified as available-for-sale under IFRS in an unrealised loss position was £439 million, £3,178 million and £966 million. Notes B1 and D3 provide further details on the impairment charges and unrealised losses of Jackson's available-for-sale securities.

## H: OTHER INFORMATION ON STATEMENT OF FINANCIAL POSITION ITEMS

### H1: Intangible assets attributable to shareholders

#### a Goodwill

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Cost</b>			
At 1 January . . . . .	1,461	1,461	1,461
Disposal of Taiwan Agency business . . . . .	—	—	(44)
Additional consideration paid on previously acquired businesses . . . . .	—	—	13
At 31 December . . . . .	<u>1,461</u>	<u>1,461</u>	<u>1,430</u>
<b>Aggregate impairment</b>			
At 1 January and 31 December . . . . .	(120)	(120)	(120)
<b>Net book amount at 31 December . . . . .</b>	<u><u>1,341</u></u>	<u><u>1,341</u></u>	<u><u>1,310</u></u>

#### Impairment testing

Goodwill does not generate cash flows independently of other groups of assets and thus is assigned to cash generating units (CGUs) for the purposes of impairment testing. These CGUs are based upon how management monitors the business and represent the lowest level to which goodwill can be allocated on a reasonable basis. An allocation to CGUs of the Prudential Group's goodwill attributable to shareholders is shown below:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
M&G . . . . .	1,153	1,153	1,153
Other . . . . .	188	188	157
	<u><u>1,341</u></u>	<u><u>1,341</u></u>	<u><u>1,310</u></u>

'Other' represents goodwill amounts allocated across CGUs in Asia and US operations. These goodwill amounts are not individually material.

#### Assessment of whether goodwill may be impaired

With the exception of M&G, the goodwill attributable to shareholders in the statement of financial position mainly relates to acquired life businesses. Prudential routinely compares the aggregate of net asset value and acquired goodwill on an IFRS basis of acquired life business with the value of the business as determined using the EEV methodology, as described in note D1. Any excess of IFRS over EEV carrying value is then compared with EEV basis value of current and projected future new business to determine whether there is any indication that the goodwill in the IFRS statement of financial position may be impaired. The assumptions underpinning the Prudential Group's EEV basis of reporting are included in the EEV basis supplementary information.

Goodwill is tested for impairment by comparing the CGUs carrying amount, excluding any goodwill, with its recoverable amount.

#### M&G

The recoverable amount for the M&G CGU has been determined by calculating its value in use. This has been calculated by aggregating the present value of future cash flows expected to be derived from the M&G operating segment (based upon management projections).

The discounted cash flow valuation has been based on a five-year (three year plan for the year ended 31 December 2007) plan prepared by M&G, and approved by management, and cash flow projections for later years.

The value in use is particularly sensitive to a number of key assumptions as follows:

- i The set of economic, market and business assumptions used to derive the five-year plan. The direct and secondary effects of recent developments, e.g. the fall in global equity markets, are considered by management in arriving at the expectations for the financial projections for the plan.
- ii The assumed growth rate on forecast cash flows beyond the terminal year of the plan. A growth rate of 2.5%, 2.5%, and 2.5% as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, has been used to extrapolate beyond the plan period representing management's best estimate view of the long-term growth rate of the business after considering the future and past growth rates and external sources of data.
- iii The risk discount rate (applicable across 2007, 2008 and 2009). Differing discount rates have been applied in accordance with the nature of the individual component businesses. For retail and institutional business a risk discount rate of 12% has been applied to post-tax cash flows. The pre-tax risk discount rate was 16%. Management have determined the risk discount rate by reference to an average implied discount rate for comparable UK listed asset managers calculated by reference to risk-free rates, equity risk premiums of 5% and an average 'beta' factor for relative market risk of comparable UK listed asset managers. A similar approach has been applied for the other component businesses of M&G.
- iv That asset management contracts continue on similar terms.

Management believes that any reasonable change in the key assumptions would not cause the recoverable amount of M&G to fall below its carrying amount.

*Japanese life company*

The aggregate goodwill impairment of £120 million at 31 December 2007, 31 December 2008 and 31 December 2009 relates to the goodwill held in relation to the Japanese life operation which was impaired in 2005.

*b Deferred acquisition costs and other intangible assets*

Deferred acquisition costs and other intangible assets in the consolidated statement of financial position attributable to shareholders consist of:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Deferred acquisition costs (DAC) related to insurance contracts as classified under IFRS 4 . . . . .	2,644	5,097	3,823
Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 . . . . .	<u>113</u>	<u>108</u>	<u>107</u>
	<u>2,757</u>	<u>5,205</u>	<u>3,930</u>
Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 . . . . .	59	64	52
Present value of future profits of acquired investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 . . . . .	4	1	1
Distribution rights . . . . .	<u>16</u>	<u>79</u>	<u>66</u>
	<u>79</u>	<u>144</u>	<u>119</u>
Total of deferred acquisition costs and other intangible assets . . . . .	<u>2,836</u>	<u>5,349</u>	<u>4,049</u>
Arising in:			
UK insurance operations . . . . .	157	134	127
US insurance operations (note (i)) . . . . .	1,928	3,962	3,092
Asian insurance operations . . . . .	745	1,247	822
Asset management operations . . . . .	<u>6</u>	<u>6</u>	<u>8</u>
	<u>2,836</u>	<u>5,349</u>	<u>4,049</u>

The movement in the year comprises:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Balance at 1 January . . . . .	2,497	2,836	5,349
Additions . . . . .	717	959	1,071
Amortisation to income statement . . . . .	(424)	(551)	(316)
Exchange differences . . . . .	(42)	1,274	(550)
Change in shadow DAC (note D3(h)) . . . . .	88	831	(1,069)
DAC movement on sale of Taiwan agency business . . . . .	—	—	(436)
Balance at 31 December . . . . .	<u>2,836</u>	<u>5,349</u>	<u>4,049</u>

Amortisation is included in the ‘acquisition costs and other operating expenditures’ line in the income statement.

*Deferred acquisition costs related to insurance contracts attributable to shareholders*

The movement in deferred acquisition costs relating to insurance contracts attributable to shareholders is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Deferred acquisition costs at 1 January . . . . .	2,315	2,644	5,097
Additions . . . . .	694	887	1,054
Amortisation . . . . .	(410)	(520)	(286)
Exchange differences . . . . .	(44)	1,255	(537)
Change in shadow DAC . . . . .	89	831	(1,069)
DAC movement on sale of Taiwan agency business . . . . .	—	—	(436)
Deferred acquisition costs at 31 December . . . . .	<u>2,644</u>	<u>5,097</u>	<u>3,823</u>

*Deferred acquisition costs related to investment management contracts attributable to shareholders*

Incremental costs associated with the origination of investment management contracts written by the Prudential Group’s insurance and asset management businesses are capitalised and amortised as the related revenue is recognised.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>At 1 January</b>			
Gross amount . . . . .	130	136	148
Accumulated amortisation . . . . .	(20)	(23)	(40)
<b>Net book amount</b> . . . . .	<u>110</u>	<u>113</u>	<u>108</u>
Additions (through internal development) . . . . .	7	12	14
Amortisation . . . . .	(3)	(17)	(15)
Other charges . . . . .	(1)	—	—
<b>At 31 December</b> . . . . .	<u>113</u>	<u>108</u>	<u>107</u>
<b>Comprising:</b>			
Gross amount . . . . .	136	148	162
Accumulated amortisation . . . . .	(23)	(40)	(55)
<b>Net book amount</b> . . . . .	<u>113</u>	<u>108</u>	<u>107</u>

*Present value of acquired in-force business of long-term business contracts attributable to shareholders*

The present value of acquired in-force business (PVAIF) relating to investment contracts without discretionary participation features represents the contractual right to benefit from providing these investment management services in the future. The fair value is measured as the present value of the future profits of the asset management component of these contracts. These contracts are accounted for under the provisions of IAS 18. The remainder of the PVAIF balance relates to insurance contracts and is accounted for under UK GAAP as permitted by IFRS 4.

The present value of future profits of acquired asset management contracts relates to unit-linked contracts acquired as part of the M&G acquisition in 1999.

Amortisation is charged to the 'acquisition costs and other operating expenditure' line in the income statement over the period of provision of asset management services as those profits emerge.

	2007		2008		2009	
	Insurance contracts	Investment management	Insurance contracts	Investment management	Insurance contracts	Investment management
	£m		£m		£m	
<b>At 1 January</b>						
Cost . . . . .	220	12	161	12	184	12
Accumulated amortisation . . . . .	(154)	(6)	(102)	(8)	(120)	(11)
<b>Net book amount . . . . .</b>	<u>66</u>	<u>6</u>	<u>59</u>	<u>4</u>	<u>64</u>	<u>1</u>
Exchange differences . . . . .	2	—	14	—	(6)	—
Amortisation charge . . . . .	(9)	(2)	(9)	(3)	(6)	—
<b>At 31 December . . . . .</b>	<u>59</u>	<u>4</u>	<u>64</u>	<u>1</u>	<u>52</u>	<u>1</u>
<b>Comprising:</b>						
Cost . . . . .	161	12	184	12	175	12
Accumulated amortisation . . . . .	(102)	(8)	(120)	(11)	(123)	(11)
<b>Net book amount . . . . .</b>	<u>59</u>	<u>4</u>	<u>64</u>	<u>1</u>	<u>52</u>	<u>1</u>

*Distribution rights attributable to the Asian insurance operations*

Distribution rights relate to facilitation fees paid in respect of the bancassurance partnership arrangements in Asia for the bank distribution of Prudential's insurance products for a fixed period of time. The distribution rights amounts are amortised over the term of the distribution contracts.

	2007	2008	2009
	£m	£m	£m
<b>At 1 January</b>			
Gross amount . . . . .	—	16	84
Accumulated amortisation . . . . .	—	0	(5)
	—	16	79
Additions . . . . .	16	62	3
Amortisation charge . . . . .	—	(4)	(9)
Exchange differences . . . . .	—	5	(7)
<b>At 31 December . . . . .</b>	<u>16</u>	<u>79</u>	<u>66</u>
<b>Comprising:</b>			
Gross amount . . . . .	16	84	79
Accumulated amortisation . . . . .	—	(5)	(13)
	<u>16</u>	<u>79</u>	<u>66</u>

**H2: Intangible assets attributable to with-profits funds**

*a Goodwill in respect of acquired investment subsidiaries for venture fund and other investment purposes*

	2007	2008	2009
	£m	£m	£m
<b>Goodwill</b>			
<b>Carrying value at 1 January . . . . .</b>	<u>587</u>	<u>192</u>	<u>174</u>
Additions . . . . .	313	—	—
Deconsolidated venture fund investments . . . . .	(708)	—	—
Impairment . . . . .	—	(18)	(50)
<b>At 31 December . . . . .</b>	<u>192</u>	<u>174</u>	<u>124</u>

All the goodwill relates to the UK insurance operations segment.

Following the sale by the Prudential Group of PPM Capital in November 2007, the only venture fund investment consolidated by the Prudential Group relates to an investment by PAC with-profits fund managed by M&G. Aside from this investment, the Prudential Group no longer controls venture fund investments and consequently ceased to consolidate these operations, resulting in the £708 million deconsolidation adjustment presented above in 2007. In

2008, following the impairment testing carried out, £18 million of the goodwill was deemed to be impaired and written off accordingly.

The only venture fund investment consolidated by the Prudential Group relates to an investment by PAC with-profits fund managed by M&G. The goodwill shown in the table above relates to this venture fund investment. Goodwill is tested for impairment for this investment by comparing the investment's carrying value including goodwill with its recoverable amount. The recoverable amount of the investment was determined by calculating its fair value less costs to sell. The fair value has been determined by using the discounted cash flow valuation. The valuation is based on cash flow projections to 2015 prepared by management after considering the historical experience and future growth rates of the business. The key assumption applied in the calculation is the risk discount rate of 14% which has been derived by reference to risk-free rates and an equity premium risk. In 2009, following the impairment testing carried out, £50 million (2008: £18 million) of the goodwill was deemed to be impaired and written off accordingly.

This impairment charge is recorded under 'acquisition costs and other operating expenditure' but is also taken account of in determining the charge/credit in the income statement for the transfer to the liability for unallocated surplus of with-profits funds. Accordingly, the charge does not affect shareholders' profits or equity.

*b Deferred acquisition costs and other intangible assets*

Other intangible assets in the Prudential Group consolidated statement of financial position attributable to with-profits funds consist of:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Deferred acquisition costs related to insurance contracts attributable to the PAC with-profits fund . . . . .	19	13	9
Distribution rights attributable to with-profits funds of the Asian insurance operations . . .	—	113	97
	<u>19</u>	<u>126</u>	<u>106</u>

*Deferred acquisition costs related to insurance contracts attributable to the PAC with-profit fund*

The movement in deferred acquisition costs relating to insurance contracts attributable to the PAC with-profits fund is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>At 1 January</b> . . . . .	31	19	13
Additions . . . . .	1	—	—
Amortisation charge . . . . .	<u>(13)</u>	<u>(6)</u>	<u>(4)</u>
<b>At 31 December</b> . . . . .	<u>19</u>	<u>13</u>	<u>9</u>

The above costs relate to non-participating business written by the PAC with-profits sub-fund.

No deferred acquisition costs are established for the participating business.

*Distribution rights attributable to with-profit funds of the Asian insurance operations*

Distribution rights relate to facilitation fees paid in relation to the bancassurance partnership arrangements in Asia for the bank distribution of Prudential's insurance products for a fixed period of time. The distribution rights amounts are amortised over the term of the distribution contracts.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>At 1 January</b>			
Gross amount . . . . .	—	—	115
Accumulated amortisation . . . . .	—	—	(2)
	—	—	113
Additions . . . . .	—	115	—
Amortisation charge . . . . .	—	(2)	(4)
Exchange differences . . . . .	—	—	(12)
<b>At 31 December</b> . . . . .	<u>—</u>	<u>113</u>	<u>97</u>
<b>Comprising:</b>			
Gross amount . . . . .	—	115	103
Accumulated amortisation . . . . .	—	(2)	(6)
	<u>—</u>	<u>113</u>	<u>97</u>

**H3: Reinsurers' share of insurance contract liabilities**

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Insurance contract liabilities . . . . .	724	1,176	1,114
Claims outstanding . . . . .	<u>59</u>	<u>64</u>	<u>73</u>
	<u>783</u>	<u>1,240</u>	<u>1,187</u>

The movement on reinsurers' share of insurance contract liabilities is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>At 1 January</b> . . . . .	878	724	1,176
Movement in the year . . . . .	(147)	243	24
Foreign exchange translation differences . . . . .	<u>(7)</u>	<u>209</u>	<u>(86)</u>
<b>At 31 December</b> . . . . .	<u>724</u>	<u>1,176</u>	<u>1,114</u>

**H4: Tax assets and liabilities**

*Assets*

Of the £285 million, £657 million, and £636 million current tax recoverable, at 31 December 2007, 2008 and 2009 respectively, the majority is expected to be recovered in one year or less.

*Deferred tax asset*

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Unrealised losses on investments . . . . .	129	1,267	1,156
Balances relating to investment and insurance contracts . . . . .	2	12	20
Short-term timing differences . . . . .	770	1,282	1,228
Capital allowances . . . . .	20	16	18
Unused deferred tax losses . . . . .	<u>30</u>	<u>309</u>	<u>286</u>
<b>Total</b> . . . . .	<u>951</u>	<u>2,886</u>	<u>2,708</u>

The deferred tax asset at 31 December 2007, 31 December 2008 and 31 December 2009 arises in the following parts of the Prudential Group.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
UK insurance operations:			
SAIF . . . . .	1	7	2
PAC with-profits fund (including PAL) . . . . .	93	272	141
Other . . . . .	11	234	149
US insurance operations . . . . .	657	1,969	1,944
Asian insurance operations . . . . .	73	101	132
Other operations . . . . .	<u>116</u>	<u>303</u>	<u>340</u>
	<u>951</u>	<u>2,886</u>	<u>2,708</u>

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 taxation regimes applicable across the Prudential Group 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. Accordingly, for the 2007, 2008 and 2009 results and statement of financial position at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the possible tax benefit of approximately £280 million, £211 million and £257 million, which may arise from capital losses valued at approximately £1.4 billion, £1 billion and £1.2 billion, is sufficiently uncertain that it has not been recognised. In addition at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, a potential deferred tax asset of £112 million, £678 million and £607 million, which may arise from tax losses and other potential temporary differences totalling £350 million, £2.2 billion and £2.1 billion, for 2007, 2008 and 2009 respectively, is sufficiently uncertain that it has not been recognised. Forecasts as to when the tax losses and other temporary differences are likely to be utilised indicate that they may not be utilised in the short term.

#### *Liabilities*

The current tax liability was £1,237 million, £842 million and £1,215 million at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. The Prudential Group considers that whilst the UK tax provision established within the current tax liability represents an appropriate provision for matters under discussion with HM Revenue & Customs in the UK, it is not possible to estimate the amount of the tax liability expected to be settled in one year or less due to the uncertainty over when these issues will be agreed.

#### *Deferred tax liability*

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Unrealised gains on investments . . . . .	2,098	765	1,744
Balances relating to investment and insurance contracts . . . . .	599	968	961
Short-term timing differences . . . . .	693	1,490	1,159
Capital allowances . . . . .	<u>12</u>	<u>6</u>	<u>8</u>
	<u>3,402</u>	<u>3,229</u>	<u>3,872</u>

Unprovided deferred income tax liabilities on temporary differences associated with investments in subsidiaries, associates and interests in joint ventures are considered to be insignificant due to the availability of various UK tax exemptions and reliefs.

#### *Discounting*

Deferred tax asset and liability balances have not been discounted.

**H5: Accrued investment income and other debtors**

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Accrued investment income</b>			
Interest receivable . . . . .	1,434	1,775	1,718
Other . . . . .	<u>589</u>	<u>738</u>	<u>755</u>
Total . . . . .	<u>2,023</u>	<u>2,513</u>	<u>2,473</u>
<b>Other debtors</b>			
Premiums receivable:			
From policyholders . . . . .	154	194	148
From intermediaries . . . . .	13	17	17
From reinsurers . . . . .	104	253	82
Other . . . . .	<u>638</u>	<u>768</u>	<u>515</u>
Total . . . . .	<u>909</u>	<u>1,232</u>	<u>762</u>
<b>Total accrued investment income and other debtors . . . . .</b>	<b><u>2,932</u></b>	<b><u>3,745</u></b>	<b><u>3,235</u></b>

Of the £2,932 million, £3,745 million and £3,235 million of accrued investment income and other debtors, £64 million, £114 million and £134 million is expected to be settled after one year or more, for 2007, 2008 and 2009 respectively.

## H6: Property, plant and equipment

Property, plant and equipment comprise Prudential Group occupied properties, development property and tangible assets. A reconciliation of the carrying amount of these items from the beginning of the year to the end of the year is as follows:

	<u>Group occupied property</u>	<u>Development property</u>	<u>Tangible assets</u>	<u>Continuing operations</u>	<u>Discontinued operations</u>	<u>Total</u>
	£m	£m	£m	£m	£m	£m
<b>At 1 January 2007</b>						
Cost . . . . .	225	479	917	1,621	226	1,847
Accumulated depreciation . . . . .	<u>(33)</u>	<u>—</u>	<u>(518)</u>	<u>(551)</u>	<u>(163)</u>	<u>(714)</u>
<b>Net book amount . . . . .</b>	<u>192</u>	<u>479</u>	<u>399</u>	<u>1,070</u>	<u>63</u>	<u>1,133</u>
<b>Year ended 31 December 2007</b>						
Opening net book amount . . . . .	192	479	399	1,070	63	1,133
Exchange differences . . . . .	2	—	1	3	—	3
Depreciation charge . . . . .	(48)	—	(50)	(98)	(9)	(107)
Additions . . . . .	71	48	109	228	3	231
Arising on acquisition of subsidiaries . . . . .	5	—	33	38	—	38
Disposal of subsidiaries . . . . .	—	—	—	—	(57)	(57)
Deconsolidated venture fund investments . . . . .	(69)	—	(261)	(330)	—	(330)
Disposals . . . . .	(2)	—	(25)	(27)	—	(27)
Reclassification from (to) held for investment . .	—	120	—	120	—	120
Reclassification from held for sale . . . . .	<u>—</u>	<u>8</u>	<u>—</u>	<u>8</u>	<u>—</u>	<u>8</u>
<b>Closing net book amount . . . . .</b>	<u>151</u>	<u>655</u>	<u>206</u>	<u>1,012</u>	<u>—</u>	<u>1,012</u>
<b>At 1 January 2008</b>						
Cost . . . . .	172	655	612	1,439	—	1,439
Accumulated depreciation . . . . .	<u>(21)</u>	<u>—</u>	<u>(406)</u>	<u>(427)</u>	<u>—</u>	<u>(427)</u>
<b>Net book amount . . . . .</b>	<u>151</u>	<u>655</u>	<u>206</u>	<u>1,012</u>	<u>—</u>	<u>1,012</u>
<b>Year ended 31 December 2008</b>						
Opening net book amount . . . . .	151	655	206	1,012	—	1,012
Exchange differences . . . . .	45	—	40	85	—	85
Depreciation charge . . . . .	(3)	—	(67)	(70)	—	(70)
Additions . . . . .	3	152	85	240	—	240
Disposals . . . . .	(1)	—	(23)	(24)	—	(24)
Reclassification from (to) held for investment . .	<u>68</u>	<u>(676)</u>	<u>—</u>	<u>(608)</u>	<u>—</u>	<u>(608)</u>
<b>Closing net book amount . . . . .</b>	<u>263</u>	<u>131</u>	<u>241</u>	<u>635</u>	<u>—</u>	<u>635</u>
<b>At 1 January 2009</b>						
Cost . . . . .	292	131	717	1,140	—	1,140
Accumulated depreciation . . . . .	<u>(29)</u>	<u>—</u>	<u>(476)</u>	<u>(505)</u>	<u>—</u>	<u>(505)</u>
<b>Net book amount . . . . .</b>	<u>263</u>	<u>131</u>	<u>241</u>	<u>635</u>	<u>—</u>	<u>635</u>
<b>Year ended 31 December 2009</b>						
Opening net book amount . . . . .	263	131	241	635	—	635
Exchange differences . . . . .	(9)	—	(31)	(40)	—	(40)
Depreciation charge . . . . .	(4)	—	(70)	(74)	—	(74)
Additions . . . . .	2	—	89	91	—	91
Disposals (including amounts disposed of with the Taiwan agency business) . . . . .	(99)	—	(15)	(114)	—	(114)
Reclassify as investment property* . . . . .	<u>—</u>	<u>(131)</u>	<u>—</u>	<u>(131)</u>	<u>—</u>	<u>(131)</u>
<b>Closing net book amount . . . . .</b>	<u>153</u>	<u>—</u>	<u>214</u>	<u>367</u>	<u>—</u>	<u>367</u>
<b>At 31 December 2009</b>						
Cost . . . . .	173	—	661	834	—	834
Accumulated depreciation . . . . .	<u>(20)</u>	<u>—</u>	<u>(447)</u>	<u>(467)</u>	<u>—</u>	<u>(467)</u>
<b>Net book amount . . . . .</b>	<u>153</u>	<u>—</u>	<u>214</u>	<u>367</u>	<u>—</u>	<u>367</u>

\* In line with changes issued by the IASB as part of its Annual Improvement Project in May 2008 as shown in note A5, all development properties have been reclassified as investment properties (see note H7). The total property, plant and equipment relates to continuing operations only.

#### Notes

i Owner occupied property can be analysed as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Freehold . . . . .	92	183	143
Long leases (>50 years) . . . . .	58	78	9
Medium leases (10-50 years) . . . . .	<u>1</u>	<u>2</u>	<u>1</u>
<b>Total</b> . . . . .	<u>151</u>	<u>263</u>	<u>153</u>

No owner-occupied property is located in Hong Kong.

#### Capital expenditure: property, plant and equipment by segment

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Insurance operations:</b>			
UK . . . . .	129	154	5
US . . . . .	31	18	12
Asia . . . . .	46	40	65
<b>Asset management operations:</b>			
M&G . . . . .	5	3	—
US . . . . .	2	2	1
Asia . . . . .	<u>4</u>	<u>8</u>	<u>2</u>
<b>Total segment</b> . . . . .	<u>217</u>	<u>225</u>	<u>85</u>
Unallocated corporate and discontinued operations . . . . .	<u>14</u>	<u>15</u>	<u>6</u>
<b>Total</b> . . . . .	<u>231</u>	<u>240</u>	<u>91</u>

#### H7: Investment properties

Investment properties principally relate to the PAC with-profits fund and are carried at fair value. A reconciliation of the carrying amount of investment properties at the beginning and end of the year is set out below:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>At 1 January</b> . . . . .	14,491	13,688	11,992
Reclassification of development property* . . . . .	—	—	131
<b>Additions:</b>			
Resulting from acquisitions . . . . .	1,707	1,414	184
Resulting from expenditure capitalised . . . . .	128	218	133
Resulting from acquisitions through business combinations . . . . .	—	463	1
Disposals (including amounts disposed of with the Taiwan agency business) . . . . .	(1,378)	(1,010)	(1,220)
Net loss from fair value adjustments . . . . .	(1,128)	(3,784)	(203)
Net foreign exchange differences . . . . .	14	395	(113)
Transfers to held for sale assets . . . . .	(25)	—	—
Transfers to owner occupied properties . . . . .	—	(68)	—
Other transfers from (to) property, plant and equipment . . . . .	<u>(121)</u>	<u>676</u>	<u>—</u>
<b>At 31 December</b> . . . . .	<u>13,688</u>	<u>11,992</u>	<u>10,905</u>

\* In line with changes issued by the IASB as part of its Annual Improvement Project in May 2008 (as shown in note H6 and A5) all development properties with a total cost of £131 million have been reclassified as investment properties at 1 January 2009. At this date these investments had a fair value of £152 million. The initial gain of £21 million is included as part of 'net loss from fair value adjustments'.

**Notes**

i Investment property can be analysed as follows:

<u>Hong Kong investment properties</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Medium leases (10-50 years) . . . . .	35	42	41
Total . . . . .	<u>35</u>	<u>42</u>	<u>41</u>
<u>Other investment properties</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Freehold . . . . .	10,332	8,427	7,696
Long leases (> 50 years) . . . . .	3,128	3,132	2,781
Medium leases (10-50 years) . . . . .	189	388	387
Short leases (<10 years) . . . . .	4	3	—
Total . . . . .	<u>13,653</u>	<u>11,950</u>	<u>10,864</u>

The income statement includes the following items in respect of investment properties:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Rental income from investment properties . . . . .	670	726	754
Direct operating expenses (including repairs and maintenance expenses) arising from investment properties:			
That generated rental income during the year . . . . .	117	109	131
That did not generate rental income during the year . . . . .	—	1	—
Total direct operating expenses . . . . .	<u>117</u>	<u>110</u>	<u>131</u>

At 31 December 2007, 31 December 2008, and 31 December 2009 respectively, investment properties of £3,665 million, £3,559 million, and £3,177 million are held under finance leases. A reconciliation between the total of future minimum lease payments at the statement of financial position date, and their present value is shown below:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Future minimum lease payments at 31 December . . . . .	979	963	1,683
Future finance charges on finance leases . . . . .	(877)	(863)	(1,517)
Present value of minimum lease payments . . . . .	<u>102</u>	<u>100</u>	<u>166</u>
Future minimum lease payments are due as follows:			
Less than 1 year . . . . .	5	5	9
1 to 5 years . . . . .	22	22	38
Over 5 years . . . . .	<u>952</u>	<u>936</u>	<u>1,636</u>
Total . . . . .	<u>979</u>	<u>963</u>	<u>1,683</u>
The present values of these minimum lease payments are:			
Less than 1 year . . . . .	5	5	8
1 to 5 years . . . . .	22	22	38
Over 5 years . . . . .	<u>75</u>	<u>73</u>	<u>120</u>
Total . . . . .	<u>102</u>	<u>100</u>	<u>166</u>

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on the future value of a factor that changes other than with the passage of time. Contingent rent recognised as an expense in 2007, 2008 and 2009 respectively, amounted to £14 million, nil and nil. Contingent rents recognised as income in the year amounted to £26 million, nil, and nil, for 2007, 2008 and 2009 respectively.

The Prudential Group's policy is to rent investment properties to tenants through operating leases. Minimum future rentals to be received on non-cancellable operating leases are receivable in the following periods:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Less than 1 year . . . . .	679	742	662
1 to 5 years . . . . .	2,464	2,599	2,282
Over 5 years . . . . .	8,266	9,106	7,792
<b>Total . . . . .</b>	<u><u>11,409</u></u>	<u><u>12,447</u></u>	<u><u>10,736</u></u>

The total minimum future rentals to be received on non-cancellable sub-leases for land and buildings at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, are £2,746 million, £3,730 million and £3,684 million.

### **H8: Investments in associates and joint ventures**

#### *Investments in associates*

The Prudential Group had four associates at 31 December 2007 and 2008, and three associates at 31 December 2009 that are accounted for using the equity method. The Prudential Group's associates are a 30% interest in The Nam Khang, a Vietnamese property developer, a 30% interest in Apollo Education and Training Organisation Vietnam and a 25% interest in OYO Developments Limited. The associate previously held in 2007 and 2008 was a 26.8% interest in IFonline Group Limited (IFonline). IFonline is no longer an associate of the Prudential Group following a restructuring of that entity in April 2009.

The Prudential Group also has investments in associates which meet the IAS 28 criteria for measurement at fair value through profit and loss in accordance with IAS 39.

#### *Associates accounted for using the equity method*

For 2007 and 2008 equity accounting is applied to IFonline based on its reporting period of the year to 30 November and is adjusted for material changes up to 31 December. Accordingly, the information is deemed to cover the same period as that of the Prudential Group.

A summary of the movements in investments in associates accounted for using the equity method in 2007, 2008 and 2009 is set out below:

	<u>Share of capital</u>	<u>Share of reserves</u>	<u>Share of net assets</u>	<u>Goodwill</u>	<u>Total carrying value</u>
	£m	£m	£m	£m	£m
Balance at 1 January 2007 . . . . .	4	(5)	(1)	7	6
Acquisitions . . . . .	5	—	5	1	6
Exchange translations and other movements . . . . .	—	—	—	—	—
Share of loss for the year after tax . . . . .	—	—	—	—	—
<b>Balance at 31 December 2007 . . . . .</b>	<b>9</b>	<b>(5)</b>	<b>4</b>	<b>8</b>	<b>12</b>
Impairments of goodwill . . . . .	—	—	—	(6)	(6)
Exchange translations and other movements . . . . .	3	1	4	—	4
Share of loss for the year after tax . . . . .	—	—	—	—	—
<b>Balance at 31 December 2008 . . . . .</b>	<b>12</b>	<b>(4)</b>	<b>8</b>	<b>2</b>	<b>10</b>
Exchange translation and other movements . . . . .	(7)	4	(3)	(1)	(3)
Share of loss for the year after tax . . . . .	—	—	—	—	(1)
<b>Balance at 31 December 2009 . . . . .</b>	<u><u>5</u></u>	<u><u>—</u></u>	<u><u>5</u></u>	<u><u>1</u></u>	<u><u>6</u></u>

There have been no changes recognised in the other comprehensive income of associates that would also be recognised in the other comprehensive income by the Prudential Group. Exchange translation and other movements for 2009 mainly related to the investment in IFonline mentioned above.

The Prudential Group's share of the assets, liabilities, revenues and profit and loss of associates accounted for using the equity method at 31 December 2007, 31 December 2008 and 31 December 2009 is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Financial position</b>			
Total assets (excluding goodwill) . . . . .	7	12	5
Total liabilities . . . . .	<u>(3)</u>	<u>(4)</u>	<u>—</u>
Net assets . . . . .	<u>4</u>	<u>8</u>	<u>5</u>
<b>Results of operations</b>			
Revenue . . . . .	5	3	1
Profit in the year . . . . .	<u>—</u>	<u>—</u>	<u>—</u>

*Associates carried at fair value through profit and loss*

The Prudential Group's associates that are carried at fair value through profit and loss comprise investments in OEICs, unit trusts, funds holding collateralised debt obligations, property unit trusts, and venture capital investments of the PAC with-profits fund where the Prudential Group has significant influence. These investments are incorporated both in the UK and overseas, and some have year ends which are non-coterminous with that of the Prudential Group. In these instances, the investments are recorded at fair value at 31 December 2007, 31 December 2008 and 31 December 2009 based on valuations or pricing information at that specific date. The aggregate fair value of associates carried at fair value through profit and loss where there are published price quotations is approximately £2 billion, £4 billion and £6 billion at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.

The aggregate assets of these associates are approximately £9 billion, £8 billion and £9 billion in 2007, 2008 and 2009 respectively. Aggregate liabilities, excluding liabilities to unit holders and shareholders for unit trusts and OEICs, are approximately £2 billion, £2 billion and £2 billion, at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. Fund revenues, with revenue arising in unit trusts and OEICs deemed to constitute the investment return for these vehicles, were approximately £0.5 billion, £0.8 billion and £0.8 billion at 31 December 2007, 31 December 2008 and 31 December 2009 respectively and in 2007, 2008 and 2009 respectively, excluding unit trusts and OEICs where all investment returns accrue to unit holders or shareholders respectively, were approximately a profit of £0.2 billion, profit of £0.3 billion and a loss of £0.2 billion.

*Investments in joint ventures*

Joint ventures represent activities over which the Prudential Group exercises joint control through contractual agreement with one or more parties. The Prudential Group's significant joint ventures, which are accounted for using proportionate consolidation, comprise various joint ventures relating to property investments where it has a 50% interest as well as the following interests, which have been held across the three years ended 31 December 2009:

<u>Investment</u>	<u>% held</u>	<u>Principal activity</u>	<u>Country</u>
ICICI Prudential Life Insurance Company Limited . . . . .	26	Life assurance	India
BOCI — Prudential Asset Management Limited . . . . .	36	Pensions	China
PruHealth . . . . .	50	Private medical insurance	UK
CITIC — Prudential Life Insurance Company Limited . . . . .	50	Life assurance	China
CITIC Prudential Fund Management Company Limited . . . . .	49	Asset management	China
Prudential ICICI Asset Management Company Limited . . . . .	49	Asset management	India
Prudential BSN Takaful Berhad . . . . .	49	General and life insurance	Malaysia

The investments noted in the table above have the same accounting year end as the Prudential Group, except for ICICI Prudential Life Insurance Company Limited and Prudential ICICI Asset Management Company Limited. Although these investments have reporting periods ending 31 March, 12 months of financial information up to 31 December is recorded. Accordingly, the information covers the same period as that of the Prudential Group.

The summarised financial data for the Prudential Group's share of investments in joint ventures is as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Financial position</b>			
Current assets . . . . .	1,277	250	386
Non-current assets . . . . .	<u>173</u>	<u>1,212</u>	<u>2,462</u>
Total assets . . . . .	<u>1,450</u>	<u>1,462</u>	<u>2,848</u>
Current liabilities . . . . .	(115)	(159)	(150)
Non-current liabilities . . . . .	<u>(1,121)</u>	<u>(1,063)</u>	<u>(2,392)</u>
Total liabilities . . . . .	<u>(1,236)</u>	<u>(1,222)</u>	<u>(2,542)</u>
Net equity . . . . .	<u>214</u>	<u>240</u>	<u>306</u>
<b>Results of operations</b>			
Revenues . . . . .	500	656	974
Expenses . . . . .	<u>(546)</u>	<u>(649)</u>	<u>(945)</u>
Net profit (loss) . . . . .	<u>(46)</u>	<u>7</u>	<u>29</u>

There are several minor service agreements in place between the joint ventures and the Prudential Group. During 2007, 2008 and 2009 respectively, the aggregate amount of the transactions were £5.4 million, £15.9 million, and £14.1 million and the balance outstanding as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, was £4.7 million, £22.5 million and £54.6 million.

The joint ventures have no significant contingent liabilities to which the Prudential Group is exposed nor does it have any significant contingent liabilities in relation to its interest in the joint ventures.

**H9: Properties held for sale**

Investment properties are classified as held for sale when contracts have been exchanged but the sale has not been completed at the period end.

Assets held for sale in 2007 of £30 million comprised investment property of PAC with-profits fund.

There were no assets held for sale at 31 December 2008 and £3 million in assets held for sale at 31 December 2009.

Gains on disposal of held for sale assets are recorded in 'investment income' within the income statement.

**H10: Cash and cash equivalents**

Cash and cash equivalents consist of cash at bank and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 days maturity from the date of acquisition. Cash and cash equivalents included in the cash flow statement comprise the following statement of financial position amounts:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Cash . . . . .	4,528	5,362	5,071
Cash equivalents . . . . .	<u>423</u>	<u>593</u>	<u>236</u>
Total cash and cash equivalents . . . . .	<u>4,951</u>	<u>5,955</u>	<u>5,307</u>

Cash and cash equivalents held centrally are considered to be available for general use by the Prudential Group. These funds amount to £394 million, £165 million and £895 million at 31 December 2007, 31 December 2008 and 31 December 2009, respectively. The remaining funds are considered not to be available for general use by the Prudential Group, and include funds held for the benefit of policyholders.

**H11: Shareholders' equity: share capital, share premium and reserves**

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
<b>Share capital and share premium</b>			
Share capital . . . . .	123	125	127
Share premium . . . . .	1,828	1,840	1,843
<b>Reserves</b>			
Retained earnings . . . . .	4,301	3,604	3,964
Translation reserve . . . . .	(112)	398	203
Available-for-sale reserve . . . . .	(78)	(909)	134
Total shareholders' equity . . . . .	<u>6,062</u>	<u>5,058</u>	<u>6,271</u>

A summary of the ordinary shares in issue is set out below:

*Share capital and share premium*

	<u>2007</u>		
	<u>Number of Ordinary shares</u>	<u>Share Capital</u>	<u>Share premium</u>
		£m	£m
Issued shares of 5p each fully paid:			
At the beginning of the year . . . . .	2,444,312,425	122	1,822
Shares issued under share option schemes . . . . .	803,818	—	6
Shares issued in lieu of cash dividends . . . . .	24,900,997	1	175
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	—	—	(175)
At end of the year . . . . .	<u>2,470,017,240</u>	<u>123</u>	<u>1,828</u>
			<u>2008</u>
Issued shares of 5p each fully paid:			
At the beginning of the year . . . . .	2,470,017,240	123	1,828
Shares issued under share option schemes . . . . .	2,307,469	—	12
Shares issued in lieu of cash dividends . . . . .	24,622,979	2	156
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	—	—	(156)
At end of the year . . . . .	<u>2,496,947,688</u>	<u>125</u>	<u>1,840</u>
			<u>2009</u>
Issued shares of 5p each fully paid:			
At the beginning of the year . . . . .	2,496,947,688	125	1,840
Shares issued under share option schemes . . . . .	605,721	—	13
Shares issued in lieu of cash dividends . . . . .	34,674,062	2	136
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	—	—	(136)
At end of the year . . . . .	<u>2,532,227,471</u>	<u>127</u>	<u>1,843</u>

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 31 December 2007, 31 December 2008 and 31 December 2009 respectively, there were options outstanding under Save As You Earn schemes to subscribe for 9,017,442 shares, 6,825,343 shares and 12,230,833 shares at prices ranging from 266 pence to 695 pence, 266 pence to 617 pence, and 266 pence to 572 pence, exercisable by the year 2014, 2015 and 2016 respectively. In addition at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, there are 2,037,220 conditional options, 967,652 conditional options and 17,292 conditional options outstanding under the RSP and 3,485,617 shares, 4,906,234 shares, and 6,644,203 shares under the GPSP exercisable at nil cost within a 10-year period.

The cost of own shares of £60 million, £75 million and £75 million as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, is deducted from retained earnings. Prudential has established trusts to facilitate the

delivery of shares under employee incentive plans and savings-related share option schemes. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, 6.6 million, 6.4 million and 5.3 million Prudential shares with a market value of £47 million, £27 million and £34 million were held in such trusts. Of this total, 5.1 million, 6.0 million and 4.8 million shares were held in trusts under employee incentive plans. In 2007, 2008 and 2009 respectively, Prudential purchased 1.3 million, 5.4 million and 3.4 million shares in respect of employee incentive plans at a cost of £10 million, £27 million and £17 million, respectively.

Of the total shares held in trust at as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, 1.5 million, 0.4 million and 0.5 million shares were held by a qualifying employee share ownership trust. These shares are expected to be fully distributed in the future on maturity of savings-related share option schemes.

The maximum number of shares held in the year was 6.4 million, which was at the beginning of the year.

<u>2007</u>	<u>no. of Shares</u>	<u>Share Price</u>		<u>Cost</u>
		<u>Low</u>	<u>High</u>	
		£	£	
January . . . . .	9,975	7.12870	7.12870	71,110
February . . . . .	9,693	7.18290	7.18790	69,661
March . . . . .	17,410	6.69790	7.17790	118,318
April . . . . .	12,239	7.49790	7.49790	91,767
May . . . . .	25,458	7.75396	8.04200	203,147
June . . . . .	10,936	7.14819	7.21819	78,456
July . . . . .	11,021	7.30319	7.30819	80,544
August . . . . .	598,924	6.99677	7.22819	4,266,196
September . . . . .	10,435	6.94500	7.02970	73,355
October . . . . .	587,121	7.66500	7.74000	4,511,614
November . . . . .	10,451	7.05250	7.06250	73,708
December . . . . .	<u>11,876</u>	<u>7.13750</u>	<u>7.14375</u>	<u>84,817</u>
<b>2007 Total</b> . . . . .	<u>1,315,539</u>			<u>9,722,693</u>

<u>2008</u>	<u>no. of Shares</u>	<u>Share Price</u>		<u>Cost</u>
		<u>Low</u>	<u>High</u>	
		£	£	
January . . . . .	8,718	6.69385	6.75385	58,704
February . . . . .	11,934	5.93975	6.02975	71,469
March . . . . .	567,163	3.30975	7.69000	3,723,404
April . . . . .	33,239	6.29500	6.97970	231,210
May . . . . .	755,425	6.67500	7.05800	5,045,623
June . . . . .	740,840	6.28000	6.37300	4,652,961
July . . . . .	245,412	5.16042	5.34000	1,308,962
August . . . . .	8,317	5.79975	5.83395	48,392
September . . . . .	211,596	4.83000	5.82500	1,033,080
October . . . . .	11,247	4.44248	4.77380	53,018
November . . . . .	15,494	3.57000	3.59540	55,042
December . . . . .	<u>2,827,057</u>	<u>3.30103</u>	<u>4.00541</u>	<u>11,175,373</u>
<b>2008 Total</b> . . . . .	<u>5,436,442</u>			<u>27,457,238</u>

<u>2009</u>	<u>no. of Shares</u>	<u>Share Price</u>		<u>Cost</u>
		<u>Low</u>	<u>High</u>	
		<u>£</u>	<u>£</u>	
January . . . . .	19,852	3.82900	3.93583	76,575
February . . . . .	19,926	3.52000	3.52000	70,140
March . . . . .	1,112,209	2.02250	3.50122	3,837,968
April . . . . .	22,164	3.37500	3.37500	74,859
May . . . . .	32,416	4.45473	6.59000	173,242
June . . . . .	26,594	4.43750	7.30870	145,230
July . . . . .	342,062	3.85500	4.02750	1,374,929
August . . . . .	14,059	4.84700	4.84700	68,144
September . . . . .	12,435	5.50000	5.50000	68,393
October . . . . .	10,332	6.33500	6.33500	65,453
November . . . . .	10,576	6.04000	6.04000	63,879
December . . . . .	<u>1,739,591</u>	<u>6.05628</u>	<u>6.35000</u>	<u>10,941,847</u>
<b>2009 Total . . . . .</b>	<b><u>3,362,216</u></b>			<b><u>16,960,659</u></b>

The Prudential 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. The total number of shares held by these funds at 31 December 2007, 31 December 2008 and 31 December 2009 respectively was 4.1 million, 9.2 million, and 10.6 million and the cost of acquiring these shares of £22 million, £47 million and £51 million, respectively, is included in the cost of own shares.

During 2007, 2008 and 2009 respectively, these funds made 772,896 net disposals, 5,060,985 net acquisitions and 1,414,263 net acquisitions of Prudential shares for a net decrease of £4 million, net increase of £26 million and a net increase of £3 million to book cost.

The market value of these shares as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively was £29 million, £37 million and £67 million.

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

#### *Reserves*

The translation reserve represents cumulative foreign exchange translation differences taken directly to equity in accordance with IFRS, net of related tax. In accordance with IFRS 1, cumulative translation differences are deemed to be zero at 1 January 2004, the date of transition to IFRS.

The available-for-sale reserve represents gains or losses arising from changes in the fair value of available-for-sale securities of Jackson, net of the related change in amortisation of deferred income and acquisition costs and of the related tax.

#### *Parent company profits and distributability of reserves*

Under English company law, Prudential may pay dividends only if “distributable reserves” of the holding company are available for the purpose. The holding company prepares its own financial information in accordance with UK GAAP. Even if distributable reserves are available, under English law Prudential may pay dividends only of the amount of its net assets is greater than the aggregate of its called up share capital and undistributable reserves (such as for example the share premium account) and the payment of the dividend does not reduce the amount of its net assets to less than that aggregate. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the UK GAAP retained earnings of the holding company from which distributable reserves may be derived, were £1,185 million, £1,280 million and £1,856 million.

## H12: Insurance contract liabilities and unallocated surplus of with-profits funds

### Movement in year

	Insurance contract liabilities	Unallocated surplus of with-profits funds
	£m	£m
At 1 January 2007 . . . . .	123,339	13,425
Income and expense included in the income statement . . . . .	9,604	541
Foreign exchange translation differences . . . . .	(167)	(7)
<b>At 31 December 2007 . . . . .</b>	<b><u>132,776</u></b>	<b><u>13,959</u></b>
At 1 January 2008 . . . . .	132,776	13,959
Income and expense included in the income statement . . . . .	(12,760)	(5,815)
Foreign exchange translation differences . . . . .	16,014	270
<b>At 31 December 2008 . . . . .</b>	<b><u>136,030</u></b>	<b><u>8,414</u></b>
At 1 January 2009 . . . . .	136,030	8,414
Income and expense included in the income statement . . . . .	19,765	1,559
Foreign exchange translation differences . . . . .	(6,574)	46
Disposal of Taiwan agency business . . . . .	(3,508)	—
<b>At 31 December 2009 . . . . .</b>	<b><u>145,713</u></b>	<b><u>10,019</u></b>

Notes B6, D2b, D3b and D4b provide further analysis of the movement in the year of the Prudential Group's policyholder liabilities and unallocated surplus of the with-profits funds.

## H13: Borrowings

### Core structural borrowings of shareholder-financed operations

As at 31 December:

	2007			
	Innovative Tier 1*	Lower Tier 2*	Senior‡	Total £m
<b>Parent company</b>				
Subordinated debt:				
€500m 5.75% Subordinated Notes 2021 (note i) . . . . .	—	365	—	365
€20m Medium-Term Subordinated Notes 2023 (note ii) . . . . .	—	15	—	15
£435m 6.125% Subordinated Notes 2031 . . . . .	—	427	—	427
US\$1,000m 6.5% Perpetual Subordinated Capital Securities (note iii) . . . . .	485	—	—	485
US\$250m 6.75% Perpetual Subordinated Capital Securities (note iv) . . . . .	124	—	—	124
US\$300m 6.5% Perpetual Subordinated Capital Securities (note iv) . . . . .	<u>154</u>	<u>—</u>	<u>—</u>	<u>154</u>
	763	807	—	1,570
Senior debt:				
£249m 5.5% Bonds 2009 (note v) . . . . .	—	—	248	248
£300m 6.875% Bonds 2023 . . . . .	—	—	300	300
£250m 5.875% Bonds 2029 . . . . .	<u>—</u>	<u>—</u>	<u>249</u>	<u>249</u>
	<u>—</u>	<u>—</u>	<u>797</u>	<u>797</u>
<b>Total parent company (note x) . . . . .</b>	<b>763</b>	<b>807</b>	<b>797</b>	<b>2,367</b>
<b>Jackson</b>				
US\$250m 8.15% Surplus Notes 2027 (note vi) . . . . .	<u>—</u>	<u>125</u>	<u>—</u>	<u>125</u>
<b>Total (note vii) . . . . .</b>	<b><u>763</u></b>	<b><u>932</u></b>	<b><u>797</u></b>	<b><u>2,492</u></b>

	2008			
	Innovative Tier 1*	Lower Tier 2*	Senior‡	Total £m
<b>Parent company</b>				
Subordinated debt:				
€500m 5.75% Subordinated Notes 2021 (note i) . . . . .	—	482	—	482
€20m Medium-Term Subordinated Notes 2023 (note ii) . . . . .	—	19	—	19
£435m 6.125% Subordinated Notes 2031 . . . . .	—	427	—	427
US\$1,000m 6.5% Perpetual Subordinated Capital Securities (note iii) . . . . .	696	—	—	696
US\$250m 6.75% Perpetual Subordinated Capital Securities (note iv) . . . . .	173	—	—	173
US\$300m 6.5% Perpetual Subordinated Capital Securities (note iv) . . . . .	190	—	—	190
	<u>1,059</u>	<u>928</u>	—	<u>1,987</u>
Senior debt:				
£249m 5.5% Bonds 2009 (note v) . . . . .	—	—	249	249
£300m 6.875% Bonds 2023 . . . . .	—	—	300	300
£250m 5.875% Bonds 2029 . . . . .	—	—	249	249
	<u>—</u>	<u>—</u>	<u>798</u>	<u>798</u>
<b>Total parent company (note x) . . . . .</b>	<b>1,059</b>	<b>928</b>	<b>798</b>	<b>2,785</b>
<b>Jackson</b>				
US\$250m 8.15% Surplus Notes 2027 (note vi) . . . . .	—	173	—	173
<b>Total (notes vii, viii) . . . . .</b>	<b><u>1,059</u></b>	<b><u>1,101</u></b>	<b><u>798</u></b>	<b><u>2,958</u></b>
				<b>2009</b>
	Innovative Tier 1*	Lower Tier 2*	Senior‡	Total £m
<b>Parent company</b>				
Subordinated debt:				
€500m 5.75% Subordinated Notes 2021(note i) . . . . .	—	443	—	443
€20m Medium-Term Subordinated Notes 2023 (note ii) . . . . .	—	18	—	18
£435m 6.125% Subordinated Notes 2031 . . . . .	—	428	—	428
£400m 11.375% Subordinated Notes 2039(note v) . . . . .	—	380	—	380
US\$1,000m 6.5% Perpetual Subordinated Capital Securities (note iii) . . . . .	619	—	—	619
US\$250m 6.75% Perpetual Subordinated Capital Securities (note iv) . . . . .	155	—	—	155
US\$300m 6.5% Perpetual Subordinated Capital Securities (note iv) . . . . .	192	—	—	192
US\$750m 11.75% Perpetual Subordinated Capital Securities (note ix) . . . . .	456	—	—	456
	<u>1,422</u>	<u>1,269</u>	—	<u>2,691</u>
Senior debt:				
£300m 6.875% Bonds 2023 . . . . .	—	—	300	300
£250m 5.875% Bonds 2029 . . . . .	—	—	249	249
	<u>—</u>	<u>—</u>	<u>549</u>	<u>549</u>
<b>Total parent company (note x) . . . . .</b>	<b>1,422</b>	<b>1,269</b>	<b>549</b>	<b>3,240</b>
<b>Jackson . . . . .</b>				
US\$250m 8.15% Surplus Notes 2027 (note vi) . . . . .	—	154	—	154
<b>Total (notes vii, viii) . . . . .</b>	<b><u>1,422</u></b>	<b><u>1,423</u></b>	<b><u>549</u></b>	<b><u>3,394</u></b>

\* These debt classifications are consistent with the treatment of capital for regulatory purposes, as defined in the FSA Handbook.

‡ The senior debt ranks above subordinated debt in the event of liquidation.

Notes

- i The €500 million 5.75% borrowings have been swapped into borrowings of £333 million with interest payable at six month £LIBOR plus 0.962%.
- ii The €20 million borrowings were issued at 20-year Euro Constant Maturity Swap (capped at 6.5%). These have been swapped into borrowings of £14 million with interest payable at three month £LIBOR plus 1.2%.
- iii Interest on the US\$1,000 million 6.5% borrowings was swapped into floating rate payments at three month US\$LIBOR plus 0.80%. In January 2009, this swap was cancelled.
- iv The US\$250 million 6.75% borrowings and the US\$300 million 6.5% borrowings can be converted, in whole or in part, at Prudential's option and subject to certain conditions, on any interest payment date falling on or after 23 March 2010 and 23 March 2011 respectively, into one or more series of Prudential preference shares.
- v The £249 million 5.5% borrowings were repaid on maturity in May 2009. In the same month Prudential issued £400 million subordinated debt in part to replace the maturing debt.
- vi The Jackson borrowings are unsecured and subordinated to all present and future indebtedness, policy claims and other creditor claims of Jackson.
- vii Maturity analysis

The following table sets out the contractual maturity analysis of the Prudential Group's core structural borrowings as at 31 December:

	<b>2007</b>	<b>2008</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Less than 1 year . . . . .	—	249	—
1 to 2 years . . . . .	248	—	—
2 to 3 years . . . . .	—	—	—
3 to 4 years . . . . .	—	—	—
4 to 5 years . . . . .	—	—	—
Over 5 years . . . . .	<u>2,244</u>	<u>2,709</u>	<u>3,394</u>
Total . . . . .	<u>2,492</u>	<u>2,958</u>	<u>3,394</u>

*Operational borrowings attributable to shareholder-financed operations*

- viii Management analyses the net core structural borrowings position as follows:

	<b>2008</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>
Total core structural borrowings (as above) . . . . .	2,958	3,394
Less: Holding company cash and short-term investments (recorded within the consolidated statement of financial position) . . . . .	<u>(1,165)</u>	<u>(1,486)</u>
Net core structural borrowings of shareholder-financed operations . . . . .	<u>1,793</u>	<u>1,908</u>

- ix In July 2009, Prudential issued US\$750 million perpetual subordinated capital securities.
- x The total parent company's core structural borrowings as shown in the tables above represent the amounts in the context of the Prudential Group consolidated level. These amounts differ from the amounts included in the parent company's own financial information due to different dates of commencement of fair value hedge accounting on the US\$300 million 6.5% borrowing.

	<b>2007</b>	<b>2008</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Borrowings in respect of short-term fixed income securities programmes</b>			
Commercial paper . . . . .	2,422	1,269	2,031
Medium-Term Notes 2008 . . . . .	48	—	—
Medium-Term Notes 2010 . . . . .	<u>7</u>	<u>9</u>	<u>7</u>
	<u>2,477</u>	<u>1,278</u>	<u>2,038</u>
<b>Non-recourse borrowings of US operations (note i)</b>			
Jackson (note ii) . . . . .	126	104	—
Investment subsidiaries . . . . .	9	23	20
Piedmont and CDO funds (note iii) . . . . .	<u>456</u>	<u>384</u>	<u>183</u>
	<u>591</u>	<u>511</u>	<u>203</u>
<b>Other borrowings</b>			
Bank loans and overdrafts (note iv) . . . . .	6	185	148
Obligations under finance leases . . . . .	7	3	3
Other borrowings (note v) . . . . .	—	—	<u>359</u>
	<u>13</u>	<u>188</u>	<u>510</u>
Total (notes vi, vii) . . . . .	<u>3,081</u>	<u>1,977</u>	<u>2,751</u>

## Notes

- i 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.
- ii This represents senior debt issued through the Federal Home Loan Bank of Indianapolis and is secured on collateral posted with FHLB by Jackson.
- iii Piedmont is an investment trust investing in certain asset-backed and mortgage-backed securities in the US. These borrowings pertain to debt instruments issued to external parties.
- iv Bank loans and overdrafts include a short-term loan of nil, £130 million and £130 million in respect of Asian operations as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively.
- v Other borrowings represents amounts whose repayment to the lender is contingent on future surpluses emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on contracts, there is no recourse to other assets of the Prudential Group and the liability is not payable to the degree of the shortfall.
- vi In addition to the operational borrowings shown in the table above, Prudential plc has issued £200 million Floating Rate Notes 2010, which were wholly subscribed to by a Prudential Group subsidiary. These borrowings have been eliminated on consolidation.
- vii Maturity analysis

The following table sets out the contractual maturity analysis of the Prudential Group's operational borrowings attributable to shareholder-financed operations:

	<u>2007</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>
Less than 1 year . . . . .	2,618	1,584	2,183
1 to 2 years . . . . .	—	9	121
2 to 3 years . . . . .	7	38	239
3 to 4 years . . . . .	44	52	172
4 to 5 years . . . . .	54	240	6
Over 5 years . . . . .	<u>358</u>	<u>54</u>	<u>30</u>
Total . . . . .	<u>3,081</u>	<u>1,977</u>	<u>2,751</u>

## Borrowings attributable to with-profits operations

### As at 31 December:

	<u>2007</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>
Non-recourse borrowings of consolidated investment funds (note i) . . . . .	789	1,161	1,016
£100m 8.5% Undated Subordinated Guaranteed Bonds of Scottish Amicable Finance plc (note ii) . . . . .	100	100	100
Other borrowings (predominantly obligations under finance leases) . . . . .	<u>98</u>	<u>47</u>	<u>168</u>
Total (note iii) . . . . .	<u>987</u>	<u>1,308</u>	<u>1,284</u>

## Notes

- i In all instances the holders of the debt instruments issued by these funds do not have recourse beyond the assets of those funds.
- ii The interests of the holders of the bonds issued by Scottish Amicable Finance plc, a subsidiary of the Scottish Amicable Insurance Fund, are subordinate to the entitlements of the policyholders of that fund.
- iii Maturity analysis

The following table sets out the contractual maturity analysis of the Prudential Group's borrowings attributable to with-profits operations as at 31 December:

	<u>2007</u> <u>£m</u>	<u>2008</u> <u>£m</u>	<u>2009</u> <u>£m</u>
Less than 1 year . . . . .	103	272	33
1 to 2 years . . . . .	16	12	77
2 to 3 years . . . . .	62	150	706
3 to 4 years . . . . .	—	418	1
4 to 5 years . . . . .	154	—	1
Over 5 years . . . . .	<u>652</u>	<u>456</u>	<u>466</u>
Total . . . . .	<u>987</u>	<u>1,308</u>	<u>1,284</u>

## H14: Provisions and contingencies

### Provisions

#### As at 31 December:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Provision in respect of defined benefit pension schemes: (I2)			
Deficit, gross of deferred tax, based on scheme assets held, including investments in Prudential insurance policies:			
Attributable to PAC with-profits fund (i.e. absorbed by the liability for unallocated surplus) . . . . .	98	67	122
Attributable to shareholder-financed operations (i.e. to shareholders' equity). . . . .	<u>85</u>	<u>82</u>	<u>128</u>
	<u>183</u>	<u>149</u>	<u>250</u>
Add back: Investments in Prudential insurance policies . . . . .	<u>172</u>	<u>157</u>	<u>187</u>
Provision after elimination of investments in Prudential insurance policies and matching policyholder liability from Group statement of financial position . . . . .	355	306	437
Other provisions (see below) . . . . .	<u>220</u>	<u>155</u>	<u>206</u>
Total provisions . . . . .	<u><u>575</u></u>	<u><u>461</u></u>	<u><u>643</u></u>

#### Analysis of other provisions:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
At 1 January . . . . .	238	220	155
Charged to income statement:			
Additional provisions . . . . .	116	48	148
Unused amounts released . . . . .	(23)	(24)	(13)
Used during the year . . . . .	(112)	(101)	(75)
Exchange differences . . . . .	<u>1</u>	<u>12</u>	<u>(9)</u>
At 31 December . . . . .	<u>220</u>	<u>155</u>	<u>206</u>
Comprising:			
Legal provisions . . . . .	19	23	15
Restructuring provisions . . . . .	35	21	17
Other provisions . . . . .	<u>166</u>	<u>111</u>	<u>174</u>
Total . . . . .	<u><u>220</u></u>	<u><u>155</u></u>	<u><u>206</u></u>

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, of the other provisions balance of £220 million, £155 million and £206 million, settlement of £77 million, £90 million and £148 millions expected to be made within one year. Employer contributions expected to be paid into defined benefit pension schemes within one year are shown in note I2.

#### Legal provisions

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the legal provisions of £19 million, £23 million and £15 million relate predominantly to Jackson. Jackson has been named in civil proceedings, which appear to be substantially similar to other class action litigation brought against many life insurers in the US, alleging misconduct in the sale of insurance products. During 2007, 2008 and 2009 respectively, £nil, £2 million and £9 million was paid.

#### Restructuring provisions

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, restructuring provisions of £35 million, £21 million and £17 million relate to restructuring activities of UK insurance operations.

In 2004 and 2005, UK insurance operations implemented restructurings relating to document management review, streamlining operations, and the relocation of activities to an offshore base in India. In December 2005, the Prudential Group announced an initiative for UK insurance operations to work more closely with M&G and in the process facilitate the realisation of substantial annualised pre-tax cost savings and opportunities for revenue synergies.

At 1 January 2007, a provision of £72 million was brought forward, and during 2007 an additional £21 million was provided, £14 million of unused provision was released, and £44 million was paid.

At 1 January 2008, a provision of £35 million was brought forward, and during 2008 an additional £4 million was provided, £7 million of unused provision was released, and £11 million was paid.

During 2009, £1 million of unused provision was released, and £3 million was paid.

#### *Other provisions*

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, other provisions of £166 million, £111 million and £174 million include provisions of £155 million, £95 million and £143 million relating to staff benefit schemes. In 2007, a provision of £134 million was brought forward, and additional £78 million was provided, £3 million of unused provision was released and £54 million was paid. In 2008, £155 million was brought forward, £37 million was provided and £15 million was released and £82 million was paid. In 2009, a provision of £95 million was brought forward, an additional £112 million was provided, £10 million of unused provision was released and £54 million was paid. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, other provisions also include £11 million, £16 million and £27 million relating to various onerous contracts where, in 2007 an additional £2 million was provided, £1 million was released and £8 million used, in 2008 an additional £10 million was provided and £5 million used and in 2009 an additional £15 million was provided and £4 million was used.

#### *Contingencies and related obligations*

##### ***Litigation***

In addition to the legal proceedings relating to Jackson mentioned above, the Prudential Group is involved in other litigation and regulatory issues. Whilst the outcome of such matters cannot be predicted with certainty, Prudential believes that the ultimate outcome of such litigation and regulatory issues will not have a material adverse effect on the Prudential Group's financial condition, results of operations, or cash flows.

##### ***Pension mis-selling review***

In 1988, the UK government introduced new pensions legislation intended to encourage more individuals to make their own arrangements for their pensions. During the period from April 1988 to June 1994, many individuals were advised by insurance companies, Independent Financial Advisers and other intermediaries to not join, to transfer from or to opt out of their occupational pension schemes in favour of private pension products introduced under the UK Income and Corporation Taxes Act 1988. The UK insurance regulator (previously the Personal Investment Authority, now the FSA), subsequently determined that many individuals were incorrectly advised and would have been better off not purchasing the private pension products sold to them. Industry participants are responsible for compensating the persons to whom private pensions were mis-sold. As a result, the FSA required that all UK life insurance companies review their potential cases of pension mis-selling and pay compensation to policyholders where necessary and, as a consequence, record a provision for the estimated costs. The Prudential Group met the requirement of the FSA to issue offers to all cases by 30 June 2002.

The table below summarises the change in the pension mis-selling provision for the years ended 31 December 2007, 31 December 2008 and 31 December 2009. The change in the provision is included in benefits and claims in the income statement and the movement in unallocated surplus of with-profits funds has been determined accordingly.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Balance at beginning of year . . . . .	401	448	345
Changes to actuarial assumptions and method of calculation . . . . .	71	(75)	20
Discount unwind . . . . .	22	20	3
Redress to policyholders . . . . .	(41)	(46)	(44)
Payment of administrative costs . . . . .	<u>(5)</u>	<u>(2)</u>	<u>(2)</u>
Balance at end of year . . . . .	<u>448</u>	<u>345</u>	<u>322</u>

The pension mis-selling provision is included within the liabilities in respect of investment contracts with discretionary participation features under IFRS 4.

The pension mis-selling provision at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, set out above of £448 million, £345 million and £322 million is stochastically determined on a discounted basis. The

average discount rate implied in the movement in 2007, 2008 and 2009 respectively, is 4.6%, 4.0% and 4.6%. The undiscounted amounts at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, expected to be paid in each of the years ending 31 December are as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Year ended 31 December			
2008 . . . . .	51	—	—
2009 . . . . .	15	17	—
2010 . . . . .	15	8	29
2011 . . . . .	15	9	8
2012 . . . . .	22	13	11
2013 . . . . .	—	12	12
2014 . . . . .	—	—	15
Thereafter . . . . .	<u>707</u>	<u>572</u>	<u>513</u>
Total undiscounted amount . . . . .	825	631	588
Aggregate discount . . . . .	<u>(377)</u>	<u>(286)</u>	<u>(266)</u>
Discounted pension mis-selling provision at 31 December 2007, 31 December 2008 and 31 December 2009, respectively . . . . .	<u>448</u>	<u>345</u>	<u>322</u>

The liability accounting for the contracts which are the subject of the mis-selling provision is reflected in two elements, namely the core policyholder liability determined on the basis applied for other contract liabilities and the mis-selling provision. The overall liability for these contracts remains appropriate in the context of the accounting for policyholder liabilities that determines the calculation of both elements. However, the constituent elements are reallocated and remeasured for the changes arising from the application of the realistic Peak 2 basis of liabilities for the core policyholder liability, as reflected in the IFRS policy improvement to apply the UK GAAP standard FRS 27 as described in section A4.

The Financial Ombudsman Service periodically updates the actuarial assumptions to be used in calculating the compensation payments, including interest rates and mortality assumptions. The pension mis-selling provision represents the discounted value of future expected payments, including benefit payments and all internal and external legal and administrative costs of adjudicating, processing and settling those claims. To the extent that amounts have not been paid, the provision increases each year reflecting the shorter period of discount.

The directors believe that, based on current information, the provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling as well as the costs and expenses of the Prudential Group's pension review unit established to identify and settle such cases. Such provision represents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The costs associated with the pension mis-selling review have been met from the inherited estate (see below). Accordingly, these costs have not been charged to the asset shares used in the determination of policyholder bonus rates. Hence policyholders' pay-out values have been unaffected by pension mis-selling.

In 1998, Prudential stated that deducting mis-selling costs from the inherited estate would not impact its bonus or investment policy and it gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing.

This review was completed on 30 June 2002. The assurance will continue to apply to any policy in-force at 31 December 2003, both for premiums paid before 1 January 2004, and for subsequent regular premiums (including future fixed, RPI or salary related increases and Department of Work and Pensions rebate business). The assurance has not applied to new business since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The maximum amount of capital support available under the terms of the assurance will reduce over time.

The bonus and investment policy for each type of with-profits policy is the same irrespective of whether or not the assurance applies and this is expected to continue for the foreseeable future. Hence removal of the assurance for new business has had no impact on policyholder returns.

### *Mortgage endowment products review*

In common with several other UK insurance companies, the Prudential Group used to sell low-cost endowment products related to repayment of residential mortgages. At sale, the initial sum assured is set at a level such that the projected benefits, including an estimate of the annual bonus receivable over the life of the policy, will equal or exceed the mortgage debt. Because of a decrease in expected future investment returns since these products were sold, the FSA is concerned that the maturity value of some of these products will be less than the mortgage debt. The FSA has worked with insurance companies to devise a programme whereby the companies write to customers indicating whether they may have a possible shortfall and outline the actions that the customers can take to prevent this possibility.

The Prudential Group is exposed to mortgage endowment products in respect of policies issued by Scottish Amicable Life plc (SAL) and policies issued by Scottish Amicable Life Assurance Society (SALAS) which were transferred into SAIF. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, provisions of £5 million, £5 million and £4 million in SAL and £43 million, £40 million and £35 million in SAIF were held within policyholder liabilities to cover potential compensation in respect of mortgage endowment product mis-selling claims. As SAIF is a separate sub-fund of the Prudential Assurance long-term business fund, this provision has no impact on shareholders.

In addition, in the years ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, Prudential Assurance's main with-profits fund paid compensation of £5 million, £1 million and £2 million in respect of mortgage endowment products mis-selling claims and at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, held a provision of £55 million, £54 million and £47 million in respect of further compensation. The movement in this provision has no impact on the Prudential Group's profit before tax.

In May 2006, the Prudential Group introduced a deadline for both Prudential and Scottish Amicable Life mortgage endowment complaints. Impacted customers have three years to lodge a mis-selling complaint in line with the time limit prescribed by the FSA and the ABI.

### *Guaranteed annuities*

PAC used to sell guaranteed annuity products in the UK and at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, held a provision of £45 million, £42 million and £31 million within the main with-profits fund within policyholder liabilities to honour guarantees on these products. The Prudential Group's main exposure to guaranteed annuities in the UK is through SAIF and at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, a provision of £563 million, £391 million and £284 million was held in SAIF to honour the guarantees. As SAIF is a separate sub-fund of the PAC long-term business fund, the movement in this provision has no impact on shareholders.

### *Other matters*

#### *Inherited estate of the PAC long-term fund*

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

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

#### *Support for long-term business funds by shareholders' funds*

As a proprietary insurance company, PAC is liable to meet its obligations to policyholders even if the assets of the long-term funds are insufficient to do so. The assets, represented by the unallocated surplus of with-profits funds, in excess of amounts expected to be paid for future terminal bonuses and related shareholder transfers ('the excess assets') in the long-term funds could be materially depleted over time by, for example, a significant or sustained

equity market downturn, costs of significant fundamental strategic change or a material increase in the pension mis-selling provision. In the unlikely circumstance that the depletion of the excess assets within the long-term fund was such that the Prudential Group's ability to satisfy policyholders' reasonable expectations was adversely affected, it might become necessary to restrict the annual distribution to shareholders or to contribute shareholders' funds to the long-term funds to provide financial support.

In 1997, the business of SALAS, a mutual society, was transferred to PAC. In effecting the transfer, a separate sub-fund, SAIF, was established within PAC's long-term business fund. This sub-fund contains all the with-profits business and all other pension business that was transferred. No new business has been or will be written in the sub-fund and the sub-fund is managed to ensure that all the invested assets are distributed to SAIF policyholders over the lifetime of SAIF policies. With the exception of certain amounts in respect of the unitised with-profits life business, all future earnings arising in SAIF are retained for SAIF policyholders. Any excess (deficiency) of revenue over expense within SAIF during a period is offset by a transfer to (from) the SAIF unallocated surplus. Shareholders have no interest in the profits of SAIF but are entitled to the asset management fees paid on this business. With the exception of certain guaranteed annuity products mentioned earlier in this note, and certain products which include a minimum guaranteed rate of accumulation, the majority of SAIF with-profits policies do not guarantee minimum rates of return to policyholders.

Should the assets of SAIF be inadequate to meet the guaranteed benefit obligations to the policyholders of SAIF, the PAC long-term fund would be liable to cover any such deficiency. Due to the quality and diversity of the assets in SAIF and the ability of SAIF to revise guaranteed benefits in the event of an asset shortfall, the directors believe that the probability of either the PAC long-term fund or the Prudential Group's shareholders' funds having to contribute to SAIF is remote.

#### *Guarantees and commitments*

Guarantee funds in both the UK and the US provide for payments to be made to policyholders on behalf of insolvent life insurance companies. These guarantee funds are financed by payments assessed on solvent insurance companies based on location, volume and types of business. The Prudential Group estimated its reserve for future guarantee fund assessments for Jackson, included within other liabilities to be £9 million, £18 million and £15 million at 31 December 2007, 31 December 2008 and 31 December 2009 respectively. Similar assessments for the UK businesses were not significant. The Directors believe that the reserve is adequate for all anticipated payments for known insolvencies.

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, Jackson has unfunded commitments of £181 million, £400 million and £339 million related to its investments in limited partnerships and £104 million, £24 million and £89 million related to commercial mortgage loans. These commitments were entered into in the normal course of business and the directors do not expect a material adverse impact on the operations to arise from them.

Jackson owns debt instruments issued by securitisation trusts managed by PPM America. At 31 December 2009, the support provided by certain forbearance agreements Jackson entered into with the counterparty to certain of these trusts could potentially expose Jackson to maximum losses of US\$750 million if circumstances allowed the forbearance period to cease. Jackson believes that, so long as the forbearance period continues, the risk of loss under the agreements is remote.

The Prudential Group has provided other guarantees and commitments to third-parties entered into in the normal course of business but the Prudential does not consider that the amounts involved are significant.

#### ***H15: Other liabilities***

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Creditors arising from direct insurance and reinsurance operations . . . . .	538	552	615
Interest payable . . . . .	76	139	83
Other items . . . . .	<u>177</u>	<u>199</u>	<u>179</u>
Total . . . . .	<u>791</u>	<u>890</u>	<u>877</u>

## I: OTHER NOTES

### II: Sale of legacy agency book and agency force in Taiwan to China Life Insurance of Taiwan

On 20 February 2009, Prudential announced that it had entered into an agreement to sell the assets and liabilities of its agency distribution business and its agency force in Taiwan to China Life Insurance Company Ltd of Taiwan for the nominal sum of NT\$1 subject to regulatory approval. In addition, Prudential would invest £45 million to purchase a 9.99% stake in China Life through a share placement. The business transferred represented 94% of Prudential's in-force liabilities in Taiwan and included Prudential's legacy interest rate guaranteed products with IFRS basis gross assets at 31 December 2008 of £4.5 billion. After taking account of IFRS shareholders' equity of the business at 31 December 2008, provisions for restructuring costs, and other costs the Prudential Group's IFRS shareholders' equity at 31 December 2008 was expected to decrease by approximately £595 million.

Prudential retains its interest in life insurance business in Taiwan through its retained bank distribution partnerships and its direct investment of 9.99% in China Life.

The sale was completed, following regulatory approval, on 19 June 2009. The trading results shown below are for the period 1 January to 19 June 2009.

The carrying value of the IFRS equity of the business, as applied in the calculation of the loss on sale, reflects the application of 'grandfathered' US GAAP under IFRS 4 of insurance assets and liabilities. US GAAP does not, and is not designed to, include the cost of holding economic capital to support the legacy interest rate guaranteed products as recognised under Prudential's supplementary reporting basis under European Embedded Value principles. The IFRS loss on sale reflects this missing element of the economic value. The effects on the IFRS income statement and equity attributable to shareholders is shown below.

The loss on sale and trading results of the Taiwan agency business for the period of ownership comprise:

	2007	2008	2009
	£m	£m	£m
<b>Loss on sale:</b>			
As estimated and announced on 20 February 2009:			
Proceeds . . . . .	—	—	—
Net asset value attributable to equity holders of Prudential and provision for restructuring costs . . . . .	—	—	(551)
Goodwill written off . . . . .	—	—	(44)
	—	—	(595)
Trading losses to completion, net of tax, as shown below . . . . .	—	—	44
Minority interests and other adjustments . . . . .	—	—	(8)
Loss on sale of the Taiwan agency business, gross and net of tax (as shown in income statement) . . . . .	—	—	(559)
Trading results before tax (including short-term fluctuations in investment returns) . . . .	(37)	1	(62)
Related tax . . . . .	(23)	(4)	18
Total . . . . .	(60)	(3)	(44)
<b>Loss on sale and trading results of the Taiwan agency business:</b>			
—Gross of tax . . . . .	(37)	1	(621)
—Tax . . . . .	(23)	(4)	18
—Net of tax . . . . .	(60)	(3)	(603)
Attributable to:			
Equity holders of Prudential . . . . .	(60)	(3)	(598)
Minority interests . . . . .	—	—	(5)
Loss on sale and results of the Taiwan agency business, net of tax . . . . .	(60)	(3)	(603)

The loss on disposal in 2009 of £559 million includes cumulative foreign exchange gains of £9 million recycled through the profit and loss account as required by IAS 21. The impact on shareholders' funds of the disposal (including trading losses up to the date of disposal) is £607 million. The difference of £12 million from the estimate of £595 million reflects a number of minor adjustments.

Cash and cash equivalents included in the net assets disposed of were £388 million and restructuring and other costs incurred in cash in the year were £64 million. In addition, Prudential invested £45 million in China Life as described

above. Accordingly, the cash outflow for the Prudential Group arising from the sale of the Taiwan agency business, as shown in the summary consolidated statement of cash flows, was £497 million.

In order to facilitate comparisons of the Prudential Group's retained businesses, the presentation of the segmental analysis of IFRS loss before shareholder tax (as shown in note B1) has been adjusted to show separately the result for the sold Taiwan agency business, as explained below.

	2007			2008		
	As previously published £m	Adjustment £m	Adjusted £m	As previously published £m	Adjustment £m	Adjusted £m
Operating profit based on longer-term investment returns . . .	1,201	(49)	1,152	1,347	(64)	1,283
Short-term fluctuations in investment returns . . . . .	(137)	86	(51)	(1,783)	62	(1,721)
Shareholders' share of actuarial gains and losses on defined benefit pension schemes . . . . .	(1)	—	(1)	(14)	1	(13)
Results of sold Taiwan agency business . . . . .	<u>Included above</u>	<u>(37)</u>	<u>(37)</u>	<u>Included above</u>	<u>1</u>	<u>1</u>
Profit/(loss) before tax . . . . .	<u>1,063</u>	<u>—</u>	<u>1,063</u>	<u>(450)</u>	<u>—</u>	<u>(450)</u>

## 12: Staff and pension plans

### a Staff and employment costs

The average number of staff employed by the Prudential Group during the year were:

	2007	2008	2009
Business operations:			
UK operations . . . . .	7,732	6,231	4,516
US operations . . . . .	3,123	3,298	3,371
Asian operations . . . . .	16,807	20,154	19,502
Venture fund investment subsidiaries of the PAC with-profit fund . . . . .	21,184	—	—
Total for continuing operations . . . . .	48,846	29,683	27,389
Discontinued banking operations . . . . .	770	—	—
Total . . . . .	<u>49,616</u>	<u>29,683</u>	<u>27,389</u>

The costs of employment were:

	2007 £m	2008 £m	2009 £m
Business operations:			
Wages and salaries . . . . .	819	791	878
Social security costs . . . . .	62	54	61
Other pension costs (see below) . . . . .	96	78	95
Pension actuarial and other (gains) losses charged to income statement . . . . .	2	(10)	138
Venture fund investment subsidiaries of the PAC with-profits fund (see below) . . . . .	423	—	—
Total for continuing operations . . . . .	1,402	913	1,172
Discontinued banking operations . . . . .	21	—	—
Total . . . . .	<u>1,423</u>	<u>913</u>	<u>1,172</u>

For the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, other pension costs comprises £68 million, £47 million and £57 million relating to defined benefit schemes and £28 million, £31 million, and £38 million relating to defined contribution schemes of continuing operations. For the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, of the defined contribution

scheme costs, £19 million, £21 million and £27 million related to overseas defined contribution schemes. For 2007, 2008 and 2009 respectively, the £68 million, £47 million and £57 million comprises a charge of £41 million, £29 million and £29 million relating to PSPS and a charge of £27 million, £18 million and £28 million for other schemes.

Consistent with the derecognition of Prudential's interest in the underlying IAS 19 surplus of PSPS as described in note (b)(i)1 below, £41 million, £29 million and £29 million, for 2007, 2008 and 2009 respectively, for PSPS represents the cash cost of contributions for ongoing service of active members and the unwind of discount on the opening provision for deficit funding for PSPS. The charge of £27 million, £18 million and £28 million, for 2007, 2008 and 2009 respectively, for other schemes comprises a £17 million, £7 million and £19 million, charge on an economic basis, reflecting the total assets of the schemes, and a further £10 million, £11 million and £9 million charge to adjust for amounts invested in Prudential insurance policies to arrive at the IAS 19 basis charge.

For 2007, 2008 and 2009 respectively, the loss of £2 million, gain of £10 million and loss of £138 million for actuarial and other gains comprises a loss of £7 million, a loss of £21 million and a loss of £155 million for actuarial and other losses on an economic basis and an actuarial gain of £5 million, gain of £31 million, and a gain of £17 million to adjust for amounts invested in Prudential insurance policies. The derivation of these amounts is shown in note (b)(i)7 below.

*b Pension plans*

*i Defined benefit plans*

*1 Summary*

The Prudential Group's business operations operate a number of pension schemes. The specific features of these plans vary in accordance with the regulations of the country in which the employees are located, although they are, in general, funded wholly by the Prudential Group and based either on a cash balance formula or on years of service and salary earned in the last year or years of employment. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS), with 87%, 87% and 86% (2007, 2008 and 2009 respectively) of the underlying scheme liabilities of the Prudential Group defined benefit schemes accounted for within PSPS.

The Prudential Group also operates two smaller defined benefit schemes for UK employees in respect of Scottish Amicable Life and M&G. For all three schemes the projected unit method was used for the most recent full actuarial valuations. There is also a small defined benefit scheme in Taiwan but as part of the sale of the Taiwan agency business completed in June 2009, the Prudential Group settled the majority of the obligations under the scheme as a significant number of employees transferred out.

Defined benefit schemes in the UK are required to be subject to full actuarial valuation 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. PSPS was last actuarially valued as at 5 April 2008. This valuation demonstrated the scheme to be 106% funded by reference to the Scheme Solvency Target that forms the basis of the scheme's statutory funding objective. Accordingly, the total contributions to be made by the Prudential Group into the scheme were reduced from the previous arrangement of £70-£75 million per annum to £50 million per annum effective from 1 July 2009. As the scheme was in a surplus position at the valuation date, no formal deficit funding plan was required. However, recognising that there had been significant deterioration in the value of the scheme assets since 5 April 2008 to the date of the finalisation of the valuation, contributions to the scheme for additional funding of £25 million per annum, as well as the £25 million per annum employer's contributions for ongoing service of current employees, was agreed with the Trustees subject to a reassessment when the next valuation is completed. The additional funding is akin to deficit funding. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the PAC life fund and shareholder-backed operations following detailed consideration in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity. In 2007, 2008 and 2009 respectively, total contributions for the year including expenses and augmentations were £82 million, £79 million and £67 million.

The valuation of the Scottish Amicable Pension Scheme as at 31 March 2008 demonstrated the scheme to be 91% funded, with a shortfall of actuarially determined liabilities of 9%, representing a deficit of £38 million. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a seven year period were made from July 2009 of £7.3 million per annum. The IAS19 deficit of the Scottish Amicable Pension Scheme of £54 million, £44 million and £139 million, for 2007, 2008 and 2009 respectively, has been allocated 50% to the PAC with-profits fund and 50% to the PAC shareholders fund.

Subsequent to the year end, the valuation of the M&G Pension Scheme as at 31 December 2008 was finalised in January 2010. The valuation demonstrated the scheme to be 76% funded, with a shortfall of actuarially determined assets to liabilities of £51 million. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period will be made from January 2010 of £14.1 million per annum for the first two years and £9.3 million per annum for the subsequent three years. The IAS 19 deficit of M&G pension scheme on an economic basis of £17 million, £23 million and £36 million at 31 December 2007, 2008 and 2009 respectively is wholly attributable to shareholders.

Under the IAS 19 valuation basis, the Prudential Group adopted IFRIC 14, 'IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' in 2008 (and effective for year ended 31 December 2007). Under IFRIC 14, on an economic basis the Prudential Group has not recognised the underlying PSPS surplus of £528 million, £728 million and £513 million, for 2007, 2008 and 2009 respectively, gross of deferred tax due to the Prudential Group not having an unconditional right of refund to any surplus in the scheme. Additionally, under IFRIC 14, the Prudential Group has also recognised a liability for committed deficit funding obligation in PSPS. Although the contributions would increase the surplus in the scheme, the corresponding asset will not be recognised in the Prudential Group accounts. At 31 December 2007 and 31 December 2008 the Prudential Group had recognised a liability for deficit funding for PSPS of £55 million and £65 million gross of deferred tax respectively based on the previous deficit funding commitment to 5 April 2010. At 31 December 2009, based on the new funding arrangement as described above, the Prudential Group has recognised a liability for deficit funding to 30 June 2012 for PSPS of £75 million gross of deferred tax. The asset and liabilities of PSPS are unaffected by the impact of the application of IFRIC 14. PSPS is managed on an economic basis for the longer-term benefit of its current and deferred pensioners and active members. The surplus in PSPS is available to absorb future adverse asset value movements and, if required, strengthening in mortality assumptions.

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, after the effect of the application of IFRIC 14, the shareholders' share of the pension liability for PSPS deficit funding obligation and the deficits of the defined benefit pension schemes amounted to a £63 million, £61 million and £92 million liability net of related tax relief. These amounts are determined after including amounts invested by the M&G scheme in Prudential policies as explained later in this note.

On the economic basis (including investments of the M&G scheme in Prudential policies as assets), for 2007, 2008 and 2009 respectively, a £35 million, £26 million and £32 million pre-tax shareholder charge to operating results based on longer-term returns arises. In addition, outside the operating result but included in total profits is a pre-tax shareholder loss of £1 million, £14 million and £74 million for shareholders' share of actuarial and other gains and losses for 2007, 2008 and 2009 respectively.

In addition for 2007, 2008 and 2009 respectively, also on the economic basis, the PAC with-profits sub-fund was charged £23 million, £10 million and £16 million for its share of the pension charge of PSPS and Scottish Amicable Life and charged with £6 million, £7 million and £81 million for its share of net actuarial and other losses on the scheme assets and liabilities. As shareholder profits for the PAC with-profits sub-fund reflects the surplus for distribution, these amounts are effectively absorbed by an increased charge in the income statement for the transfer to the liability for unallocated surplus.

At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, after the effect of the application of IFRIC 14, the total share of the liability for deficit funding on PSPS and the deficit on the smaller Scottish Amicable Scheme attributable to the PAC with-profits fund amounted to a liability of £88 million, £60 million and £110 million net of related tax relief.

## **2 Corporate governance**

The rules of the Prudential Group's largest pension arrangement, the defined benefit section of PSPS, a final salary scheme, specify that, in exercising its investment powers, the Trustee's objective is to achieve the best overall investment return consistent with the security of the assets of the scheme. In doing this, consideration is given to the nature and duration of the scheme's liabilities. The Trustee sets the benchmark for the asset mix, following analysis of the liabilities by the Scheme's Actuary and, having taken advice from the Investment Managers, then selects benchmark indices for each asset type in order to measure investment performance against a benchmark return.

The Trustee reviews strategy, the asset mix benchmark and the Investment Managers' objectives every three years, to coincide with the Actuarial Valuation, or earlier if the Scheme Actuary recommends. Interim reviews are conducted annually based on changing economic circumstances and financial market levels.

The Trustee sets the general investment policy and specifies any restrictions on types of investment and the degrees of divergence permitted from the benchmark, but delegates the responsibility for selection and realisation of

specific investments to the Investment Managers. In carrying out this responsibility, the Investment Managers are required by the Pensions Act 1995 to have regard to the need for diversification and suitability of investments. Subject to a number of restrictions contained within the relevant asset management agreements, the Investment Managers are authorised to invest in any class of investment asset. However, the Investment Managers will not invest in any new class of investment asset without prior consultation with the Trustee.

The Trustee consults the Principal Employer, the Prudential Assurance Company, on these investment principles, but the ultimate responsibility for the investment of the assets of the scheme lies with the Trustee.

The investment policies and strategies for the other two UK defined benefit schemes, the M&G Group Pension Scheme and the Scottish Amicable Staff Pension Scheme, which are both final salary schemes, follow similar principles, but have different target allocations reflecting the particular requirements of the schemes.

### 3 Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the years ended 31 December were as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	%	%	%
Discount rate* . . . . .	5.9	6.1	5.8
Rate of increase in salaries . . . . .	5.3	5.0	5.7
Rate of inflation . . . . .	3.3	3.0	3.7
Rate of increase of pensions in payment for inflation:			
Guaranteed (maximum 5%) . . . . .	3.3	3.0	3.7
Guaranteed (maximum 2.5%)† . . . . .	2.5	2.5	2.5
Discretionary† . . . . .	2.5	2.5	2.5
Expected returns on plan assets . . . . .	5.9	6.2	4.5

\* The discount rate has been determined by reference to an 'AA' corporate bond index adjusted, where applicable, to allow for the difference in duration between the index and the pension liabilities.

† The rates of 2.5% shown are those for PSPS. Assumed rates of increase of pensions in payment for inflation for all other schemes are 3.3%, 3.0% and 3.7% in 2007, 2008 and 2009 respectively.

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality, which is broadly based on adjusted versions of the medium cohort projections prepared by the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries. In 2007, the mortality assumptions were strengthened by including a floor to the medium cohort improvements.

The tables used for PSPS immediate annuities in payment at 31 December 2007 and 31 December 2008 were:

*Male:* 100% PMA 92 with CMIR17 improvements to the valuation date and medium cohort improvements subject to a floor of 1.75% up to the age of 90, decreasing linearly to zero by age of 120; and

*Female:* 100% PFA 92 with CMIR17 improvements to the valuation date and 75% medium cohort improvements subject to a floor of 1% up to the age of 90, decreasing linearly to zero by age of 120.

The tables used for PSPS immediate annuities in payment at 31 December 2009 were:

*Male:* 108.6% PNMA 00 with medium cohort improvements subject to a floor of 1.75% up to the age of 90, decreasing linearly to zero by age of 120; and

*Female:* 103.4% PNFA 00 with 75% medium cohort improvements subject to a floor of 1% up to the age of 90 and decreasing linearly to zero by age of 120.

The assumed life expectancies on retirement at age 60, based on the mortality table used was:

	<u>2007 years</u>		<u>2008 years</u>		<u>2009 years</u>	
	<u>Male</u>	<u>Female</u>	<u>Male</u>	<u>Female</u>	<u>Male</u>	<u>Female</u>
Retiring today . . . . .	26.2	28.3	26.4	28.4	27.4	28.6
Retiring in 15 years' time . . . . .	28.7	29.3	28.9	29.8	30.1	30.8

The mean term of the current PSPS liabilities is around 18 years.

Using external actuarial advice provided by the scheme actuaries being Towers Watson (previously known as Watson Wyatt) for the valuation of PSPS and by Aon Limited for the M&G scheme, and Xafinity for the Scottish

Amicable Scheme, the most recent full valuations have been updated to 31 December 2009, applying the principles prescribed by IAS 19.

#### 4 Summary financial position

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

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Economic position:			
Deficit, gross of deferred tax, based on scheme assets held, including investments in Prudential insurance policies:			
Attributable to the PAC with-profits fund (i.e. absorbed by the liability for unallocated surplus) . . . . .	(98)	(67)	(122)
Attributable to shareholder-backed operations (i.e. to shareholders' equity) . . . . .	<u>(85)</u>	<u>(82)</u>	<u>(128)</u>
Economic deficit — as explained in note 5 below . . . . .	(183)	(149)	(250)
Excludes investments in Prudential insurance policies (offset on consolidation in the Group financial information against insurance liabilities) . . . . .	<u>(172)</u>	<u>(157)</u>	<u>(187)</u>
Deficit under IAS 19 included in provisions in the statement of financial position — as explained in note 7 below . . . . .	<u>(355)</u>	<u>(306)</u>	<u>(437)</u>

The following disclosures explain the economic position and IAS 19 basis of accounting after eliminating investment in Prudential insurance policies on consolidation.

#### 5 Prudential Group economic financial position

The following tables illustrate the movement on the financial position of the Prudential Group's defined benefit pension schemes on an economic basis. The underlying position reflects the assets including the investments in Prudential policies that are offset against liabilities to policyholders on the Prudential Group consolidation and the liabilities of the schemes. The instruments in Prudential policies comprise £140 million, £103 million and £101 million at 31 December 2007, 2008 and 2009, respectively for PSPS and £172 million, £157 million and £187 million at 31 December 2007, 2008 and 2009, respectively for the M&G scheme.

Separately, the economic financial position also includes the effect of the application of IFRIC 14, whereby for PSPS, where there are additional constraints in the trust deed to prevent the company access, the surplus is not recognised and a liability to additional funding (as described earlier) is established.

## Estimated pension scheme deficit — economic basis

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:

	2007					
	(Charge) credit to income statement					
	Operating results			Results of sold Taiwan agency business	Contributions paid	Surplus (deficit) in scheme at 31 Dec 2007 (note a)
	Surplus (deficit) in scheme at 1 January 2007	(based on longer-term investment returns) (note b)	Actuarial and other gains and losses (note c)			
<b>All schemes</b>						
<b>Underlying position (without the effect of IFRIC 14)</b>						
Surplus (deficit) . . . . .	65	(14)	295	—	101	447
Less: amount attributable to PAC with- profits fund . . . . .	<u>(73)</u>	<u>(9)</u>	<u>(205)</u>	<u>—</u>	<u>(51)</u>	<u>(338)</u>
Shareholders' share:						
Gross of tax surplus (deficit) . . . . .	(8)	(23)	90	—	50	109
Related tax . . . . .	<u>—</u>	<u>6</u>	<u>(25)</u>	<u>—</u>	<u>(14)</u>	<u>(33)</u>
Net of shareholders' tax . . . . .	<u>(8)</u>	<u>(17)</u>	<u>65</u>	<u>—</u>	<u>36</u>	<u>76</u>
<b>Effect of IFRIC 14</b>						
Surplus (deficit) . . . . .	(284)	(44)	(302)	—	—	(630)
Less: amount attributable to PAC with- profits fund . . . . .	<u>193</u>	<u>32</u>	<u>211</u>	<u>—</u>	<u>—</u>	<u>436</u>
Shareholders' share:						
Gross of tax (deficit) surplus . . . . .	(91)	(12)	(91)	—	—	(194)
Related tax . . . . .	<u>27</u>	<u>2</u>	<u>26</u>	<u>—</u>	<u>—</u>	<u>55</u>
Net of shareholders' tax . . . . .	<u>(64)</u>	<u>(10)</u>	<u>(65)</u>	<u>—</u>	<u>—</u>	<u>(139)</u>
<b>With the effect of IFRIC 14</b>						
Surplus (deficit) . . . . .	(219)	(58)	(7)	—	101	(183)
Less: amount attributable to PAC with- profits fund . . . . .	<u>120</u>	<u>23</u>	<u>6</u>	<u>—</u>	<u>(51)</u>	<u>98</u>
Shareholders' share:						
Gross of tax (deficit) surplus . . . . .	(99)	(35)	(1)	—	50	(85)
Related tax . . . . .	<u>27</u>	<u>8</u>	<u>1</u>	<u>—</u>	<u>(14)</u>	<u>22</u>
Net of shareholders' tax . . . . .	<u>(72)</u>	<u>(27)</u>	<u>—</u>	<u>—</u>	<u>36</u>	<u>(63)</u>

<b>(Charge) credit to income statement</b>							
<b>Operating results</b>							
<b>Surplus (deficit) in scheme at 1 January 2008</b>	<b>(based on longer-term investment returns) (note b)</b>	<b>Actuarial and other gains and losses (note c)</b>	<b>Results of sold Taiwan agency business</b>	<b>Contributions paid</b>	<b>Exchange</b>	<b>Surplus (deficit) in scheme at 31 Dec 2008 (note a)</b>	<b>£m</b>
<b>All schemes Underlying position (without the effect of IFRIC 14)</b>							
Surplus (deficit) . . . . .	447	46	61	(1)	95	(4)	644
Less: amount attributable to PAC with-profits fund . . . . .	<u>(338)</u>	<u>(48)</u>	<u>(49)</u>	—	<u>(48)</u>	—	<u>(483)</u>
Shareholders' share:							
Gross of tax surplus (deficit) . . . . .	109	(2)	12	(1)	47	(4)	161
Related tax . . . . .	<u>(33)</u>	<u>1</u>	<u>(2)</u>	—	<u>(13)</u>	—	<u>(47)</u>
Net of shareholders' tax . . . . .	<u>76</u>	<u>(1)</u>	<u>10</u>	<u>(1)</u>	<u>34</u>	<u>(4)</u>	<u>114</u>
<b>Effect of IFRIC 14</b>							
Surplus (deficit) . . . . .	(630)	(82)	(81)	—	—	—	(793)
Less: amount attributable to PAC with-profits fund . . . . .	<u>436</u>	<u>58</u>	<u>56</u>	—	—	—	<u>550</u>
Shareholders' share:							
Gross of tax (deficit) surplus . . . . .	(194)	(24)	(25)	—	—	—	(243)
Related tax . . . . .	<u>55</u>	<u>6</u>	<u>7</u>	—	—	—	<u>68</u>
Net of shareholders' tax . . . . .	<u>(139)</u>	<u>(18)</u>	<u>(18)</u>	—	—	—	<u>(175)</u>
<b>With the effect of IFRIC 14</b>							
Surplus (deficit) . . . . .	(183)	(36)	(20)	(1)	95	(4)	(149)
Less: amount attributable to PAC with-profits fund . . . . .	<u>98</u>	<u>10</u>	<u>7</u>	—	<u>(48)</u>	—	<u>67</u>
Shareholders' share:							
Gross of tax (deficit) surplus . . . . .	(85)	(26)	(13)	(1)	47	(4)	(82)
Related tax . . . . .	<u>22</u>	<u>7</u>	<u>5</u>	—	<u>(13)</u>	—	<u>21</u>
Net of shareholders' tax . . . . .	<u>(63)</u>	<u>(19)</u>	<u>(8)</u>	<u>(1)</u>	<u>34</u>	<u>(4)</u>	<u>(61)</u>

	(Charge) credit to income statement					Surplus (deficit) in scheme at 31 Dec 2009 (note a) £m
	Surplus (deficit) in scheme at 1 January 2009	Operating results (based on longer-term investment returns) (note b)	Actuarial and other gains and losses (note c)	Contributions paid	Disposal of Taiwan agency business	
<b>All schemes Underlying position (without the effect of IFRIC 14)</b>						
Surplus (deficit) . . . . .	644	(71)	(337)	85	17	338
Less: amount attributable to PAC with-profits fund . . . . .	<u>(483)</u>	<u>33</u>	<u>207</u>	<u>(42)</u>	<u>—</u>	<u>(285)</u>
Shareholders' share:						
Gross of tax surplus (deficit) . . . . .	161	(38)	(130)	43	17	53
Related tax . . . . .	<u>(47)</u>	<u>11</u>	<u>36</u>	<u>(11)</u>	<u>(4)</u>	<u>(15)</u>
Net of shareholders' tax . . . . .	<u>114</u>	<u>(27)</u>	<u>(94)</u>	<u>32</u>	<u>13</u>	<u>38</u>
<b>Effect of IFRIC 14</b>						
Surplus (deficit) . . . . .	(793)	23	182	—	—	(588)
Less: amount attributable to PAC with-profits fund . . . . .	<u>550</u>	<u>(17)</u>	<u>(126)</u>	<u>—</u>	<u>—</u>	<u>407</u>
Shareholders' share:						
Gross of tax (deficit) surplus . . . . .	(243)	6	56	—	—	(181)
Related tax . . . . .	<u>68</u>	<u>(2)</u>	<u>(15)</u>	<u>—</u>	<u>—</u>	<u>51</u>
Net of shareholders' tax . . . . .	<u>(175)</u>	<u>4</u>	<u>41</u>	<u>—</u>	<u>—</u>	<u>(130)</u>
<b>With the effect of IFRIC 14</b>						
Surplus (deficit) . . . . .	(149)	(48)	(155)	85	17	(250)
Less: amount attributable to PAC with-profits fund . . . . .	<u>67</u>	<u>16</u>	<u>81</u>	<u>(42)</u>	<u>—</u>	<u>122</u>
Shareholders' share:						
Gross of tax (deficit) surplus . . . . .	(82)	(32)	(74)	43	17	(128)
Related tax . . . . .	<u>21</u>	<u>9</u>	<u>21</u>	<u>(11)</u>	<u>(4)</u>	<u>36</u>
Net of shareholders' tax . . . . .	<u>(61)</u>	<u>(23)</u>	<u>(53)</u>	<u>32</u>	<u>13</u>	<u>(92)</u>

(a) On the 'economic basis', after including the underlying assets represented by the investments in Prudential insurance policies as scheme assets, the underlying statements of financial position of the schemes at 31 December were:

	2007				2008				2009			
	Other schemes		Total	%	Other schemes		Total	%	Other schemes		Total	%
	PSPS	note iii			PSPS	note iii			PSPS	note iii		
			£m			£m				£m		
Equities . . . . .	1,278	265	1,543	28	823	213	1,036	19	830	266	1,096	20
Bonds . . . . .	1,134	249	1,383	25	2,430	277	2,707	51	3,406	280	3,686	67
Properties . . . . .	545	54	599	11	283	18	301	6	272	15	287	5
Cash-like investments(note i) . . . . .	<u>1,932</u>	<u>5</u>	<u>1,937</u>	<u>36</u>	<u>1,267</u>	<u>6</u>	<u>1,273</u>	<u>24</u>	<u>441</u>	<u>2</u>	<u>443</u>	<u>8</u>
Total value of assets . . . . .	4,889	573	5,462	100	4,803	514	5,317	100	4,949	563	5,512	100
Present value of benefit obligations . . . . .	<u>(4,361)</u>	<u>(654)</u>	<u>(5,015)</u>		<u>(4,075)</u>	<u>(598)</u>	<u>(4,673)</u>		<u>(4,436)</u>	<u>(738)</u>	<u>(5,174)</u>	
	528	(81)	447		728	(84)	644		513	(175)	338	
Effect of the application of IFRIC 14 for pension schemes:												
Derecognition of PSPS surplus . . . . .	(528)	—	(528)		(728)	—	(728)		(513)	—	(513)	
Set up obligation for deficit funding for PSPS . . . . .	<u>(102)</u>	<u>—</u>	<u>(102)</u>		<u>(65)</u>	<u>—</u>	<u>(65)</u>		<u>(75)</u>	<u>—</u>	<u>(75)</u>	
Pre-tax deficit(note ii) . . . . .	<u>(102)</u>	<u>(81)</u>	<u>(183)</u>		<u>(65)</u>	<u>(84)</u>	<u>(149)</u>		<u>(75)</u>	<u>(175)</u>	<u>(250)</u>	

#### Notes

- i The PSPS has entered into a derivatives based strategy to match the duration and inflation profile of its liabilities. This involved a reallocation from other investments to cash-like investments with an interest and inflation swap overlay. In broad terms, the scheme is committed to making a series of payments related to LIBOR on a nominal amount and in return the scheme receives a series of fixed and inflation-linked payments which match a proportion of its liabilities. As at 31 December 2007, 31 December 2008 and 31 December 2009

respectively, the nominal value of the interest rate swaps amounted to £1.2 billion, £1.2 billion, and £1.1 billion and inflation-linked swaps amounted to £0.7 billion, £0.3 billion and £1.9 billion respectively.

- ii The resulting scheme deficit arising from the excess of liabilities over assets at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, of £183 million, £149 million and £250 million comprised a deficit of £98 million, £67 million and £122 million attributable to the PAC with-profits fund and deficit of £85 million, £82 million and £128 million attributable to shareholder operations.
- iii In addition to PSPS, there are two smaller schemes in the UK, the Scottish Amicable Pension Scheme, and the M&G Pension Scheme, with a combined deficit at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, of £71 million, £67 million and £175 million, gross of tax. There is also a small scheme in Taiwan, which at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, had a deficit of £10 million, £17 million and nil, gross of tax. As part of the sale of the Taiwan agency business in June 2009 the Prudential Group has settled the majority of the obligations under the Taiwan scheme relating to the employees who were transferred out.

The movements in the deficit on the 'economic basis' between scheme assets and liabilities were:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Current service cost . . . . .	(19)	(19)	(11)
Curtailed credit . . . . .	—	14	—
Other finance income . . . . .	2	(2)	(8)
Cash costs and unwind of discount on opening provision for deficit funding for PSPS . . . . .	(41)	(29)	(29)
Contributions . . . . .	101	95	85
Actuarial and other gains and losses . . . . .	(7)	(20)	(155)
Movement due to the sold Taiwan agency business and exchange translation difference . . . . .	—	(5)	17
Net decrease in deficit . . . . .	<u>36</u>	<u>34</u>	<u>(101)</u>

- (b) The components of the (charge) credit to operating results (gross of allocation of the share attributable to the PAC with-profits fund) are as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Service cost . . . . .	(58)	(45)	(34)
Curtailed credit . . . . .	—	44	—
Finance (expense) income:			
Interest on pension scheme liabilities . . . . .	(265)	(289)	(277)
Expected return on assets . . . . .	309	336	240
Total (charge) credit without the effect IFRIC 14 . . . . .	(14)	46	(71)
Effect of IFRIC 14 for pension schemes . . . . .	(44)	(82)	23
Total (charge) credit after the effect of IFRIC 14 . . . . .	<u>(58)</u>	<u>(36)</u>	<u>(48)</u>

The net charge to operating profit (gross of the share attributable to the PAC with-profits fund) of £58 million, £36 million and £48 million, for 2007, 2008 and 2009 respectively, is made up of a charge relating to PSPS of £41 million, £29 million and £29 million and a charge in respect of other schemes of £17 million, £7 million and £19 million, for 2007, 2008, and 2009 respectively. This net charge represents:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Underlying IAS 19 charge for other pension schemes . . . . .	(17)	(7)	(19)
Cash costs for PSPS . . . . .	(34)	(25)	(25)
Unwind of discount on opening provision for deficit funding for PSPS . . . . .	(7)	(4)	(4)
	<u>(58)</u>	<u>(36)</u>	<u>(48)</u>

Consistent with the derecognition of Prudential's interest in the underlying IAS 19 surplus of PSPS, the charge to operating profit on longer-term investment returns for PSPS reflects the cash cost of contributions for ongoing service of active members. In addition, the charge to the operating results also includes a charge for the unwind of discount on the opening provision for deficit funding for PSPS.

- (c) The components of the (charge) credit for actuarial and other gains and losses (gross of allocation of the share attributable to the PAC with-profits fund but excluding the charge relating to the sold Taiwan agency business) are as follows:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Actual less expected return on assets . . . . .	(8)	(356)	108
(Losses) gains on changes of assumptions for plan liabilities . . . . .	317	272	(521)
Experience (gains) losses on liabilities . . . . .	(14)	145	76
Total charge without the effect of IFRIC 14 . . . . .	295	61	(337)
Effect of IFRIC 14 for pension schemes . . . . .	(302)	(81)	182
Actuarial and other gains and losses after the effect of IFRIC 14 . . . . .	<u>(7)</u>	<u>(20)</u>	<u>(155)</u>

The net charge for actuarial and other gains and losses is recorded within the income statement but, within the segmental analysis of profit, the shareholders' share of actuarial and other gains and losses (i.e. net of allocation of the share to the PAC with-profits funds) is excluded from operating profit based on longer-term investment returns.

The 2009 actuarial losses of £337 million primarily reflects the effects of increases in inflation rates and decrease in risk discount rates partially offset by the excess of market returns over long-term assumptions and experience gains on liabilities.

The 2008 actuarial gains of £61 million reflected gains on changes of assumptions of £272 million due to the effect of an increase in the risk discount rate combined with the effect of decreases in inflation rates and experience gains of £145 million which were partially offset by the shortfall of market returns over long term assumptions of £356 million. The 2007 gains on changes of assumptions for liabilities of £317 million reflected gains due to changes in economic assumptions of £509 million which more than offset the actuarial losses of £192 million from the effect of strengthened mortality assumptions for the UK pension schemes.

Consistent with the derecognition of Prudential's interest in the underlying IAS 19 surplus of PSPS, the actuarial gains and losses do not include those of PSPS. In addition, as a result of applying of IFRIC 14, the Prudential Group has recognised a provision for deficit funding in respect of PSPS. The change in 2009 in relation to this provision recognised above as other gains and losses on defined benefit pension schemes was £nil, £13 million and £48 million, for 2007, 2008 and 2009 respectively.

## 6 Movement in IAS 19 basis financial position

The change in the present value of the benefit obligation and the change in fair value of the assets for the total of the PSPS, Scottish Amicable Life, M&G and Taiwan schemes over the period were as follows:

	2007					Total Economic basis: net obligations  £m
	PSPS Provision for deficit funding	IAS 19 basis: change in fair value of plan assets	Investments in Prudential insurance policies	Economic basis: total assets	Other schemes IAS 19 basis: change in present value of benefit obligations	
Fair value of plan assets, beginning of year . . . . .		366	161	527		527
Present value of benefit obligation, beginning of year . . . . .					(603)	(603)
Provision for deficit funding for PSPS . . . . .	(143)	—	—	—	—	(143)
	(143)	366	161	527	(603)	(219)
Service cost — current charge only . . . . .					(19)	(19)
Interest cost . . . . .					(31)	(31)
Expected return on plan assets . . . . .		23	10	33		33
Employee contributions . . . . .			1	1	(1)	—
Employer contributions . . . . .	82	10	9	19		101
Actuarial gains (losses) . . . . .		9	(5)	4	(11)	(7)
Benefit payments . . . . .		(7)	(4)	(11)	11	—
Cash costs and unwind of discount on the opening provision for deficit funding for PSPS . . . . .	(41)					(41)
Movement in the provision for deficit funding for PSPS . . . . .	—	—	—	—	—	—
Fair value of plan assets, end of year . . . . .		401	172	573		573
Present value of benefit obligation, end of year . . . . .					(654)	(654)
Provision for deficit funding of PSPS . . . . .	(102)					(102)
Economic basis deficit . . . . .						(183)

	Other schemes					Total Economic basis: net obligations £m
	IAS 19 basis: change in fair value of plan assets	Investments in Prudential insurance policies	Economic basis: total assets	IAS 19 basis: change in present value of benefit obligations		
Fair value of plan assets, beginning of year . . . . .	401	172	573		573	
Present value of benefit obligation, beginning of year . . . . .				(654)	(654)	
Provision for deficit funding for PSPS . .	<u>(102)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(102)</u>	
	(102)	401	172	(654)	(183)	
Service cost — current charge only . . . .				(19)	(19)	
Curtailment credit . . . . .				14	14	
Interest cost . . . . .				(39)	(39)	
Expected return on plan assets . . . . .		26	11	37	37	
Employee contributions . . . . .			1	1	(1)	
Employer contributions . . . . .	79	7	9	16	95	
Actuarial gains (losses) . . . . .		(67)	(31)	(98)	90	
Benefit payments . . . . .		(10)	(5)	(15)	15	
Cash costs and unwind of discount on the opening provision for deficit funding for PSPS . . . . .	(29)				(29)	
Movement in the provision for deficit funding for PSPS . . . . .	(13)				(13)	
Exchange translation difference . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>(4)</u>	<u>(4)</u>	
Fair value of plan assets, end of year . . .		357	157	514	514	
Present value of benefit obligation, end of year . . . . .				(598)	(598)	
Provision for deficit funding of PSPS . . .	(65)				<u>(65)</u>	
Economic basis deficit . . . . .					<u>(149)</u>	

	Other schemes					Total Economic basis: net obligations £m
	IAS 19 basis: change in fair value of plan assets	Investments in Prudential insurance policies	Economic basis: total assets	IAS 19 basis: change in present value of benefit obligations		
Fair value of plan assets, beginning of year . . . . .	357	157	514		514	
Present value of benefit obligation, beginning of year . . . . .				(598)	(598)	
Provision for deficit funding for PSPS . .	<u>(65)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(65)</u>	
	(65)	357	157	(598)	(149)	
Service cost — current charge only . . . .				(11)	(11)	
Interest cost . . . . .				(35)	(35)	
Expected return on plan assets . . . . .		18	9	27	27	
Employee contributions . . . . .			1	(1)		
Employer contributions . . . . .	67	9	9	18	85	
Actuarial gains (losses) . . . . .		6	17	23	(107)	
Benefit payments . . . . .		(11)	(6)	(17)	17	
Cash costs and unwind of discount on the opening provision for deficit funding for PSPS . . . . .	(29)				(29)	
Movement in the provision for deficit funding for PSPS . . . . .	(48)				(48)	
Disposal of Taiwan agency business, including exchange translation differences . . . . .	<u>—</u>	<u>(3)</u>	<u>—</u>	<u>(3)</u>	<u>17</u>	
Fair value of plan assets, end of year . . .		376	187	563	563	
Present value of benefit obligation, end of year . . . . .				(738)	(738)	
Provision for deficit funding of PSPS . . .	(75)				<u>(75)</u>	
Economic basis deficit . . . . .					<u>(250)</u>	

## 7 IAS 19 basis financial position as consolidated

The IAS 19 basis pensions deficit can be summarised as follows:

	2005	2006	2007	2008	2009
	£m	£m	£m	£m	£m
Fair value of plan assets, end of year . . . . .	4,622	4,988	5,150	5,057	5,224
Present value of funded benefit obligation . . . . .	<u>(5,228)</u>	<u>(5,023)</u>	<u>(4,826)</u>	<u>(4,493)</u>	<u>(4,951)</u>
Funded status . . . . .	(606)	(35)	324	564	273
Present value of unfunded obligations (M&G scheme)* . . . . .	<u>(190)</u>	<u>(187)</u>	<u>(189)</u>	<u>(180)</u>	<u>(223)</u>
	(796)	(222)	135	384	50
Effect of the application of IFRIC 14 for pension schemes;					
Derecognition of PSPS' surplus . . . . .	—	(141)	(528)	(728)	(513)
Set up obligation for deficit funding for PSPS . . . . .	—	(143)	(102)	(65)	(75)
Adjustment in respect of investment of PSPS in Prudential policies . . . . .	<u>—</u>	<u>126</u>	<u>140</u>	<u>103</u>	<u>101</u>
Deficit recognised in the statement of financial position . . . . .	<u>(796)</u>	<u>(380)</u>	<u>(355)</u>	<u>(306)</u>	<u>(437)</u>

\* The M&G pension scheme assets are invested in Prudential insurance policies. For IFRS accounting purposes, the M&G scheme is in effect unfunded. Please see above for more details.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Components of net periodic pension cost</b>			
Current service cost . . . . .	(58)	(45)	(34)
Curtailed credit . . . . .	—	44	—
Interest cost . . . . .	(265)	(289)	(277)
Expected return on assets — economic basis . . . . .	309	336	240
Less: expected return on investments of scheme assets in Prudential insurance policies . . . . .	<u>(20)</u>	<u>(22)</u>	<u>(16)</u>
Expected return on assets — IAS 19 basis(†) . . . . .	<u>289</u>	<u>314</u>	<u>224</u>
	<u>(34)</u>	<u>24</u>	<u>(87)</u>
Effect of the application of IFRIC 14 . . . . .	<u>(34)</u>	<u>(71)</u>	<u>30</u>
Pension cost (as referred to in note(I2a)) . . . . .	<u>(68)</u>	<u>(47)</u>	<u>(57)</u>
Actuarial gains and losses — economic basis . . . . .	295	60	(337)
Less: actuarial losses on investments of scheme assets in Prudential insurance policies . . . . .	<u>1</u>	<u>79</u>	<u>8</u>
	<u>296</u>	<u>139</u>	<u>(329)</u>
Effect of the application of IFRIC 14 . . . . .	<u>(298)</u>	<u>(129)</u>	<u>191</u>
Actuarial gains and losses — IAS 19 basis* (as referred to in note(I2a)) . . . . .	<u>(2)</u>	<u>10</u>	<u>(138)</u>
Net periodic pension cost (included within acquisition and other operating expenditure in the income statement) . . . . .	<u>(70)</u>	<u>(37)</u>	<u>(195)</u>

\* Consistent with the derecognition of the Prudential interest in the underlying IAS 19 surplus of PSPS, the effect on the net periodic pension cost for PSPS was to replace the usual IAS 19 pension charges and credits with the cash cost of contribution for ongoing services of active members and also not to report the actuarial gains and losses.

† In determining the expected return on scheme assets for 2007, 2008 and 2009 respectively, the 5.9%, 6.1% and 4.5% rate shown below has been applied to the opening assets.

The long-term expected rate of return has been taken to be the weighted average (by market value) of the long-term expected rates of return on each major asset class shown below:

	<u>2005</u>		<u>2006</u>		<u>2007</u>		<u>2008</u>		<u>2009</u>	
	<u>£m</u>	<u>%</u>								
<b>Scheme assets (IAS 19 basis before effect of IFRIC 14)</b>										
Equity . . . . .	2,376	51	1,432	29	1,332	26	875	17	917	18
Bonds . . . . .	1,593	35	2,185	44	1,299	25	2,619	52	3,587	69
Properties . . . . .	575	12	621	12	583	11	290	6	278	5
Cash-like investments . . . . .	78	2	750	15	1,936	38	1,273	25	442	8
Total . . . . .	<u>4,622</u>	<u>100</u>	<u>4,988</u>	<u>100</u>	<u>5,150</u>	<u>100</u>	<u>5,057</u>	<u>100</u>	<u>5,224</u>	<u>100</u>

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Prospectively for 2010</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>
<b>Long-term expected rate of return</b>				
Equity . . . . .	7.5	7.5	6.8	8.5
Bonds . . . . .	4.8	5.4	4.8	5.3
Properties . . . . .	6.8	6.75	6.05	6.75
Cash . . . . .	<u>5.0</u>	<u>5.5</u>	<u>2.0</u>	<u>4.75</u>
Weighted average long-term expected rate of return . . . . .	<u>5.9</u>	<u>6.1</u>	<u>4.5</u>	<u>5.9</u>

The expected rates of return have been determined by reference to long-term expectations, the carrying value of the assets and equity and other market conditions at the statement of financial position date.

The actual return on scheme assets was a gain £282 million, a loss of £20 million and a gain of £348 million on an IAS 19 basis, for 2007, 2008 and 2009 respectively.

None of the scheme assets included shares in Prudential or property occupied by the Prudential Group.

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m	£m	£m
Fair value of scheme assets, end of year (IAS 19 basis) . . . . .	4,622	4,988	5,150	5,057	5,224
Present value of the benefit obligation, end of year . . . .	<u>(5,418)</u>	<u>(5,210)</u>	<u>(5,015)</u>	<u>(4,673)</u>	<u>(5,174)</u>
Underlying scheme assets in surplus (deficit) of benefit obligation, before the effect of the application of IFRIC 14 . . . . .	<u>(796)</u>	<u>(222)</u>	<u>135</u>	<u>384</u>	<u>50</u>
Experience adjustments on scheme liabilities . . . . .	1	18	(14)	145	76
Percentage of scheme liabilities at 31 December . . . . .	(0.02)%	(0.35)%	0.28%	3.10%	1.47%
Experience adjustments on scheme assets (IAS 19 basis) . . . . .	527	140	(7)	(277)	100
Percentage of scheme assets at 31 December . . . . .	<u>11.42%</u>	<u>2.81%</u>	<u>(0.14)%</u>	<u>(5.48)%</u>	<u>1.91%</u>

The experience adjustments on scheme liabilities in 2008 of a gain of £145 million related mainly to the 'true up' reflecting improvements in data consequent upon the 2008 triennial valuation of PSPS.

Total employer contributions expected to be paid into the Prudential Group defined benefit schemes for the year ending 31 December 2010 £88 million.

## 8 Sensitivity of the pension scheme liabilities of the PSPS, Scottish Amicable Life and M&G pension schemes to key variables

The table below shows the sensitivity of the underlying PSPS, Scottish Amicable Life and M&G pension scheme liabilities at 31 December 2007 of £4,361 million, £454 million and £189 million respectively, at 31 December 2008 of £4,075 million, £398 million and £180 million respectively and 31 December 2009 of £4,436 million, £515 million and £223 million respectively to changes in discount rates and inflation rates.

<u>2007</u>		
<u>Assumption</u>	<u>Change in assumption</u>	<u>Impact on scheme liabilities on IAS 19 basis</u>
Discount rate	Decrease by 0.2% from 5.9% to 5.7%	Increase in scheme liabilities by: PSPS 3.5% Scottish Amicable Life 5.3% M&G 4.8%
Discount rate	Increase by 0.2% from 5.9% to 6.1%	Decrease in scheme liabilities by: PSPS 3.4% Scottish Amicable Life 5.1% M&G 4.5%
Rate of inflation	Decrease by 0.2% from 3.3% to 3.1% with consequent reduction in salary increases	Decrease in scheme liabilities by: PSPS 1.3% Scottish Amicable Life 5.0% M&G 4.4%
<u>2008</u>		
<u>Assumption</u>	<u>Change in assumption</u>	<u>Impact on scheme liabilities on IAS 19 basis</u>
Discount rate	Decrease by 0.2% from 6.1% to 5.9%	Increase in scheme liabilities by: PSPS 3.3% Scottish Amicable Life 4.9% M&G 4.5%
Discount rate	Increase by 0.2% from 6.1% to 6.3%	Decrease in scheme liabilities by: PSPS 3.1% Scottish Amicable Life 4.6% M&G 4.2%
Rate of inflation	Decrease by 0.2% from 3.0% to 2.8% with consequent reduction in salary increases	Decrease in scheme liabilities by: PSPS 0.8% Scottish Amicable Life 4.5% M&G 3.8%

**2009**

<u>Assumption</u>	<u>Change in assumption</u>	<u>Impact on scheme liabilities on IAS 19 basis</u>
Discount rate	Decrease by 0.2% from 5.8% to 5.6%	Increase in scheme liabilities by: PSPS 3.5% Scottish Amicable Life 5.2% M&G 4.9%
Discount rate	Increase by 0.2% from 5.8% to 6.0%	Decrease in scheme liabilities by: PSPS 3.2% Scottish Amicable Life 4.8% M&G 4.9%
Rate of inflation	Decrease by 0.2% from 3.7% to 3.5% with consequent reduction in salary increases	Decrease in scheme liabilities by: PSPS 0.9% Scottish Amicable Life 4.9% M&G 4.5%

The sensitivity of the underlying pension scheme liabilities to changes in discount rates and inflation rates as shown above does not directly equate to an impact on the profit or loss attributable to shareholders or shareholders' equity due to the effect of the application of IFRIC 14 on PSPS and the allocation of a share of the interest in financial position of the PSPS and Scottish Amicable schemes to the PAC with-profits fund as described in note (b)(i)(1) above.

For PSPS, the underlying surplus of the scheme of £528 million, £728 million, and £513 million, as at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, has not been recognised under IFRIC 14. Any change in the underlying scheme liabilities to the extent that it is not sufficient to alter PSPS into a liability in excess of the deficit funding provision will not have an impact on the Prudential Group's results and financial position.

In the event that a change in the PSPS scheme liabilities results in a deficit position for the scheme which is recognisable, the deficit recognised affects the Prudential Group's results and financial position only to the extent of the amounts attributable to shareholder operations. The amounts attributable to the PAC with-profits fund are absorbed by the liability for unallocated surplus and have no direct effect on the profit or loss attributable to shareholders or shareholders' equity. This applies similarly to the Scottish Amicable Scheme, whose deficit has been allocated 50% to the PAC with-profits fund and 50% to the PAC shareholders fund.

## **9 Transfer value of PSPS scheme**

At 31 December 2009, it is estimated that the assets of the scheme are broadly sufficient to cover the liabilities of PSPS on a 'buyout' basis including an allowance for expenses. The 'buyout' basis refers to a basis that might apply in the circumstance of a transfer to another appropriate financial institution. In making this assessment it has been assumed that a more conservative investment strategy applies together with a more prudent allowance for future mortality improvements and no allowance for discretionary pension increases.

### *ii Other pension plans*

The Prudential Group operates various defined contribution pension schemes including schemes in Jackson and Asia. As noted earlier, the cost of the Prudential Group's contributions for continuing operations to these schemes in 2007, 2008 and 2009 respectively, was £28 million, £31 million and £38 million.

## **I3: Share-based payments**

The Prudential Group maintains a number of main share award and share option plans relating to Prudential Shares, which are described below.

The Group Performance Share Plan (GPSP) is the incentive plan in which all executive directors and other senior executives within the Prudential Group can participate. This scheme was established as a replacement for the Restricted Share Plan (RSP) under which no further awards could be made after March 2006. Awards are granted either in the form of a nil cost option, conditional right over shares, or such other form that shall confer to the participant an equivalent economic benefit, with a vesting period of three years. The performance measure for the awards is that Prudential's Total Shareholder Return (TSR) outperforms an index comprising of peer companies. Vesting of the awards between each performance point is on a straight line sliding scale basis. Participants are entitled to the value of reinvested dividends that would have accrued on the shares that vest. Shares are currently

purchased in the open market by a trust for the benefit of qualifying employees. Beginning 2010, newly issued shares will be used in settling the awards that vest and are released.

The RSP was, until March 2006, the Prudential Group's long-term incentive plan for executive directors and other senior executives designed to provide rewards linked to shareholder return. Each year participants were granted a conditional option to receive a number of shares. There was a deferment period of three years at the end of which the award vested to an extent that depended on the performance of the Prudential Group's shares including notional reinvested dividends and on the Prudential Group's underlying financial performance. After vesting, the option may be exercised at zero cost at any time, subject to closed period rules, in the balance of a 10-year period. Shares are purchased in the open market by a trust for the benefit of qualifying employees.

The Business Unit Performance Plan ("BUPP") is an incentive plan created to provide a common framework under which awards would be made to senior employees in the UK, Jackson and Asia including the Chief Executive Officers. Awards made under this plan in 2007, 2008 and 2009 are based on growth in Shareholder Capital Value on the European Embedded Value (EEV) basis with performance measured over three years. Upon vesting of awards made up to 2008, half of the awards are released as shares and the other half released in cash. From 2009 all awards made will be settled in shares after vesting. Participants are entitled to receive the value of reinvested dividends over the performance period for those shares that vest. The growth parameters for the awards are relevant to each region and vesting of the awards between each performance point is on a straight line sliding scale basis.

UK-based employees and executive directors are eligible to participate in the Prudential HM Revenue & Customs (HMRC) approved UK Savings Related Share Option Scheme (SAYE scheme), Republic of Ireland based employees can participate in the equivalent Irish SAYE scheme and the Asia-based executive director can participate in the equivalent International SAYE scheme. The schemes allow employees to save towards the exercise of options over Prudential plc shares, at an option price set at the beginning of the savings period at a discount of up to 20% to the market price. In 2009, the rules governing the SAYE schemes were amended so that savings contracts for seven years were discontinued and employees may now save up to £250 per month for three or five years. On maturity at the end of the set term, participants may exercise their options within six months of the end of the savings period and purchase Prudential plc shares. If an option is not exercised within six months, participants are entitled to a refund of their cash contributions plus interest if applicable under the rules. Shares are issued to satisfy options that 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 other share option schemes operated by Prudential, or which have been issued under any other share incentive scheme of Prudential, to exceed 10% of its ordinary share capital at the proposed date of grant.

UK-based executive directors are also eligible to participate in Prudential's HMRC approved Share Incentive Plans which allows all employees based in the UK insurance business and the Group Head Office to purchase shares of Prudential plc (partnership shares) on a monthly basis out of gross salary. For every four partnership shares bought, an additional matching share is awarded, purchased on the open market. Dividend shares accumulate while the employee participates in the plan. Partnership shares may be withdrawn from the scheme at any time. If the employee withdraws from the plan within five years, the matching shares are forfeited and if within three years, dividend shares are forfeited.

Jackson operates a performance-related share award which, subject to the prior approval of the Jackson Remuneration Committee, may grant share awards to eligible Jackson employees in the form of a contingent right to receive shares or a conditional allocation of shares. These share awards have vesting periods of four years and are at nil cost to the employee. Award holders do not have any right to dividends or voting rights attaching to the shares. The shares are held in the employee share trust in the form of American Depository Receipts which are tradable on the New York Stock Exchange.

The Prudential Corporation Asia Long-Term Incentive Plan (PCA LTIP) is an incentive plan created in 2008 for senior employees and senior executives based in Asia to replace the Asia Business Unit Performance Plan (BUPP). Awards under the new PCA LTIP will vest after three years subject to the employee being in employment at the time of vesting without any performance conditions. Awards are discretionary and on a year by year basis determined by Prudential Corporation Asia's full year financial results and the employee's contribution to the business in each case for the year prior to the award being made. All awards will be in Prudential shares except for countries where share awards are not feasible due to securities and/or tax reasons, where awards will be replaced by the cash value of the shares that would otherwise have been transferred.

Certain senior executives have annual incentive plans with awards paid partly in cash and partly in deferred shares. The portion of any award made in the form of awards of shares is deferred for three years with the release of shares

subject to close periods. The shares are held in the employee share trust and shares equivalent to dividends otherwise payable will accumulate for the benefit of award holders during the deferral period up to the release date.

In addition, there are other share awards including the Prudential Corporation Asia Deferred Bonus Plan (PCADBP), Prudential Capital Deferred Bonus Plan (PruCap DBP) and other arrangements. There are no performance conditions attaching to these deferred bonus plans and an award vests in full subject to the individual being employed by Prudential at the end of the vesting period. The other arrangements relate to various awards that have been made without performance conditions to individual employees, typically in order to facilitate recruitment of senior employees where awards from their previous employers may be forfeited on leaving.

Movements in share options outstanding under the Prudential Group's share-based compensation plans relating to Prudential plc shares during 2007, 2008 and 2009 were as follows:

Options outstanding (including conditional options)	2007		2008		2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	millions	£	millions	£	millions	£
Beginning of year: . . . . .	16.5	2.47	14.5	2.57	12.7	2.44
Granted . . . . .	4.0	2.69	6.9	3.28	14.0	2.28
Exercised . . . . .	(1.9)	3.42	(3.5)	2.73	(1.7)	1.05
Forfeited . . . . .	(1.4)	1.37	(1.5)	0.69	(0.8)	2.48
Expired . . . . .	(2.7)	2.13	(3.7)	4.94	(5.3)	3.77
End of year . . . . .	<u>14.5</u>	<u>2.57</u>	<u>12.7</u>	<u>2.44</u>	<u>18.9</u>	<u>2.07</u>
Options immediately exercisable, end of year . . . . .	0.2	3.35	0.6	2.29	0.3	4.16

The weighted average share price of Prudential plc for the year ended 31 December 2007, 31 December 2008 and 31 December 2009 was £7.15, £5.46 and £4.17 respectively.

Movements in share awards outstanding under the Prudential Group's share-based compensation plans relating to Prudential plc shares at 31 December 2007, 31 December 2008 and 31 December 2009 were as follows:

Awards outstanding	2007	2008	2009
	Number of awards	Number of awards	Number of awards
	millions	millions	millions
Beginning of year: . . . . .	6.6	8.0	8.6
Granted . . . . .	3.8	3.5	7.9
Exercised . . . . .	(1.3)	(1.7)	(2.2)
Forfeited . . . . .	(1.1)	(0.9)	(0.8)
Expired . . . . .	—	(0.3)	(1.0)
End of year . . . . .	<u>8.0</u>	<u>8.6</u>	<u>12.5</u>

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2007.

Range of exercise prices	Outstanding			Exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise prices	Number exercisable	Weighted average exercise prices
	millions	years	£	millions	£
Between £0 and £1. . . . .	5.5	8.6	—	—	—
Between £1 and £2. . . . .	—	—	—	—	—
Between £2 and £3. . . . .	2.7	1.3	2.66	—	—
Between £3 and £4. . . . .	1.2	1.7	3.62	0.2	3.37
Between £4 and £5. . . . .	2.9	2.7	4.62	—	—
Between £5 and £6. . . . .	2.2	3.5	5.62	—	—
Between £6 and £7. . . . .	—	0.9	6.55	—	6.95
Between £7 and £8. . . . .	—	—	—	—	—
	<u>14.5</u>	<u>4.7</u>	<u>2.57</u>	<u>0.2</u>	<u>3.35</u>

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2008.

<u>Range of exercise prices</u>	<u>Outstanding</u>			<u>Exercisable</u>	
	<u>Number outstanding</u>	<u>Weighted average remaining contractual life</u>	<u>Weighted average exercise prices</u>	<u>Number exercisable</u>	<u>Weighted average exercise prices</u>
	millions	years	£	millions	£
Between £0 and £1. . . . .	5.9	8.3	—	0.3	—
Between £1 and £2. . . . .	—	—	—	—	—
Between £2 and £3. . . . .	0.3	1.7	2.66	0.0	2.66
Between £3 and £4. . . . .	0.5	1.4	3.56	0.0	3.65
Between £4 and £5. . . . .	4.6	3.3	4.45	0.3	4.07
Between £5 and £6. . . . .	1.4	2.8	5.59	—	—
Between £6 and £7. . . . .	0.0	0.4	6.17	0.0	6.17
Between £7 and £8. . . . .	—	—	—	—	—
	<u>12.7</u>	<u>5.5</u>	<u>2.44</u>	<u>0.6</u>	<u>2.29</u>

The following table provides a summary of the range of exercise prices for Prudential plc options (including conditional options) outstanding at 31 December 2009.

<u>Range of exercise prices</u>	<u>Outstanding</u>			<u>Exercisable</u>	
	<u>Number outstanding</u>	<u>Weighted average remaining contractual life</u>	<u>Weighted average exercise prices</u>	<u>Number exercisable</u>	<u>Weighted average exercise prices</u>
	millions	years	£	millions	£
Between £0 and £1. . . . .	6.7	8.6	—	0.0	—
Between £1 and £2. . . . .	—	—	—	—	—
Between £2 and £3. . . . .	10.0	3.6	2.88	—	—
Between £3 and £4. . . . .	0.1	1.0	3.62	0.1	3.43
Between £4 and £5. . . . .	1.5	3.0	4.37	0.2	4.73
Between £5 and £6. . . . .	0.6	1.9	5.60	0.0	5.65
Between £6 and £7. . . . .	—	—	—	—	—
Between £7 and £8. . . . .	—	—	—	—	—
	<u>18.9</u>	<u>5.2</u>	<u>2.07</u>	<u>0.3</u>	<u>4.16</u>

The years shown above for weighted average remaining contractual life include the time period from end of vesting period to expiration of contract.

The weighted average fair values of Prudential plc options and awards granted during the period are as follows:

<u>2007</u>			<u>2008</u>			<u>2009</u>		
<u>Weighted average fair value</u>			<u>Weighted average fair value</u>			<u>Weighted average fair value</u>		
<u>RSP and GPSP</u>	<u>Other options</u>	<u>Awards</u>	<u>GPSP</u>	<u>Other options</u>	<u>Awards</u>	<u>RSP and GPSP</u>	<u>Other options</u>	<u>Awards</u>
£	£	£	£	£	£	£	£	£
<u>4.78</u>	<u>2.55</u>	<u>7.33</u>	<u>4.16</u>	<u>2.14</u>	<u>5.69</u>	<u>3.52</u>	<u>1.55</u>	<u>4.67</u>

The fair value amounts relating to all options including conditional nil cost options above were determined using the Black-Scholes and the Monte Carlo option-pricing models using the following assumptions:

	2007		2008		2009	
	GPSP	Other options	GPSP	Other options	GPSP	Other Options
Dividend yield (%) . . . . .	2.32	2.32	3.60	3.60	4.41	4.41
Expected volatility (%) . . . . .	28.90	27.17	30.87	34.67	56.21	60.55
Risk-free interest rate (%) . . . . .	5.46	5.25	4.23	4.46	1.92	2.15
Expected option life (years) . . . . .	3.00	3.48	3.00	3.74	3.00	3.67
Weighted average exercise price (£) . . . . .	—	5.62	—	4.74	—	2.96
Weighted average share price (£) . . . . .	<u>7.52</u>	<u>7.47</u>	<u>6.63</u>	<u>6.16</u>	4.83	3.82

Under IFRS, compensation costs for all share-based compensation plans are determined using the Black-Scholes model and the Monte Carlo model. Share options and awards are valued using the share price at the date of grant. The compensation costs for all awards and options are recognised in net income over the plans' respective vesting periods. The Prudential Group uses the Black-Scholes model to value all options and awards other than the GPSP, for which the Prudential Group uses a Monte Carlo model in order to allow for the impact of the TSR performance conditions. These models are used to calculate fair values for share options and awards at the grant date based on the quoted market price of the stock at the measurement date, the amount, if any, that the employees are required to pay, the dividend yield, expected volatility, risk-free interest rates and exercise prices.

The expected volatility is measured as the standard deviation of expected share price returns based on statistical analysis of daily share prices over a period up to the grant date equal to the expected life of options. Risk-free interest rates are UK gilt rates with projections for three, five and seven year terms to match corresponding vesting periods. Dividend yield is determined as the average yield over the year of grant and expected dividends are not incorporated into the measurement of fair value. For the GPSP, volatility and correlation between Prudential and an index constructed from a simple average of the TSR growth of 11 companies is required. For grants in 2007, an average index volatility and correlation of 18% and 72% respectively, were used. For grants in 2008, an average index volatility and correlation of 26% and 82% respectively, were used. For grants in 2009 an average index volatility and correlation of 40% and 83%, respectively, were used. Changes to the subjective input assumptions could materially affect the fair value estimate.

When options are granted or awards made to employees, an estimate is made of what percentage is more than likely to vest, be forfeited, lapse or cancelled based on historical information. Based on these estimates, compensation expense to be accrued at that date is calculated and amortised over the vesting period. For early exercises of options or release of awards due to redundancy, death or resignation, the compensation expense is immediately recognised and for forfeitures due to employees leaving the Prudential Group, any previously recognised expense is reversed. However, if an employee loses their award because of the Prudential Group's failure to meet the performance criteria, previously recognised expense is not reversed.

During 2007, 2008 and 2009, the Prudential Group granted share options to certain non-employee independent financial advisors. Those options were measured using the Black-Scholes option pricing model with assumptions consistent with those of other share options. These transactions were measured using an option model because the Prudential Group does not receive a separate and measurable benefit from those non-employees in exchange for the options granted. As such, the fair value of the options themselves is more readily determinable than the services received in return.

**c Total share-based payment expense**

Total expense recognised in the consolidated financial information related to share-based compensation is as follows:

	2007	2008	2009
	£m	£m	£m
Share-based compensation expense . . . . .	28	23	37
Amount accounted for as equity-settled . . . . .	19	27	29
Carrying value at 31 December of liabilities arising from share-based payment transactions . .	18	12	13
Intrinsic value of above liabilities for which rights had vested at 31 December . . . . .	<u>4</u>	<u>4</u>	<u>7</u>

#### 14: Key management and directors' remuneration

##### a Key management remuneration

Key management principally constitutes the directors of Prudential plc as they have authority and responsibility for planning, directing and controlling the activities of the Prudential Group.

Total key management remuneration amounts to £15,670,000, £18,122,000 and £20,989,000, for 2007, 2008 and 2009 respectively. This comprises salaries and short-term benefits of £9,496,000, £10,425,000 and £11,570,000, for 2007, 2008 and 2009 respectively, post-employment benefits of £967,000, £1,003,000 and £1,132,000, for 2007, 2008 and 2009 respectively, leaving benefits of £nil, £507,000 and £915,000, for 2007, 2008 and 2009 respectively, and share-based payments of £5,207,000, £6,187,000 and £7,372,000, for 2007, 2008 and 2009 respectively.

Post-employment benefits comprise the change in the transfer value of the accrued benefit relating to directors' defined benefit pension schemes in the year and the total contributions made to directors' other pension arrangements.

The share-based payments charge is the sum of £3,456,000, £4,624,000 and £5,270,000, for 2007, 2008 and 2009 respectively, which is determined in accordance with IFRS 2, 'Share-Based Payments' (see note I3) and £1,751,000, £1,563,000 and £2,102,000, for 2007, 2008 and 2009 respectively, of deferred share awards.

##### b Directors' remuneration

	2007 £000					
	Salary/ Fees	Bonus	Benefits*	Cash supplements for pension purposes†	Total Emoluments 2007	Value of anticipated releases from LTIPs in respect of performance periods ending 31 December 2007§
<b>Chairman</b>						
Sir David Clementi . . . . .	508	—	41	127	676	—
<b>Executive directors</b>						
Philip Broadley . . . . .	567	590	56	153	1,366	814
Clark Manning (notes i,ii) . . . . .	500	1,724	16	—	2,240	2,933
Michael McLintock(note iii) . . . . .	320	1,780	48	—	2,148	1,280
Mark Norbom (until 14 December 2006)(note iv) . . . . .	—	—	—	—	—	—
Nick Prettejohn (note v) . . . . .	615	615	54	80	1,364	—
Barry Stowe (notes vi, vii) . . . . .	500	500	140	125	1,265	—
Mark Tucker(note viii) . . . . .	907	1,134	59	227	2,327	1,588
Total executive directors . . . . .	3,409	6,343	373	585	10,710	6,615
<b>Non-executive directors</b>						
Sir Winfried Bischoff (from 2 August 2007) . . . . .	25	—	—	—	25	—
Keki Dadiseth(note ix) . . . . .	81	—	—	—	81	—
Michael Garrett . . . . .	66	—	—	—	66	—
Ann Godbehere (from 2 August 2007) . . . . .	29	—	—	—	29	—
Bridget Macaskill . . . . .	79	—	—	—	79	—
Roberto Mendoza (until 17 May 2007) . . . . .	24	—	—	—	24	—
Kathleen O'Donovan . . . . .	98	—	—	—	98	—
James Ross . . . . .	98	—	—	—	98	—
Lord Turnbull . . . . .	73	—	—	—	73	—
Total non-executive directors . . . . .	573	—	—	—	573	—
<b>Overall total</b> . . . . .	<b>4,490</b>	<b>6,343</b>	<b>414</b>	<b>712</b>	<b>11,959</b>	<b>6,615</b>

\* Benefits include, where provided, cash allowances for cars, the use of a car and driver, medical insurance, security arrangements, expatriate benefits.

† Pension supplements that are paid in cash as per pension policy are included in the table. The pension policy and pension arrangements for current executive directors are set out subsequently.

§ Value of anticipated LTIP releases is the total of cash paid plus, for shares released, the value of the released shares based on the share price at 31 December 2007. All executive directors participate in long-term incentive plans and the details of share releases from awards with a performance period ending 31 December 2007 are provided in the footnotes to the table on share awards. Executive directors' participation in all-employee plans are set out subsequently.

#### Notes

- (i) In 2007 it was assumed that for Clark Manning a deferred share award from the 2007 annual bonus valued at \$200,000 would be made. This is included in the 2007 bonus figure.
- (ii) Clark Manning's bonus figure excludes a contribution of £6,745, from a profit sharing plan, which has been made into a 401K retirement plan. This is included in the table on pension contributions in the section 'Directors' pensions and life assurances'.
- (iii) Michael McLintock's 2007 annual incentive contains a deferral element. As a result of a review of remuneration structures of Michael McLintock, an additional award was made under the current LTIP in 2007. Also, in 2007 it was assumed that a deferred share award from the 2007 annual bonus valued at £640,000 would be made. This is included in the 2007 bonus figure.
- (iv) Mark Norbom's directorship with Prudential plc ended on 14 December 2006 but he remained in employment until 31 January 2007. In connection with the termination of his employment he received a payment of £291,000 and nine successive monthly payments of £55,792. He also received private medical and life cover, school fees and club memberships until 31 October 2007 and housing benefits until 5 May 2007.
- (v) In 2007 it was assumed that for Nick Prettejohn a deferred share award from the 2007 annual bonus valued at £307,625 would be made. This is included in the 2007 bonus figure.
- (vi) In 2007 it was assumed that for Barry Stowe a deferred share award from the 2007 annual bonus valued at £250,000 would be made. This is included in the 2007 bonus figure.
- (vii) Barry Stowe's benefits include those relating to his expatriate status including costs of £88,288 related to housing.
- (viii) In 2007 it was assumed that for Mark Tucker a deferred share award from the 2007 annual bonus valued at £453,600 would be made. This is included in the 2007 bonus figure.
- (ix) Keki Dadiseth was paid allowances totalling £9,400 in 2007 in respect of his accommodation expenses in London whilst on Prudential business, in lieu of reimbursing hotel costs as is the usual practice for directors who are not resident in the UK.
- (x) In aggregate, total fees paid to Directors amounted to £573,000 in 2007.

	2008 £000					
	Salary/ Fees	Bonus	Benefits*	Cash supplements for pension purposes †	Total Emoluments 2008	Value of anticipated releases from LTIPs in respect of performance periods ending 31 December 2008§
<b>Chairman</b>						
Sir David Clementi (note i) . . . . .	538	—	43	134	715	—
<b>Executive directors</b>						
Philip Broadley (until 15 May 2008)(note ii) . . . . .	236	118	22	64	440	655
Clark Manning (note iii) . . . . .	567	1,177	24	—	1,768	929
Michael McLintock(note iv) . . . . .	320	1,780	54	—	2,154	881
Nick Prettejohn(note v) . . . . .	650	650	59	85	1,444	577
Barry Stowe(notes vi, vii) . . . . .	550	337	182	138	1,207	—
Tidjane Thiam (from 25 March 2008)(notes viii, ix, x) . . . . .	505	650	59	30	1,244	—
Mark Tucker . . . . .	975	942	66	244	2,227	1,297
Total executive directors . . . . .	<u>3,803</u>	<u>5,654</u>	<u>466</u>	<u>561</u>	<u>10,484</u>	<u>4,339</u>
<b>Non-executive directors</b>						
Sir Winfried Bischoff (from 2 August 2007). . . . .	63	—	—	—	63	—
Keki Dadiseth(note xi) . . . . .	73	—	—	—	73	—
Michael Garrett . . . . .	73	—	—	—	73	—
Ann Godbehere . . . . .	81	—	—	—	81	—
Bridget Macaskill . . . . .	86	—	—	—	86	—
Harvey McGrath (from 1 September 2008)(note xii) . . . . .	167	—	—	—	167	—
Kathleen O'Donovan . . . . .	108	—	—	—	108	—
James Ross . . . . .	101	—	—	—	101	—
Lord Turnbull . . . . .	81	—	—	—	81	—
Total non-executive directors . . . . .	<u>833</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>833</u>	<u>—</u>
<b>Overall total</b> . . . . .	<u>5,174</u>	<u>5,654</u>	<u>509</u>	<u>695</u>	<u>12,032</u>	<u>4,339</u>

\* Benefits include, where provided, cash allowances for cars, the use of a car and driver, medical insurance, security arrangements, expatriate benefits.

† Pension supplements that are paid in cash are included in the table. The pension policy and pension arrangements for current executive directors are set out subsequently.

§ Value of anticipated LTIP releases is the total of cash paid plus, for shares released, the value of the released shares based on the share price at 31 December 2008. All executive directors participate in long-term incentive plans and the details of share releases from awards with a performance period ending 31 December 2008 are provided in the footnotes to the table on share awards. Executive directors' participation in all-employee plans are set out subsequently.

#### Notes

- (i) Sir David Clementi was Chairman until 31 December 2008 and remained an employee until 31 January 2009.
- (ii) Philip Broadley resigned in 2007. In view of his flexibility in agreeing a leaving date after the 2008 Annual General Meeting and for his agreement to act as a consultant for six months post his date of leaving, he was provided with the following:
- a total payment of £507,105 paid in two tranches in June and December 2008;
  - medical insurance and life assurance cover for six months after his leaving date; and
  - treatment as a 'good leaver' in respect of his outstanding share awards. The deferred share awards under his 2006 and 2007 annual incentive plans were released on his leaving. His outstanding long-term incentive awards will vest according to the rules of the plans in the same way as other recipients of awards, but pro-rated where appropriate for the time worked during the performance period.
- All of these payments after June 2008 were subject to his continuing to be available for consultancy for six months after his leaving date and subject to his compliance with non-solicitation and confidentiality conditions.
- (iii) Clark Manning's bonus figure excludes a contribution of US\$13,800 from a profit sharing plan, which has been made into a 401K retirement plan. This is included in the table on pension contributions in the section 'Directors' pensions and life assurances'.

- (iv) In 2008 it was assumed that for Michael McLintock a deferred share award from the 2008 annual bonus valued at £640,000 would be made. This is included in the 2008 bonus figure.
- (v) In 2008 it was assumed that for Nick Prettejohn a deferred share award from the 2008 annual bonus valued at £325,000 would be made. This is included in the 2008 bonus figure.
- (vi) In 2008 it was assumed that for Barry Stowe a deferred share award from the 2008 annual bonus valued at £62,013 would be made. This is included in the 2008 bonus figure.
- (vii) Barry Stowe's benefits primarily relate to his expatriate status including costs of £91,829 related to housing, £34,113 for children's education and £21,165 for home leave.
- (viii) On appointment, Tidjane Thiam was provided with a guarantee that his 2008 bonus would not be less than 100% of salary.
- (ix) In 2008 it was assumed that for Tidjane Thiam a deferred share award from the 2008 annual bonus valued at £325,000 would be made. This is included in the 2008 bonus figure.
- (x) In addition to the 2008 bonus disclosed in the table above, Tidjane Thiam received a payment of £650,631 to compensate for the loss of 2007 bonus and in lieu of 2005 awards which were due to vest in March 2008.
- (xi) Keki Dadiseth was paid allowances totalling £12,063 in 2008 in respect of his accommodation expenses in London whilst on Prudential's business, in lieu of reimbursing hotel costs as is the usual practice for directors who are not resident in the UK.
- (xii) Harvey McGrath joined Prudential on 1 September 2008 and became Chairman on 1 January 2009
- (xiii) In aggregate, total fees paid to Directors amounted to £833,000 in 2008

							2009 £000
	Salary/ fees	Bonus	Benefits*	Cash supplements for pension purposes †	Other cash payments	Total Emoluments 2009	Value of anticipated releases from LTIPs in respect of performance periods ending at 31 Dec 2009§
<b>Chairman</b> . . . . .							
Harvey McGrath . . . . .	500	—	42	—	—	542	—
<b>Executive directors</b> . . . . .							
Rob Devey (from 16 November 2009) (note i) . . . . .	69	600	138	1	—	808	—
Clark Manning (note ii) . . . . .	696	2,028	29	—	—	2,753	1,223
Michael McLintock (note iii) . . . . .	320	1,750	53	6	—	2,129	2,572
Nic Nicandrou (from 28 October 2009) (note iv) . . . . .	98	550	5	1	—	654	—
Nick Prettejohn (note v) . . . . .	488	505	40	63	607	1,703	763
Barry Stowe (note vi) . . . . .	646	618	262	162	—	1,688	1,098
Tidjane Thiam (note vii) . . . . .	763	1,056	49	87	—	1,955	—
Mark Tucker (note viii) . . . . .	731	841	99	183	308	2,162	1,731
Total executive directors . . . . .	<u>3,811</u>	<u>7,948</u>	<u>675</u>	<u>503</u>	<u>915</u>	<u>13,852</u>	<u>7,387</u>
<b>Non-executive directors</b> . . . . .							
Sir Winfried Bischoff (note ix) . . . . .	47	—	—	—	—	47	—
Keki Dadiseth (note x) . . . . .	86	—	—	—	—	86	—
Michael Garrett . . . . .	77	—	—	—	—	77	—
Ann Godbehere . . . . .	94	—	—	—	—	94	—
Bridget Macaskill . . . . .	89	—	—	—	—	89	—
Kathleen O'Donovan . . . . .	109	—	—	—	—	109	—
James Ross . . . . .	107	—	—	—	—	107	—
Lord Turnbull . . . . .	87	—	—	—	—	87	—
Total non-executive directors . . . . .	<u>696</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>696</u>	<u>—</u>
<b>Overall total</b> . . . . .	<u>5,007</u>	<u>7,948</u>	<u>717</u>	<u>503</u>	<u>915</u>	<u>15,090</u>	<u>7,387</u>

\* Benefits include where provided the use of a car and driver, medical insurance, security arrangements and expatriate benefits.

† Pension supplements that are paid in cash are included in the table. The policy on pensions is described in the section on 'Pensions and long-term savings policy'. The pension and long-term savings arrangements for current executive directors are described in the section on 'Directors' pensions and life assurance'.

§ Value of anticipated LTIP releases is the total of cash paid plus, for shares released, the value of the released shares based on the share price at 31 December 2009. All executive directors participate in long-term incentive plans and the details of share releases from awards with a performance period ending 31 December 2009 are provided in the footnote to the tables on share awards. 2009 figures include deferred share awards made from 2009 annual incentive plans which are detailed in the section 'Other share awards'.

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- (i) As part of Rob Devey's appointment terms, it was agreed that any bonus award for Rob would be assessed as if he had been in employment for the whole of 2009. A deferred share award from the 2009 annual bonus valued at £240,000 has been made to Rob. This is included in the 2009 bonus figure. Actual costs reimbursed to Rob as part of his relocation arrangements are included in the benefits figure. It should be noted that Rob elected not to receive his cash supplement for pension purposes in full during 2009. It is anticipated that the Company will make a request to the Trustees of the Alternative Retirement Benefit Scheme during 2010 to accept a contribution for an amount equivalent to this supplement.
  - (ii) Clark Manning's bonus figure excludes a contribution of \$14,700 from a profit sharing plan which has been made into a 401K retirement plan. This is included in the table on pension contributions. A deferred share award from the 2009 annual bonus valued at \$476,250 has been made to Clark. This is included in the 2009 bonus figure.
  - (iii) For Michael McLintock a deferred share award from the 2009 annual bonus valued at £625,000 was made. This is included in the 2009 bonus figure.
  - (iv) As part of Nic Nicandrou's appointment terms, it was agreed that any bonus award for Nic would be assessed as if Nic had been in employment for the whole of 2009. A deferred share award from the 2009 annual bonus valued at £220,000 was made to Nic. This is included in the 2009 bonus figure. Nic has not yet been reimbursed for any relocation expenses. It should be noted that Nic elected not to receive his cash supplement for pension purposes in full during 2009. It is anticipated that the Company will make a request to the Trustees of the Long Term Savings Plan during 2010 to accept a contribution for an amount equivalent to this supplement.
  - (v) Nick Prettejohn's 2009 annual bonus payment has been prorated for length of service during the year and is based on performance outcomes achieved at the end of 2009. This bonus was fully paid in cash in March 2010. The figure in the 'Other cash payments' column reflects a termination payment that was agreed as part of his leaving arrangements which was paid in instalments on 13 October 2009 and 11 January 2010.
  - (vi) For Barry Stowe a deferred share award from the 2009 annual bonus valued at HK\$2,248,852 has been made. This is included in the 2009 bonus figure. Barry's benefits primarily relate to his expatriate status including costs of £148,051 for housing, £41,528 for children's education and £32,607 for home leave.
  - (vii) Tidjane Thiam's 2009 annual bonus outcome was determined taking into account the period of time he was remunerated as Chief Financial Officer and Group Chief Executive. For Tidjane a deferred share award from the 2009 annual bonus valued at £528,137 has been made. This is included in the 2009 bonus figure.
  - (viii) As part of Mark Tucker's remuneration arrangements following his resignation from Prudential, it was agreed that his 2009 annual bonus payment would be prorated based on length of service during the year and paid at a target level of performance. The figure in the 'Other cash payments' column reflects a termination payment that was agreed as part of his leaving arrangements and paid on 11 January 2010.
  - (ix) Sir Winfried Bischoff left Prudential on 15 September 2009.
  - (x) Keki Dadiseth was paid allowances totalling £5,398 in 2009 in respect of his accommodation expenses in London whilst on Prudential business as is the usual practice for directors who are not resident in the UK.
  - (xi) In aggregate, total fees paid to Directors amounted to £696,000 in 2009.

#### ***Executive directors' non-executive director earnings***

Executive directors who are released to serve as non-executive directors of other external companies retain the earnings resulting from such duties.

In 2007, Michael McLintock earned £48,542 from an external company. Other directors served as non-executive directors on the boards of companies in the educational and cultural sectors without receiving a fee for those services.

In 2008, Tidjane Thiam earned 27,000 euros and Michael McLintock earned £38,333 from external companies. Other directors served as non-executive directors on the boards of companies in the educational and cultural sectors without receiving a fee for those services.

In 2009, Tidjane Thiam earned 15,000 euros and Michael McLintock earned £42,500 from external companies. Tidjane Thiam no longer has any paid external non-executive directorships. Some directors also served as non-executive directors on the boards of companies in the educational and cultural sectors without receiving a fee for those services.

**Directors' outstanding long-term incentive awards**

Plan name	Year of initial award	Conditional share awards outstanding at 1 Jan (Number of shares)	Conditional awards in the year (Number of shares)	Market price at date of original award (pence)	Releases or rights granted upon vesting in 2008 (Number of shares)	Conditional share awards outstanding 31 Dec 2008 (Number of shares)	Conditional awards in the year (Number of shares)	Market price at date of original award (pence)	Releases or rights granted upon vesting in 2009 (Number of shares)	Conditional awards in the year (Number of shares)	Market price at date of original award (pence)	Releases or rights granted upon vesting in 2009 (Number of shares)	Conditional awards in the year (Number of shares)	Market price at date of original award (pence)	Scrip dividend equivalents on vested shares (Number of shares released)	Rights exercised in 2009	Rights based in 2009	Conditional share awards outstanding at 31 Dec (Number of shares)	Date of end of performance period
<b>Philip Broadley</b>																			
Restricted Share Plan	2004	210,713	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 06
Restricted Share Plan	2005	182,983	—	683.00	114,365	182,983(2)	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 07
Group Performance Share Plan	2006	170,127	—	—	—	170,127(3)	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 08
Group Performance Share Plan	2007	—	147,559	745.00	—	147,559(4)	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 09
		563,823	147,559	—	—	500,669	—	—	—	114,365	—	—	—	—	—	—	—	—	
<b>Rob Devey</b>																			
Group Performance Share Plan	2009	—	—	—	—	—	—	—	—	—	639	—	—	—	—	—	—	120,898	31 Dec 11
Business Unit Performance Plan (share element)	2009	—	—	—	—	—	—	—	—	—	639	—	—	—	—	—	—	120,897	31 Dec 11
		—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	241,795	
<b>Clark Manning</b>																			
Restricted Share Plan	2004	196,174	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 06
Restricted Share Plan	2005	163,352	—	683.00	102,095	163,352(2)	—	683.00	102,095	—	—	—	—	—	—	—	—	—	31 Dec 07
Group Performance Share Plan	2006	241,415	—	—	—	241,415(3)	—	—	—	—	—	—	—	—	18,259	223,067	18,348	—	31 Dec 08
Business Unit Performance Plan (share element)	2006	120,707	—	—	—	120,707	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 08
Group Performance Share Plan	2007	—	191,140	745.00	—	191,140(4)	—	—	—	—	—	—	—	—	—	—	—	191,140	31 Dec 09
Business Unit Performance Plan (share element)	2007	—	95,570	745.00	—	95,570	—	—	—	—	—	—	—	—	—	—	—	95,570	31 Dec 09
Group Performance Share Plan	2008	—	—	—	—	—	—	674.50	—	—	—	—	—	—	—	—	—	182,262	31 Dec 10
Business Unit Performance Plan (share element)	2008	—	—	—	—	—	—	674.50	—	—	—	—	—	—	—	—	—	91,131	31 Dec 10
Group Performance Share Plan	2009	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 11
Business Unit Performance Plan (share element)	2009	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	468,476	31 Dec 11
		721,648	286,710	—	—	812,184	273,393	—	—	—	—	—	—	—	18,259	223,067	139,055	922,225	
<b>Nic Nicandrou</b>																			
Group Performance Share Plan	2009	—	—	—	—	—	—	—	—	—	639	—	—	—	—	—	—	316,328	31 Dec 11
		—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	316,328	
<b>Michael McLintock</b>																			
Restricted Share Plan	2004	67,429	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 06
Restricted Share Plan	2005	58,555	—	—	—	58,555(2)	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 07
Group Performance Share Plan	2006	64,199	—	—	—	64,199(3)	—	—	36,597	—	—	—	—	—	4,852	59,319	4,880	—	31 Dec 08
Group Performance Share Plan	2007	—	52,040	745.00	—	52,040(4)	—	—	—	—	—	—	—	—	—	—	—	52,040	31 Dec 09
Group Performance Share Plan	2008	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 10
Group Performance Share Plan	2009	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	92,022	31 Dec 11
		190,183	52,040	—	—	174,794	48,330	—	—	—	—	—	—	—	4,852	59,319	4,880	164,569	

Plan name	Year of initial award	Conditional share awards outstanding Jan 2007 (Number of shares)	Market price at original award (pence)	Releases or rights (options) granted upon vesting in 2007 (Number of shares)	Conditional share awards outstanding 31 Dec 2007 (Number of shares)	Market price at original award (pence)	Releases or rights (options) granted upon vesting in 2008 (Number of shares)	Conditional share awards outstanding 31 Dec 2008 (Number of shares)	Market price at original award (pence)	Rights exercised in 2008 (Number of shares)	Conditional share awards outstanding 31 Dec 2008 (Number of shares)	Market price at original award (pence)	Scrip dividend equivalents on vested shares (Number of shares released)	Rights exercised in 2009 (Number of shares)	Conditional share awards outstanding 31 Dec 2009 (Number of shares)	Date of end of performance period
<b>Mark Norborn</b>																
Restricted Share Plan . . . . .	2004	200,177	—	—	—	—	—	—	—	—	—	—	—	—	—	31 Dec 06
Restricted Share Plan . . . . .	2005	182,983	—	—	(5)	—	—	—	—	—	—	—	—	—	—	31 Dec 07
Group Performance Share Plan . . . . .	2006	144,648	—	—	(5)	—	—	—	—	—	—	—	—	—	—	31 Dec 08
Business Unit Performance Plan (share element) . . . . .	2006	72,324	—	—	(5)	—	—	—	—	—	—	—	—	—	—	31 Dec 08
		600,132	—	—	—	—	—	—	—	—	—	—	—	—	—	—
<b>Nick Prettejohn</b>																
Group Performance Share Plan . . . . .	2006	149,964	—	—	149,964(3)	—	—	149,964(6)	—	—	11,341	138,566	11,398	—	—	31 Dec 08
Business Unit Performance Plan (share element) . . . . .	2006	74,982	—	—	74,982	—	—	74,982(7)	—	—	—	—	74,982	—	—	31 Dec 08
Group Performance Share Plan . . . . .	2007	—	130,071	745,00	130,071(4)	—	—	130,071	—	—	130,071	—	—	130,071	—	31 Dec 09
Business Unit Performance Plan (share element) . . . . .	2007	—	65,035	745,00	65,035	—	—	65,035	—	—	65,035	—	—	65,035	—	31 Dec 09
Group Performance Share Plan . . . . .	2008	—	—	—	—	127,622	674,50	127,622	—	—	127,622	—	—	127,622	—	31 Dec 10
Business Unit Performance Plan (share element) . . . . .	2008	—	—	—	—	63,811	674,50	63,811	—	—	63,811	—	—	63,811	—	31 Dec 10
Group Performance Share Plan . . . . .	2009	—	—	—	—	—	—	—	—	—	—	—	—	242,997	—	31 Dec 11
Business Unit Performance Plan (share element) . . . . .	2009	—	—	—	—	—	—	—	—	—	—	—	—	242,997	—	31 Dec 11
		224,946	195,106	—	420,052	191,433	—	611,485	485,994	—	11,341	138,566	86,380	872,533	—	—
<b>Barry Stowe</b>																
Group Performance Share Plan . . . . .	2007	—	105,706	745,00	105,706(4)	—	—	105,706	—	—	105,706	—	—	—	105,706	31 Dec 09
Business Unit Performance Plan (share element) . . . . .	2007	—	52,853	745,00	52,853	—	—	52,853	—	—	52,853	—	—	52,853	—	31 Dec 09
Group Performance Share Plan . . . . .	2008	—	—	—	—	107,988	—	107,988	—	—	107,988	—	—	107,988	—	31 Dec 10
Business Unit Performance Plan (share element) . . . . .	2008	—	—	—	—	53,994	—	53,994	—	—	53,994	—	—	53,994	—	31 Dec 10
Group Performance Share Plan . . . . .	2009	—	—	—	—	—	—	—	455,5	—	196,596	455,5	—	196,596	—	31 Dec 11
Business Unit Performance Plan (share element) . . . . .	2009	—	—	—	—	—	—	—	—	—	196,596	455,5	—	196,596	—	31 Dec 11
		—	158,559	—	158,559	161,982	—	320,541	393,192	—	713,733	—	—	—	—	—
<b>Tidjane Thiam</b>																
Group Performance Share Plan . . . . .	2008	—	—	—	—	314,147	674,50	314,147(8)	—	—	314,147	—	—	—	314,147	31 Dec 10
Group Performance Share Plan . . . . .	2009	—	—	—	—	—	—	—	455,5	—	299,074	455,5	—	299,074	—	31 Dec 11
		—	—	—	—	314,147	—	314,147	—	—	299,074	—	—	613,221	—	—
<b>Mark Tucker</b>																
Restricted Share Plan . . . . .	2005	356,817	—	—	356,817(2)	—	683,00	223,011	—	—	223,011(2)	—	—	—	223,011	31 Dec 07
Group Performance Share Plan . . . . .	2006	337,044	—	—	337,044(3)	—	—	337,044(6)	—	—	337,044(6)	—	25,493	311,428	25,616	31 Dec 08
Group Performance Share Plan . . . . .	2007	—	295,067	745,00	295,067(4)	—	—	295,067	—	—	295,067	—	—	295,067	—	31 Dec 09
Group Performance Share Plan . . . . .	2008	—	—	—	—	294,512	674,50	294,512	—	—	294,512	—	—	294,512	—	31 Dec 10
		693,861	295,067	—	988,928	294,512	—	1,149,634	—	—	1,149,634	—	25,493	311,428	25,616	812,590

*Cash rights granted under the Business Unit Performance Plan*

Plan name	Year of initial award	Conditional awards outstanding at 1 Jan 2007	Conditional awards in 2007	Payments made in 2007	Conditional awards outstanding at 31 Dec 2007	Conditional awards in 2008	Payments made in 2008	Conditional awards outstanding at 31 Dec 2008	Conditional awards in 2009	Cash rights lapsed in 2009	Conditional awards outstanding at 31 Dec 2009	Date of end of performance period
		£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	
<b>Clark Manning</b>												
Business Unit Performance Plan (Cash element)	2006	577	—	—	577	—	—	577(7)	—	577	—	31 Dec 08
Business Unit Performance Plan (Cash element)	2007	—	624	—	624	—	—	624	—	—	624	31 Dec 09
Business Unit Performance Plan (Cash element)	2008	—	—	—	—	652	—	652	—	—	652	31 Dec 10
<b>Mark Norborn</b>												
Business Unit Performance Plan (Cash element)	2006	361	—	—	—(5)	—	—	—	—	—	—	31 Dec 08
<b>Nick Prettejohn</b>												
Business Unit Performance Plan (Cash element)	2006	374	—	—	374	—	—	374(7)	—	374	—	31 Dec 08
Business Unit Performance Plan (Cash element)	2007	—	400	—	400	—	—	400	—	—	400	31 Dec 09
Business Unit Performance Plan (Cash element)	2008	—	—	—	—	423	—	423	—	—	423	31 Dec 10
<b>Barry Stowe</b>												
Business Unit Performance Plan (Cash element)	2007	—	325	—	325	—	—	325	—	—	325	31 Dec 09
Business Unit Performance Plan (Cash element)	2008	—	—	—	—	358	—	358	—	—	358	31 Dec 10

## Notes

### 2007

Performance levels under current awards at 31 December 2007:

<u>Note</u>	<u>Plan</u>	<u>Award Year</u>	<u>Performance Levels</u>
1	Restricted Share Plan	2004	The ranking of the Company's TSR was ranked at 56th percentile at the end of the three-year performance period ending on 31 December 2006 and as a result the 2004 awards lapsed.
2	Restricted Share Plan	2005	The ranking of the Company's TSR at the end of the three-year performance period ending on 31 December 2007 was 30th out of the remaining 85 companies in the FTSE 100 (35th percentile) and as a result it is anticipated that options over 62.5% of the maximum number of shares in each award was made in 2008 would result in nil cost options over 114,365 shares for Philip Broadley, 102,095 shares for Clark Manning, 36,597 shares for Michael McLintock and 223,011 shares for Mark Tucker.
3	Group Performance Share Plan	2006	At 31 December 2007 Prudential's TSR performance was 121.4% of the TSR performance of the index. At this performance level, 100% of the maximum award would vest.
4	Group Performance Share Plan	2007	At 31 December 2007 Prudential's TSR performance was 113.1% of the TSR performance of the index. At this performance level, 84% of the maximum award would vest.
5	Mark Norbom		The 2005 RSP, 2006 GPSP and the 2006 BUPP awards for Mark Norbom lapsed on the termination of his employment.

### 2008

Performance levels under current awards at 31 December 2008:

<u>Note</u>	<u>Plan</u>	<u>Award Year</u>	<u>Performance Levels</u>									
6	Group Performance Share Plan	2006	At 31 December 2008 Prudential's TSR performance was 117% of the TSR performance of the index. As a result, it is anticipated that awards over 92.4% of the maximum number of shares will be earned, resulting in 311,428 shares for Mark Tucker, 157,197 shares for Philip Broadley, 223,067 shares for Clark Manning, 59,319 shares for Michael McLintock, and 138,566 shares for Nick Prettejohn.									
7	Business Unit Performance Share Plans	2006	At 31 December 2008 Shareholder Capital Value performance under the 2006 BUPPs was as follows: <table border="1" style="margin-left: 40px;"> <thead> <tr> <th></th> <th><u>% growth SCV</u></th> <th><u>Anticipated payout</u></th> </tr> </thead> <tbody> <tr> <td>Jackson</td> <td>6.1</td> <td>nil</td> </tr> <tr> <td>UK</td> <td>1.2</td> <td>nil</td> </tr> </tbody> </table>		<u>% growth SCV</u>	<u>Anticipated payout</u>	Jackson	6.1	nil	UK	1.2	nil
	<u>% growth SCV</u>	<u>Anticipated payout</u>										
Jackson	6.1	nil										
UK	1.2	nil										
8	Tidjane Thiam		For 2008 as part of the terms of appointment, a double award under the Group Performance Share Plan of 320% of salary was made to Tidjane Thiam.									

### 2009

Performance levels under current awards at 31 December 2009:

<u>Note</u>	<u>Plan</u>	<u>Award Year</u>	<u>Performance Levels</u>																
9	Group Performance Share Plan	2007	At 31 December 2009 Prudential's TSR performance was 143.72% of the TSR performance of the index. Hence it is anticipated that awards granted under this scheme in 2007 will vest in full. This results in 270,478 shares for Mark Tucker; 191,140 shares for Clark Manning; 52,040 shares for Michael McLintock; 119,231 shares for Nick Prettejohn and 105,706 shares for Barry Stowe. In accordance with the plan rules, the anticipated number of shares released for Mark Tucker and Nick Prettejohn as a result of their resignation from Prudential will be prorated accordingly.																
10	Business Unit Performance Share Plans	2007	At 31 December 2009, Shareholder Capital Value performance under the 2007 BUPPs was as follows: <table border="1" style="margin-left: 40px;"> <thead> <tr> <th></th> <th><u>% compound in growth in SCV</u></th> <th><u>No. of shares released from 2007 BUPP share award</u></th> <th><u>Anticipated value of 2007 BUPP cash award release</u></th> </tr> </thead> <tbody> <tr> <td>Jackson</td> <td>4.1%</td> <td>nil</td> <td>nil</td> </tr> <tr> <td>UK</td> <td>0.3%</td> <td>nil</td> <td>nil</td> </tr> <tr> <td>Asia</td> <td>20.6%</td> <td>33,615</td> <td>£206,700</td> </tr> </tbody> </table>		<u>% compound in growth in SCV</u>	<u>No. of shares released from 2007 BUPP share award</u>	<u>Anticipated value of 2007 BUPP cash award release</u>	Jackson	4.1%	nil	nil	UK	0.3%	nil	nil	Asia	20.6%	33,615	£206,700
	<u>% compound in growth in SCV</u>	<u>No. of shares released from 2007 BUPP share award</u>	<u>Anticipated value of 2007 BUPP cash award release</u>																
Jackson	4.1%	nil	nil																
UK	0.3%	nil	nil																
Asia	20.6%	33,615	£206,700																

2009 awards made under the Group Performance Share Plan and the Business Unit Performance Share Plans have a performance period from 1 January 2009 to 31 December 2011. In determining the 2009 conditional share awards the shares were valued at the average share price for the 30 days immediately following the announcement of Prudential's 2008 results, and the price used to determine the number of shares was 347.74 pence.

The awards for Clark Manning and Barry Stowe were made in ADRs (one ADR is equivalent to approximately two Prudential plc shares or \$10.31). The figures in the table are represented in terms of Prudential shares.

**(i) Restricted Share Plan awards**

For RSP awards in 2005, no rights were granted if Prudential's TSR performance as ranked against the comparator group (those companies remaining out of the FTSE 100 at the beginning of the performance period) was at the 50th percentile or below. The maximum grant is made only if the TSR ranking of the Company is 20th percentile or above. Between these points, the size of the grant made is calculated on a straight line sliding scale. In normal circumstances, directors may take up their right to receive shares at any time during the following seven years

Rights which were exercised from options granted from 2005 Restricted Share Plan awards during 2008 are set out in the following table:

	Year of option grant	RSP rights outstanding at 1 Jan 2008	Rights granted during 2008 (Number of shares)	Rights exercised during 2008 (Number of shares)	Rights outstanding at 31 Dec 2008 (pence)	Price paid for the award	Exercise price (pence)	Market price on date of exercise (pence)	Earliest exercise date	Latest exercise date
Philip Broadley . . . . .	2008	—	114,365	114,365	—	—	nil	539.5	17 April 2008	04 April 2015
Clark Manning . . . . .	2008	—	102,095	102,095	—	—	nil	647.5	17 April 2008	04 April 2015
Michael McLintock . . . . .	2008	—	36,597	36,597	—	—	nil	377.0	17 April 2008	04 April 2015

**(ii) Awards**

The awards made under the Group Performance Share Plan and the Business Unit Performance Plan in respect of 2007 have a performance period from 1 January 2007 to 31 December 2009.

In determining the 2007 conditional share awards the shares were valued at their average share price during the preceding calendar year, and the price used to determine the number of shares was 614.91 pence.

The 2008 awards made under the Group Performance Share Plan and the Business Unit Performance Plan in respect of 2008 have a performance period from 1 January 2008 to 31 December 2010.

In determining the 2008 conditional share awards the shares were valued at the average share price for the 30 days immediately following the announcement of Prudential's 2007 results, and the price used to determine the number of shares was 662.11 pence.

2009 awards made under the Group Performance Share Plan and the Business Unit Performance have a performance period from 1 January to 31 December 2011.

In determining the 2009 conditional share awards the shares were valued at the average share price for the 30 days immediately following the announcement of Prudential's 2008 results, and the price used to determine the number of shares was 347.74 pence.

**(iii) Group Performance Share Plan (Group PSP) — all executive directors**

Awards under the Group Performance Share Plan are based on Prudential's Total Shareholder Return compared with the TSR performance of its competitors.

**Business specific cash based long term incentive plans**

Plan name	Year of initial award	Face Value of conditional awards outstanding at 1 Jan 2007 £000	Conditionally awarded in 2007 £000	Payments made in 2007 £000	Face value of conditional awards outstanding at 31 Dec 2007 £000	Conditionally awarded in 2008 £000	Payments made in 2008 £000	Face value of conditional awards outstanding at 31 Dec 2008 £ 000	Conditionally awarded in 2009 £000	Payments made in 2009 £000	Face value of conditional awards outstanding at 31 Dec 2009 £ 000	Date of end of performance period
<b>Clark Manning</b>												
Business Cash LTIP . . . . .	2004	1,295	—	2,013	—	—	—	—	—	—	—	31 Dec 06
Business Cash LTIP . . . . .	2005	1,295	—	—	1,295	—	2,385	—	—	—	—	31 Dec 07
<b>Michael McLintock</b>												
Phantom M&G options . . . . .	2000	184	—	403	—	—	—	—	—	—	—	31 Dec 02
Phantom M&G options . . . . .	2001	368	—	—	368	—	846	—	—	—	—	31 Dec 03
Phantom M&G options . . . . .	2002	368	—	—	368	—	1,306	—	—	—	—	31 Dec 04
Phantom M&G options . . . . .	2003	368	—	—	368	—	850	—	—	—	—	31 Dec 05
Phantom M&G options . . . . .	2004	368	—	—	368	—	780	—	—	—	—	31 Dec 06
Phantom M&G shares . . . . .	2004	225	—	583	—	—	—	—	—	—	—	31 Dec 06
Phantom M&G options . . . . .	2005	368	—	—	368	—	—	368	—	394	—	31 Dec 07
Phantom M&G shares . . . . .	2005	225	—	—	225	—	527	—	—	—	—	31 Dec 07
Phantom M&G options . . . . .	2006	368	—	—	368	—	—	368	—	254	—	31 Dec 08
Phantom M&G shares . . . . .	2006	225	—	—	225	—	—	225	—	380	—	31 Dec 08

Plan name	Year of initial award	Face Value of conditional awards outstanding at 1 Jan 2007	Conditionally awarded in 2007	Payments made in 2007	Face value of conditional awards outstanding at 31 Dec 2007	Conditionally awarded in 2008	Payments made in 2008	Face value of conditional awards outstanding at 31 Dec 2008	Conditionally awarded in 2009	Payments made in 2009	Face value of conditional awards outstanding at 31 Dec 2009	Date of end of performance period
		£000	£000	£000	£000	£000	£000	£ 000	£000	£000	£ 000	
Phantom M&G shares . . . . .	2007	—	1,333	—	1,333	—	—	1,333	—	—	1,333	31 Dec 09
M&G Executive LTIP . . . . .	2008	—	—	—	—	1,141	—	1,141	—	—	1,141	31 Dec 10
M&G Executive LTIP . . . . .	2009	—	—	—	—	—	—	—	1,830	—	1,830	31 Dec 11
<b>Mark Norbom</b>												
Business Cash LTIP . . . . .	2004	713	—	413	—	—	—	—	—	—	—	31 Dec 06
Business Cash LTIP . . . . .	2005	750	—	—	—	—	—	—	—	—	—	31 Dec 07
<b>Total cash payments . . . . .</b>		—	—	<b>3,412</b>	—	—	<b>6,694</b>	—	—	<b>1,028</b>	—	

2007

**Clark Manning**

In 2004 and 2005 Clark Manning participated in a cash-based long-term plan that rewards the growth in appraisal value of Jackson. The award payout equals an initial award value adjusted by the change in the Prudential plc share price over the performance period. In order for any award to be made under the 2005 plan, the growth rate over the performance period must be greater or equal to 8% compound growth per annum. At this level of performance, the initial award value is US\$864,240. If the on-target performance level of 11.5% per annum compound is achieved the initial award value is doubled. If the annual growth rate is at least 17.5%, the payout increases to a maximum of three times the initial award value. For performance between these points, payouts are on a straight line sliding scale.

For the 2004 award the results led to a payment of US\$4,028,896. The face values of the awards for Clark Manning are converted at the average exchange rate for 2007 which was US\$2.0015 = £1. For the 2005 Business Cash LTIP, the compound annual growth rate in appraisal value was 22.8% and as a result a payment of US\$4,416,308 was made.

**Michael McLintock**

Michael McLintock's 2004, 2005 and 2006 cash long-term incentive awards were under the M&G Chief Executive Long-Term Incentive Plan that provides a cash reward through phantom M&G share awards and options. For these awards, the phantom share price at the beginning of the performance period was £1. The change in the phantom share price equals the change in M&G profit, modified up or down by the investment performance of M&G, over the performance period. For each year the face value of the share award was £225,000 and the phantom option award had a face value of £367,800. Provided the phantom share options have value, they may be exercised in part or in full during annual exercise periods (three to seven years from the start of the performance period).

For the 2004 award the phantom share price at the end of the performance period was £2.59. This resulted in a payment from the phantom share award of £582,750 and a phantom option award of 367,800 units. Michael McLintock did not exercise any of these options. For the 2005 award, the phantom share price at the end of the performance period was £2.34. This will result in a payment of £526,500 from the share element of the award.

Under the rules of Michael McLintock's 2000 phantom option award, a payment of £402,741 was made at the end of the seven-year exercise period. Following consultations with shareholders an award with a face value of £1,333,000 was made in 2007 under the share element of the M&G Chief Executive Long-Term Incentive Plan.

**Mark Norbom**

Mark Norbom's awards under the Business Cash LTIP for 2004 vested as a result of Asia's performance and a payment of £412,751 was made in 2007. On the termination of his employment his award under the 2005 Business Cash LTIP lapsed.

2008

**Clark Manning**

In 2005 Clark Manning participated in a cash-based long-term plan that rewards the growth in appraisal value of Jackson. The award payout equals an initial award value adjusted by the change in the Prudential plc share price over the performance period. In order for any award to be made under the 2005 plan, the growth rate over the performance period must be greater or equal to 8% compound growth per annum. At this level of performance, the initial award value is US\$864,240. If the on-target performance level of 11.5% per annum compound is achieved the initial award value is doubled. If the annual growth rate is at least 17.5%, the payout increases to a maximum of

three times the initial award value. For performance between these points, payouts are on a straight line sliding scale.

For the 2005 award the results led to a payment of US\$4,416,308. The face values of the awards for Clark Manning have been converted at the average exchange rate for 2008 which was US\$1.8518 = £1.

### *Michael McLintock*

Michael McLintock's 2005 and 2006 cash long-term incentive awards were under the M&G Chief Executive Long-Term Incentive Plan that provides a cash reward through phantom M&G share awards and options. For these awards, the phantom share price at the beginning of the performance period was £1. The change in the phantom share price equals the change in M&G profit, modified up or down by the investment performance of M&G, over the performance period. For each year the face value of the share award was £225,000 and the phantom option award had a face value of £367,800. Provided the phantom share options have value, they may be exercised in part or in full during annual exercise periods after three to seven years from the start of the performance period.

For the 2005 award the phantom share price at the end of the performance period was £2.34. This resulted in a payment from the phantom share award of £526,500 and a phantom option award of 367,800 units. Michael McLintock did not exercise any of these options. For the 2006 award, the phantom share price at the end of the performance period was £1.69. This will result in a payment of £380,250 from the share element of the award.

Under the rules of Michael McLintock's 2001 phantom option award, a payment of £845,940 was made at the end of the seven year exercise period. An award under the share element of the M&G Chief Executive Long-Term Incentive Plan with a face value of £1,333,000 was made in 2007. Following consultations with shareholders an award with a face value of £1,141,176 was made in 2008 under the M&G Executive Long-Term Incentive Plan, approved by shareholders at the AGM in 2008.

2009

### *Michael McLintock*

For the 2005 phantom option award of 367,800 units, the option price at the end of the performance period was £1.07. This resulted in a payment of £393,546 to Michael McLintock. For the 2006 award, the phantom share price at the end of the performance period was £1.69 and the phantom option price was £0.69. This resulted in a payment from the phantom share award of £380,250 and the phantom option award of £253,782.

The 2008 Directors' Remuneration Report stated that an award of 2,282,353 phantom shares of £1 with an anticipated value of £1,940,000 was made in 2009. Following a re-evaluation of the per unit expected value calculation, the number of units required to deliver this anticipated value has been reduced to 1,830,189. The anticipated value of this award remains unchanged.

### *Other Share Awards*

The table below sets out the share awards that have been made to executive directors under their appointment terms and those deferred from annual incentive plan payouts. The values of the deferred share awards are included in the bonus and total figures in the Directors' remuneration table presented previously. The number of shares is calculated using the average share price over the three business days commencing on the day of the announcement of the Prudential Group's annual financial results for the relevant year.

2007

For the awards from the 2006 annual incentives, made in 2007, the average share price was 681.50 pence.

Year of initial grant	Conditional share awards outstanding at 1 Jan 2007	Conditionally awarded in 2007	Scrip dividends accumulated	Shares released in 2007	Conditional Share awards outstanding at 31 Dec 2007	Date of end of restricted period	Shares released in 2007	Date of release	Market price at original date of award (pence)	Market price at date of vesting or release (pence)	
	(Number of shares)				(Number of shares)						(Number of shares)
<b>Philip Broadley</b>											
Deferred 2003 annual bonus award . . . . .	2004	6,387	—	—	6,387	—	31 Dec 06	6,387	15 Mar 07	502	675
Deferred 2005 annual bonus award(note 1) . . . . .	2006	31,954	—	789	—	32,743(1,2)	31 Dec 08	—	—	—	—
Deferred 2006 annual bonus award(note 1) . . . . .	2007	—	31,100	768	—	31,686(1,2)	31 Dec 09	—	—	—	—
<b>Clark Manning</b>											

	Year of initial grant	Conditional share awards outstanding at 1 Jan 2007 (Number of shares)	Conditionally awarded in 2007 (Number of shares)	Scrip dividends accumulated (Number of shares)	Shares released in 2007 (Number of shares)	Conditional Share awards outstanding at 31 Dec 2007 (Number of shares)	Date of end of restricted period	Shares released in 2007 (Number of shares)	Date of release	Market price at original date of award (pence)	Market price at date of vesting or release (pence)
Deferred 2006 annual bonus award(note 1) . . . . .	2007	—	9,100	224	—	9,324(1,3)	31 Dec 09	—	—	—	—
<b>Michael McLintock</b>											
Deferred 2003 annual bonus award . . . . .	2004	57,121	—	—	57,121	—	31 Dec 06	57,121	15 Mar 07	502	675
Deferred 2004 annual bonus award . . . . .	2005	93,750	—	2,317	96,067	—	31 Dec 07	96,067	31 Dec 07	475	712
Deferred 2005 annual bonus award(note 1) . . . . .	2006	84,779	—	2,095	—	86,874(1)	31 Dec 08	—	—	—	—
Deferred 2006 annual bonus award(note 1) . . . . .	2007	—	81,438	2,012	—	83,450(1,4)	31 Dec 09	—	—	—	—
<b>Mark Norbom</b>											
Awards under appointment terms (note 7) . . . . .	2004	89,353	—	—	89,353	—(7)	01 Jan 07	89,353	02 Feb 07	439	705.5
		31,596	—	—	—	—(7)	01 Jan 08	—	—	—	—
		15,339	—	—	—	—(7)	01 Jan 09	—	—	—	—
		414,826	—	—	87,403	—(7)	20 Feb 13	87,403	28 Feb 07	439	673.5
Deferred 2004 annual bonus award(note 1) . . . . .	2005	33,965	—	—	33,965	—(7)	31 Dec 07	33,965	08 Feb 07	475	715
Deferred 2005 annual bonus award(note 1) . . . . .	2006	18,306	—	—	18,306	—(7)	31 Dec 08	18,306	08 Feb 07	715.5	715
<b>Nick Prettejohn</b>											
Awards under appointment terms (note 8) . . . . .	2006	16,000	—	—	16,000	—	31 Oct 07	16,000	31 Oct 07	627.5	712
		5,500	—	—	—	5,500	31 Oct 08	—	—	—	—
Deferred 2006 annual bonus award(note 1) . . . . .	2007	—	11,837	291	—	12,128(1,5)	31 Dec 09	—	—	—	—
<b>Barry Stowe</b>											
Awards under appointment terms (note 9) . . . . .	2006	7,088	—	—	7,088	—	01 May 07	7,088	01 May 07	702	746
		7,088	—	—	—	7,088	01 May 08	—	—	—	—
		7,088	—	—	—	7,088	01 May 09	—	—	—	—
		28,706	—	—	—	28,706	01 Sept 09	—	—	—	—
		7,088	—	—	—	7,088	01 Jan 10	—	—	—	—
		2,110	—	—	—	2,110	01 May 10	—	—	—	—
<b>Mark Tucker</b>											
Deferred 2005 annual bonus award note 1 . . . . .	2006	37,206	—	919	—	38,125(1)	31 Dec 08	—	—	—	—
Deferred 2006 annual bonus award(note 1) . . . . .	2007	—	72,302	1,786	—	74,088(1,6)	31 Dec 09	—	—	—	—

## Notes

- (1) Under the annual bonus plans, the element of bonus for performance above specified levels are made in the form of a share award deferred for three years.
- (2) In 2007, a deferred share award from his 2006 annual bonus valued at £211,947 was made to Philip Broadley. This was included in the 2006 total Directors' remuneration. Under the terms agreed on his leaving the Company, the outstanding deferred awards to Philip Broadley were released after his termination date.
- (3) In 2007, a deferred share award from his 2006 annual bonus valued at US\$121,360 was made to Clark Manning. This was included in the 2006 Directors' remuneration. The exchange rate used was US\$1.8430 = £1.
- (4) In 2007, a deferred share award from his 2006 annual bonus valued at £555,000 was made to Michael McLintock. This was included in the 2006 Directors' remuneration.
- (5) In 2007, a deferred share award from his 2006 annual bonus valued at £80,673 was made to Nick Prettejohn. This was included in the 2006 Directors' remuneration.
- (6) In 2007, a deferred share award from his 2006 annual bonus valued at £492,744 was made to Mark Tucker. This was included in the 2006 Directors' remuneration.
- (7) Mark Norbom's deferred shares under the 2004 Annual Incentive Plan (33,965 shares) and 2005 Annual Incentive Plan (18,306 shares) were released to him in February 2007. In addition, the 89,353 employer replacement shares which vested on 1 January 2007 were released and the Remuneration Committee exercised its discretion to allow a further 87,403 shares out of his awards under the appointment terms to vest.

representing the proportion of the performance period which Mark Norbom had worked in respect of his pension replacement shares. Awards over 374,358 shares granted under the terms of Mark Norbom's appointment lapsed.

- (8) In order to secure the appointment of Nick Prettejohn, he was awarded rights to Prudential plc shares that vest as set out in the table. In normal circumstances, releases are conditional on Nick Prettejohn being employed by Prudential at the date of vesting. If there is a change of control of Prudential he may be entitled to retain any unvested awards.
- (9) In order to secure the appointment of Barry Stowe and to compensate him for the loss of substantial amounts of outstanding long-term remuneration, he was awarded rights to Prudential plc American Depositary Receipts, that vest as set out in the table. The figures in the table are the equivalent number of Prudential plc shares (one American Depositary Receipt equals two Prudential plc shares). In normal circumstances, releases are conditional on Barry Stowe being employed by Prudential at the date of vesting. If there is a change of control of Prudential he may be entitled to retain any unvested awards.

In order to compensate for the loss of share options, Barry Stowe was also awarded 1,255 Prudential plc ADRs in 2007.

For the awards from the 2007 annual incentives, made in 2008, the average share price was 618.50 pence.

	Year of initial grant	Conditional share awards outstanding at 1 Jan 2008 (Number of shares)	Conditionally awarded in 2008 (Number of shares)	Scrip dividends accumulated (Number of shares)	Shares released in 2008 (Number of shares)	Conditional share awards outstanding at 31 Dec 2008 (Number of shares)	Date of end of restricted period	Shares released in 2008 (Number of shares)	Date of release	Market price at original date of award (pence)	Market price at date of vesting or release (pence)
<b>Philip Broadley</b>											
Deferred 2005 annual bonus award(note 1)	2006	32,743	—	606	33,349	—(1,2)	31 Dec 08	33,349	21 Aug 08	715.5	506.5
Deferred 2006 annual bonus award(note 1)	2007	<u>31,868</u>	<u>—</u>	<u>590</u>	<u>32,452</u>	<u>—(1,2)</u>	<u>31 Dec 09</u>	<u>32,458</u>	<u>21 Aug 08</u>	<u>723</u>	<u>506.5</u>
<b>Clark Manning</b>											
Deferred 2006 annual bonus award(note 1)	2007	9,324	—	276	—	9,600(1,3)	31 Dec 09	—	—	—	—
Deferred 2007 annual bonus award(note 1)	2008	<u>—</u>	<u>16,514</u>	<u>489</u>	<u>—</u>	<u>17,003(1)</u>	<u>31 Dec 10</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Michael McLintock</b>											
Deferred 2005 annual bonus award(note 1)	2006	86,874	—	2,580	89,454	—(1)	31 Dec 08	89,454	31 Dec 08	715.5	416.5
Deferred 2006 annual bonus award(note 1)	2007	83,450	—	2,479	—	85,929(1,4)	31 Dec 09	—	—	—	—
Deferred 2007 annual bonus award(note 1)	2008	<u>—</u>	<u>103,811</u>	<u>3,084</u>	<u>—</u>	<u>106,895</u>	<u>31 Dec 10</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Nick Prettejohn</b>											
Awards under appointment terms (note 8)	2006	5,500	—	—	5,500	—	31 Oct 08	5,500	31 Oct 08	627.5	315
Deferred 2006 annual bonus award(note 1)	2007	12,128	—	359	—	12,487	31 Dec 09	—	—	—	—
Deferred 2007 annual bonus award(note 1)	2008	<u>—</u>	<u>49,898</u>	<u>1,482</u>	<u>—</u>	<u>51,380(1,5)</u>	<u>31 Dec 10</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Barry Stowe</b>											
Awards under appointment terms (note 9)	2006	7,088	—	—	7,088	—	01 May 08	7,088	01 May 08	702	697
		7,088	—	—	—	7,088	01 May 09	—	—	—	—
		28,706	—	—	—	28,706	01 Sep 09	—	—	—	—
		7,088	—	—	—	7,088	01 Jan 10	—	—	—	—
		2,110	—	—	—	2,110	01 May 10	—	—	—	—
Deferred 2007 annual bonus award(note 1)	2008	<u>—</u>	<u>40,551</u>	<u>1,204</u>	<u>—</u>	<u>41,755(1,6)</u>	<u>31 Dec 10</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Tidjane Thiam</b>											
Awards under appointment terms (note 10)	2008	—	16,336	—	—	16,336	31 Mar 09	—	—	—	—
		—	41,148	—	—	41,148	31 Mar 09	—	—	—	—
		—	48,362	—	—	48,362	31 Mar 10	—	—	—	—
		—	41,135	—	—	41,135	31 Mar 10	—	—	—	—
		<u>—</u>	<u>49,131</u>	<u>—</u>	<u>—</u>	<u>49,131</u>	<u>31 Mar 11</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Mark Tucker</b>											
Deferred 2005 annual bonus award	2006	38,125	—	1,132	39,257	—(1)	31 Dec 08	39,257	31 Dec 08	715.5	416.5
Deferred 2006 annual bonus award(note 1)	2007	74,088	—	2,200	—	76,288(1,7)	31 Dec 09	—	—	—	—
Deferred 2007 annual bonus award(note 1)	2008	<u>—</u>	<u>73,576</u>	<u>2,185</u>	<u>—</u>	<u>75,761(1,7)</u>	<u>31 Dec 10</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

#### Notes:

- (1) Under the annual bonus plans, the element of bonus for performance above specified levels are made in the form of a share award deferred for three years. The value of the 2007 deferred share award is included in the total 2007 figure in the Directors' remuneration summary table.
- (2) Under the terms agreed on his leaving Prudential, the outstanding deferred awards to Philip Broadley have been released to him.
- (3) In 2008, a deferred share award from his 2007 annual bonus valued at \$200,000 was made to Clark Manning. This is included in the 2007 total in the Directors' remuneration summary table. The exchange rate used was US\$2.0015 = £1.
- (4) In 2008, a deferred share award from his 2007 annual bonus valued at £640,000 was made to Michael McLintock. This is included in the 2007 total in the Directors' remuneration summary table.
- (5) In 2008, a deferred share award from his 2007 annual bonus valued at £307,625 was made to Nick Prettejohn. This is included in the 2007 total in the Directors' remuneration summary table.
- (6) In 2008, a deferred share award from his 2007 annual bonus valued at £250,000 was made to Barry Stowe. This is included in the 2007 total in the Directors' remuneration summary table.
- (7) In 2008, a deferred share award from his 2007 annual bonus valued at £453,600 was made to Mark Tucker. This is included in the 2007 total in the Directors' remuneration summary table.

- (8) In order to secure the appointment of Nick Prettejohn, he was awarded rights to Prudential plc shares that vest as set out in the table. In normal circumstances, releases are conditional on Nick Prettejohn being employed by Prudential at the date of vesting. If there is a change of control of Prudential he may be entitled to retain any unvested awards.
- (9) In order to secure the appointment of Barry Stowe and to compensate him for the loss of substantial amounts of outstanding long-term remuneration, he was awarded rights to Prudential plc American Depositary Receipts, which vest as set out in the table. The figures in the table are the equivalent number of Prudential plc shares (one American Depositary Receipt equals two Prudential plc shares). In normal circumstances, releases are conditional on Barry Stowe being employed by Prudential at the date of vesting. If there is a change of control of Prudential he may be entitled to retain any unvested awards.
- (10) In order to secure the appointment of Tidjane Thiam, the following awards were made
- to compensate for the loss of 2007 bonus an award of 49,131 shares with a value of £325,000 vesting on 31 March 2011; and
  - In order to compensate for the loss of outstanding deferred share awards under annual incentive plans and long-term awards with his previous employer he was granted restricted share awards, in lieu of his 2006 and 2007 awards, without performance measures which will vest in March 2009 and 2010, respectively. These awards were valued taking the relative share prices of his previous employer on the day prior to his last working day and Prudential on his first working day.

## 2009

For the awards from the 2008 annual incentives, made in 2009, the average share price was 308.63 pence.

	Year of initial grant	Conditional share awards outstanding at 1 Jan 2009 (Number of shares)	Conditionally awarded in 2009 (Number of shares)	Script dividends accumulated (Number of shares)	Shares released in 2009 (Number of shares)	Conditional share awards outstanding at 31 Dec 2009 (Number of shares)	Date of end of restricted period	Shares released in 2009 (Number Of shares)	Date of release	Market price at original date of award (pence)	Market price at date of vesting or release (pence)
<b>Rob Devey (note 2)</b>											
Awards under appointment terms . . . . .	2009	—	50,575	—	—	50,575	31 Mar 12	—	—	—	—
<b>Clark Manning</b>											
Deferred 2006 annual bonus award . . . . .	2007	9,600	—	464	—	10,064	31 Dec 09	—	—	—	—
Deferred 2007 annual bonus award . . . . .	2008	17,003	—	822	—	17,825	31 Dec 10	—	—	—	—
<b>Michael McLintock</b>											
Deferred 2006 annual bonus award . . . . .	2007	85,929	—	4,161	—	90,090	31 Dec 09	—	—	—	—
Deferred 2007 annual bonus award . . . . .	2008	106,895	—	5,176	—	112,071	31 Dec 10	—	—	—	—
Deferred 2008 annual bonus award . . . . .	2009	—	207,368	10,042	—	217,410	31 Dec 11	—	—	—	—
<b>Nick Prettejohn (note 3)</b>											
Deferred 2006 annual bonus award . . . . .	2007	12,487	—	604	13,091	—	31 Dec 09	13,091	1 Oct 09	723	592
Deferred 2007 annual bonus award . . . . .	2008	51,380	—	2,488	53,868	—	31 Dec 10	53,868	1 Oct 09	635	592
Deferred 2008 annual bonus award (note 1) . . . . .	2009	—	105,304	5,099	110,403	—	31 Dec 11	110,403	1 Oct 09	349.5	592
<b>Nic Nicandrou (note 4)</b>											
Awards under appointment terms . . . . .	2009	—	10,616	—	—	10,616	31 Mar 10	—	—	—	—
			5,889	—	—	5,889	31 Mar 10	—	—	—	—
			13,898	—	—	13,898	31 Mar 11	—	—	—	—
			16,059	—	—	16,059	31 Mar 11	—	—	—	—
			68,191	—	—	68,191	31 Mar 12	—	—	—	—
<b>Barry Stowe</b>											
Awards under appointment terms . . . . .	2006	7,088	—	—	7,088	—	1 May 09	7,088	15 May 09	702	437
		28,706	—	—	28,706	—	1 Sep 09	28,706	1 Sep 09	702	525.5
		7,088	—	—	—	7,088	1 Jan 10	—	—	—	—
		2,110	—	—	—	2,110	1 May 10	—	—	—	—
Deferred 2007 annual bonus award . . . . .	2008	41,755	—	2,022	—	43,777	31 Dec 10	—	—	—	—
Deferred 2008 annual bonus award (note 1) . . . . .	2009	—	20,092	972	—	21,064	31 Dec 11	—	—	—	—
<b>Tidjane Thiam</b>											
Awards under appointment terms . . . . .	2008	16,336	—	—	16,336	—	31 Mar 09	16,336	31 Mar 09	662	337
		41,148	—	—	41,148	—	31 Mar 09	41,148	31 Mar 09	662	337
		48,362	—	—	—	48,362	31 Mar 10	—	—	—	—
		41,135	—	—	—	41,135	31 Mar 10	—	—	—	—
		49,131	—	—	—	49,131	31 Mar 11	—	—	—	—
Deferred 2008 annual bonus award (note 1) . . . . .	2009	—	105,304	5,099	—	110,403	31 Dec 11	—	—	—	—
<b>Mark Tucker (note 5)</b>											
Deferred 2006 annual bonus award . . . . .	2007	76,288	—	3,694	79,982	—	31 Dec 09	79,982	1 Oct 09	723	592
Deferred 2007 annual bonus award . . . . .	2008	75,761	—	3,669	79,430	—	31 Dec 10	79,430	1 Oct 09	635	592

### Notes:

- (1) Under the annual bonus plans, the element of bonus for performance above specified levels are made in the form of a share award deferred for three years. The value of the 2008 deferred share award is included in the total 2008 figure in the Directors' remuneration summary table.
- (2) In order to secure the appointment of Rob Devey and to compensate him for the loss of outstanding long-term remuneration, Rob was awarded rights to Prudential shares as set out in the table.
- (3) Under the terms agreed on his leaving Prudential, the outstanding deferred awards to Nick Prettejohn have been released to him.
- (4) In order to secure the appointment of Nic Nicandrou and to compensate him for the loss of outstanding long-term remuneration, Nic was awarded rights to Prudential shares as set out in the table.
- (5) Under the terms agreed on his leaving Prudential, the outstanding deferred awards to Mark Tucker have been released to him.

### Outstanding share options

Options outstanding under the Savings-Related Share Option (SAYE) scheme are set out below. The SAYE is open to all UK and certain overseas employees. Options under this scheme up to HMRC limits are granted at a 20%

discount and cannot normally be exercised until a minimum of three years has elapsed. No payment has been made for the grant of any options. The price to be paid for exercise of these options is shown in the table below. No variations to any outstanding options have been made.

## 2007

	Year of initial grant	Option outstanding at 1 Jan 2007	Exercised in 2007	Market price on exercise date (pence)	Options forfeit in 2007	Options granted in 2007	Options outstanding at 31 Dec 2007	Market price at 31 Dec 2007 (pence)	Original exercise price (pence)	Exercise price adjusted for 2004 Rights issue (pence)	Earliest exercise date	Latest exercise date
Philip Broadley . . . . .	2000	2,716	2,716	763.5	—	—	—	—	364	346	01 Jun 07	30 Nov 07
Michael McLintock . . . . .	2003	6,153	—	—	—	—	6,153	712	280	266	01 Jun 08	30 Nov 08
Nick Prettejohn . . . . .	2006	661	—	—	—	—	661	712	565	n/a	01 Jun 09	30 Nov 09
Mark Tucker . . . . .	2005	2,297	—	—	—	—	2,297	712	407	n/a	01 Dec 08	31 May 09

### Notes:

- (1) Gains of £11,339 were made by directors in 2007 on the exercise of share options.
- (2) No price was paid for the award of any option.
- (3) The highest and lowest share prices during 2007 were 811 pence and 618 pence respectively.

## 2008

	Year of initial grant	Option outstanding at 1 Jan 2008	Exercised in 2008	Market price on exercise date (pence)	Options forfeit in 2008	Options granted in 2008	Options outstanding at 31 Dec 2008	Market price at 31 Dec 2008 (pence)	Original exercise price (pence)	Exercise price adjusted for 2004 Rights issue (pence)	Earliest exercise date	Latest exercise date
Michael McLintock . . . . .	2003	6,153	6,153	517.5	—	—	—	416.5	280	266	01 Jun 08	30 Nov 08
Nick Prettejohn . . . . .	2006	661	—	—	—	—	661	416.5	565	n/a	01 Jun 09	30 Nov 09
Tidjane Thiam . . . . .	2008	—	—	—	—	1,705	1,705	416.5	551	n/a	01 Jun 11	30 Nov 11
Mark Tucker . . . . .	2005	2,297	—	—	—	—	2,297	416.5	407	n/a	01 Dec 08	31 May 09

### Notes:

- (1) Gains of £15,420 were made by directors in 2008 on the exercise of share options.
- (2) No price was paid for the award of any option.
- (3) The highest and lowest share prices during 2008 were 726 pence and 245 pence respectively.

## 2009

	Year of initial grant	Option outstanding at 1 Jan 2009	Exercised in 2009	Market Price on Exercise date (pence)	Options forfeit in 2009	Options granted in 2009	Options outstanding at 31 Dec 2009	Market price at 31 Dec 2009 (pence)	Original exercise price (pence)	Exercise price adjusted for 2004 Rights issue (pence)	Earliest exercise date	Latest exercise date
Nick Prettejohn . . . . .	2006	661	—	—	661	—	—	—	565	n/a	01 Jun 09	30 Nov 09
Tidjane Thiam . . . . .	2008	1,705	—	—	—	—	1,705	640	551	n/a	01 Jun 11	30 Nov 11
Mark Tucker . . . . .	2005	2,297	—	—	2,297	—	—	—	407	n/a	01 Dec 08	31 May 09

### Notes

- (1) Gains of £nil were made by directors in 2009 on the exercise of share options.
- (2) No price was paid for the award of any option.
- (3) The highest and lowest share prices during 2009 were 650.5 pence and 207 pence respectively.

## Dilution

For 2007, 2008 and 2009 Prudential met its obligations under its share plans by funding an employee trust which acquires shares on the open market either at the time of grant or by maintaining sufficient shares in the trust to meet the requirements as awards vest. Shares relating to options granted under all-employee share plans are satisfied by new issue shares. The combined dilution from all outstanding options at 31 December 2007, 31 December 2008 and 31 December 2009 was 0.1%, 0.02% and 0.2% respectively of the total share capital at the time. From 2010 onwards shares released from Prudential's GPSP and BUPP will be fulfilled by using new issue shares as the primary vehicle to satisfy these arrangements rather than purchasing shares in the open market.

### *Directors' pensions and life assurance*

In 2007, 2008 and 2009 the Chief Executive of Jackson employed in the US was eligible to participate in Jackson's Defined Contribution Retirement Plan, a qualified 401K retirement plan, on the same basis as all other US based employees, into which contributions of 6% of basic salary up to a maximum of US\$13,500, US\$13,500 and US\$14,700 were made in 2007, 2008 and 2009 respectively. He is also eligible to participate in the profit sharing element of Jackson's IRS-approved Defined Contribution Retirement Plan. The plan is an all-employee plan that provides eligible participants with annual profit sharing, depending on the financial results of Jackson for the plan year, with a maximum of 6% of salary capped at US\$13,200 in 2007, US\$9,200 in 2008 and US\$14,700 in 2009.

The Chief Executive of Asia is eligible to receive a 25% cash salary supplement for pension purposes. UK executive directors are offered a choice of a combination of HMRC approved pension schemes and/or cash supplementary payments. If an executive director opts to join one of the HMRC approved pension plans, participation is on the same basis as other employees who joined at the same date as the executive director in question. For defined benefit schemes, the policy is to retain a notional scheme earnings cap, set at £112,800 and £117,600 and £123,600 for the 2007/08, 2008/09 and 2009/10 tax years respectively. No employees with employment offers after 30 June 2003 are eligible for membership of any defined benefit schemes.

For UK executive directors hired after 30 June 2003 Prudential's policy is to provide a supplement of 25% of salary. This includes, where relevant, any Company contributions to the staff defined contribution pension plan, which UK executive directors may choose to join. This plan has no salary cap.

Prudential's current practice in respect of pension arrangements for the current executive directors is set out below. Philip Broadley participated in a non-contributory scheme that provided a pension of 1/60th of Final Pensionable Earnings for each year of service on retirement at age 60.

Philip Broadley was entitled to supplements based on the portion of his basic salary not covered for pension benefits under a HMRC approved scheme. He was also provided with life assurance cover of four times salary.

Michael McLintock participates in a contributory scheme that provides a target pension of 2/3rds of Final Pensionable Earnings on retirement at age 60 for an employee with 30 years or more potential service, for which his contribution is 4% of basic salary. In both cases Final Pensionable Earnings are capped by a notional scheme earnings cap which replicates the HMRC earnings cap in-force before A-Day (6 April 2006).

Michael McLintock is entitled to supplements based on the portion of his basic salary not covered for pension benefits under a HMRC approved scheme. He is also provided with life assurance cover of four times salary.

Rob Devey, Nic Nicandrou and Tidjane Thiam are entitled to a total salary supplement of 25% of basic salary. They were all members of the staff defined contribution pension plan as at 31 December 2009, which provides death in service benefits including life assurance of four times salary. The company contributions to the pension plan are included in the supplement.

Clark Manning participates in a US tax-qualified defined contribution plan (a 401K plan). He also provided with life assurance cover of two times salary.

Barry Stowe is paid a salary supplement of 25% of his salary. He is also provided with life assurance cover of four times salary.

Where supplements for pension purposes are paid in cash, the amounts are included in the Directors' remuneration table summary.

Details of directors' pension entitlements under HMRC approved defined benefit schemes and supplements that are in the form of contributions to pension arrangements paid by Prudential are set out in the following table.

2007

	Age at 31 Dec 2007	Years of pensionable service at 31 Dec 2007	Accrued benefit at 31 Dec 2007	Additional pension earned during year ended 31 Dec 2007		Transfer value of accrued benefit at 31 Dec (note 3)		Amounts of (B-A) less contributions made by directors during 2007	Contributions to pension and life assurance arrangements (note 4)
				Ignoring inflation on pension earned to 31 Dec 2006 (note 1)	Allowing for inflation on pension earned to 31 Dec 2006 (note 2)	2007 B	2006 A		
			£000	£000	£000	£000	£000	£000	£000
Sir David Clementi . . . . .	58	—	—	—	—	—	—	—	15
Philip Broadley . . . . .	46	7	14	2	2	135	111	24	—
Clark Manning . . . . .	49	—	—	—	—	—	—	—	15
Michael McLintock . . . . .	46	15	38	3	4	435	397	25	91
Nick Prettejohn . . . . .	47	—	—	—	—	—	—	—	74
Barry Stowe . . . . .	50	—	—	—	—	—	—	—	—
Mark Tucker . . . . .	50	—	—	—	—	—	—	—	11

**Notes:**

- (1) As required by Stock Exchange Listing rules.
- (2) As required by the Companies Act remuneration regulations.
- (3) The transfer value equivalent has been calculated in accordance with Actuarial Guidance Note GN11.
- (4) Supplements in the form of cash are included in the Directors' Remuneration summary table.

2008

	Age at 31 Dec 2008	Years of pensionable service at 31 Dec 2008	Accrued benefit at 31 Dec 2008	Additional pension earned during year ended 31 Dec 2008		Transfer value of accrued benefit at 31 Dec (note 3)		Amounts of (B-A) less contributions made by directors during 2008	Contributions to pension and life assurance arrangements (note 4)
				Ignoring inflation on pension earned to 31 Dec 2007 (note 1)	Allowing for inflation on pension earned to 31 Dec 2007 (note 2)	2008 B	2007 A		
			£000	£000	£000	£000	£000	£000	£000
Sir David Clementi . . . . .	59	—	—	—	—	—	—	—	18
Philip Broadley(*) . . . . .	47	8	16	2	2	147	135	12	—
Clark Manning . . . . .	50	—	—	—	—	—	—	—	14
Michael McLintock . . . . .	47	16	43	4	4	426	435	(22)	94
Nick Prettejohn . . . . .	48	—	—	—	—	—	—	—	78
Barry Stowe . . . . .	51	—	—	—	—	—	—	—	4
Tidjane Thiam . . . . .	46	—	—	—	—	—	—	—	96
Mark Tucker . . . . .	51	—	—	—	—	—	—	—	14

\* Philip Broadley left on 31 May 2008 and all transfer information provided is for that date.

**Notes:**

- (1) As required by Stock Exchange Listing rules.
- (2) As required by the Companies Act remuneration regulations.
- (3) The transfer value equivalent has been calculated in accordance with Actuarial Guidance Note GN11.
- (4) Supplements in the form of cash are included in the Directors' remuneration summary table.

	Age at 31 Dec 2009	Years of pensionable service at 31 Dec 2009	Accrued benefit at 31 Dec 2009 £000	Additional pension earned during year ended 31 Dec 2009		Transfer value of accrued benefit at 31 Dec (note 3)		Amounts of (B-A) less contributions made by directors during 2009 £000	Contributions to pension and life assurance arrangements (note 4) £000
				Ignoring inflation on pension earned to 31 Dec 2008 (note 1) £000	Allowing for inflation on pension earned to 31 Dec 2008 (note 2) £000	2009 B £000	2008 A £000		
Rob Devey . . . . .	41	—	—	—	—	—	—	—	0
Clark Manning . . . . .	51	—	—	—	—	—	—	—	21
Michael McLintock . . . . .	48	17	47	5	5	755	426	329(5)	89
Nic Nicandrou . . . . .	44	—	—	—	—	—	—	—	0
Nick Prettejohn . . . . .	49	—	—	—	—	—	—	—	59
Barry Stowe . . . . .	52	—	—	—	—	—	—	—	2
Tidjane Thiam . . . . .	47	—	—	—	—	—	—	—	113
Mark Tucker . . . . .	52	—	—	—	—	—	—	—	16

**Notes:**

- (1) As required by Stock Exchange Listing rules.
- (2) As required by the Companies Act remuneration regulations.
- (3) The transfer value equivalent has been calculated in accordance with Actuarial Guidance Note GN11.
- (4) Supplements in the form of cash are included in the Directors' remuneration table.
- (5) A number of factors operating together have resulted in the increase in transfer value over the year. This includes increases due to changes in market conditions from inflation rates rising and interest rates falling, an extra year of service accruing, an increase in the HMRC earnings cap and Michael drawing one year closer to retirement.

No enhancements to the retirement benefits paid to or receivable by directors or former directors other than the discretionary pension increases awarded to all pensioners have been made during the years 2007, 2008 or 2009.

Total contributions to directors' pension arrangements including cash supplements for pension purposes were £1,163,687 for 2007, £1,027,267 for 2008 and £876,466 for 2009 of which £166,557 for 2007, £268,668 for 2008 and £298,586 for 2009 related to money purchase schemes.

**c Five highest paid individuals**

Of the five individuals with the highest emoluments, two for 2009 (2008: two, 2007: one) are Directors whose emoluments are disclosed in note I4. The aggregate of the emoluments in respect of the other three for 2009 (2008: three; 2007: four) are as follows:

	<u>2007</u> £m	<u>2008</u> £m	<u>2009</u> £m
Basic salaries, allowances and benefits in kind . . . . .	1	1	1
Pension contributions* . . . . .	—	—	—
Bonuses paid or receivable . . . . .	19	10	12
Share based and other cash payments . . . . .	<u>4</u>	<u>2</u>	<u>4</u>
Total . . . . .	<u>24</u>	<u>13</u>	<u>17</u>

\* Pension contributions payable in the period were less than £100,000 in each period.

Their emoluments were within the following bands:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
£2,600,001 — £2,700,000 . . . . .	—	1	—
£3,300,001 — £3,400,000 . . . . .	1	—	—
£3,800,001 — £3,900,000 . . . . .	1	—	—
£4,700,001 — £4,800,000 . . . . .	—	1	—
£4,900,001 — £5,000,000 . . . . .	1	—	—
£5,200,001 — £5,300,000 . . . . .	—	—	1
£5,400,001 — £5,500,000 . . . . .	—	—	1
£6,000,001 — £6,100,000 . . . . .	—	1	—
£6,600,001 — £6,700,000 . . . . .	—	—	1
£12,600,001 — £12,700,000 . . . . .	<u>1</u>	<u>—</u>	<u>—</u>

**I5: Fees payable to auditor (including expenses)**

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Fees payable to Prudential’s auditor for the audit of Prudential’s annual accounts . . . . .	1.8	1.6	1.8
Fees payable to Prudential’s auditor and its associates for other services:			
Audit of subsidiaries and associates pursuant to legislation . . . . .	4.4	5.0	5.5
Other services supplied pursuant to legislation . . . . .	2.9	2.4	2.7
Other services relating to taxation . . . . .	0.4	0.6	0.6
Valuation and actuarial services . . . . .	0.7	0.7	0.1
Services relating to corporate finance transactions . . . . .	0.2	—	0.7
All other services . . . . .	<u>1.0</u>	<u>0.5</u>	<u>1.0</u>
Total . . . . .	<u>11.4</u>	<u>10.8</u>	<u>12.4</u>

In addition, there were fees incurred of £0.2 million, £0.2 million and £0.2 million, for 2007, 2008 and 2009 respectively, for the audit of pension schemes.

The Audit Committee regularly monitors the non-audit services provided to the Prudential Group by its auditor and has developed a formal Auditor Independence Policy which sets out the types of services that the auditor may provide, consistent with the guidance in Sir Robert Smith’s report ‘Audit Committees — Combined Code Guidance’ and with the provisions of the US Sarbanes-Oxley Act.

The Audit Committee annually reviews the auditor’s objectivity and independence.

**I6: Related party transactions**

Transactions between Prudential and its subsidiaries are eliminated on consolidation.

In addition, Prudential has transactions and outstanding balances with certain unit trusts, OEICs, collateralised debt obligations and similar entities which are not consolidated and where a group company acts as manager. These entities are regarded as related parties for the purposes of IAS 24. The balances are included in the Prudential Group’s statement of financial position at fair value or amortised cost in accordance with their IAS 39 classifications. The transactions are included in the income statement and include amounts paid on issue of shares or units, amounts received on cancellation of shares or units and paid in respect of the periodic charge and administration fee. Further details of the aggregate assets, liabilities, revenues, profits or losses and reporting dates of entities considered to be associates under IFRS are disclosed in note H8.

Executive officers and directors of Prudential may from time to time purchase insurance, asset management or annuity products marketed by group companies in the ordinary course of business on substantially the same terms as those prevailing at the time for comparable transactions with other persons.

Apart from the transactions with directors referred to below, no director had interests in shares, transactions or arrangements that require disclosure, other than those given in note I4. Key management and directors’ remuneration are disclosed in note I4.

In 2007, 2008 and 2009, other transactions with directors were not deemed significant both by virtue of their size and in the context of the directors’ financial positions. As indicated above, all of these transactions are on terms broadly equivalent to those that prevail in arm’s length transactions.

## **I7: Subsidiary undertakings**

### *i Principal subsidiaries*

The principal subsidiary undertakings of Prudential at 31 December 2007, all wholly owned except PCA Life Assurance Company Limited and audited by KPMG Audit Plc and/or its member firms, were:

	<u>Main activity</u>	<u>Country of incorporation</u>
The Prudential Assurance Company Limited . . . . .	Insurance	England and Wales
Prudential Annuities Limited* . . . . .	Insurance	England and Wales
Prudential Retirement Income Limited (PRIL)* . . . . .	Insurance	Scotland
M&G Investment Management Limited* . . . . .	Asset management	England and Wales
Jackson National Life Insurance Company* . . . . .	Insurance	US
Prudential Assurance Company Singapore (Pte) Limited* . . . . .	Insurance	Singapore
PCA Life Assurance Company Limited* (99% owned). . . . .	Insurance	Taiwan

\* Owned by a subsidiary undertaking of Prudential.

Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation, except for PRIL which operates mainly in England and Wales.

The principal subsidiary undertakings of Prudential at 31 December 2008, all wholly owned except PCA Life Assurance Company Limited and audited by KPMG Audit Plc and/or its member firms, were:

	<u>Main activity</u>	<u>Country of incorporation</u>
The Prudential Assurance Company Limited . . . . .	Insurance	England and Wales
Prudential Annuities Limited* . . . . .	Insurance	England and Wales
Prudential Retirement Income Limited (PRIL)* . . . . .	Insurance	Scotland
M&G Investment Management Limited* . . . . .	Asset management	England and Wales
Jackson National Life Insurance Company* . . . . .	Insurance	US
Prudential Assurance Company Singapore (Pte) Limited* . . . . .	Insurance	Singapore
PCA Life Assurance Company Limited* (99% owned). . . . .	Insurance	Taiwan

\* Owned by a subsidiary undertaking of Prudential.

Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation, except for PRIL which operates mainly in England and Wales.

The principal subsidiary undertakings of Prudential at 31 December 2009, all wholly owned and audited by KPMG Audit Plc and/or its member firms, were:

	<u>Main activity</u>	<u>Country of incorporation</u>
The Prudential Assurance Company Limited . . . . .	Insurance	England and Wales
Prudential Annuities Limited* . . . . .	Insurance	England and Wales
Prudential Retirement Income Limited (PRIL)* . . . . .	Insurance	Scotland
M&G Investment Management Limited* . . . . .	Asset management	England and Wales
Jackson National Life Insurance Company* . . . . .	Insurance	US
Prudential Assurance Company Singapore (Pte) Limited* . . . . .	Insurance	Singapore

\* Owned by a subsidiary undertaking of Prudential.

Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation, except for PRIL which operates mainly in England and Wales.

### *ii Dividend restrictions and minimum capital requirements*

Certain Prudential Group subsidiaries are subject to restrictions on the amount of funds they may transfer in the form of cash dividends or otherwise to the parent company. UK insurance companies are required to maintain solvency margins which must be supported by capital reserves and other resources, including unrealised gains on investments. Jackson can pay dividends on its capital stock only out of earned surplus unless prior regulatory approval is obtained. Furthermore, without the prior regulatory approval, dividends cannot be distributed if all dividends made within the preceding 12 months exceed the greater of Jackson's statutory net gain from operations or 10% of Jackson's statutory surplus for the prior year. In 2010, the maximum amount of dividends that can be paid by Jackson without prior regulatory approval is US\$454 million (£281 million) (in 2009: US\$290 million)

(£202 million)) and (in 2008: US\$490 million (£246 million)). The Prudential Group's Asian subsidiaries, mainly the Singapore and Malaysia businesses, may remit dividends to the Prudential Group, in general, provided the statutory insurance fund meets the capital adequacy standard required under local statutory regulations.

The Prudential Group capital position statement for life assurance businesses is set out in note D5, showing the available capital reflecting the excess of regulatory basis over liabilities for each fund or group of companies determined by reference to the local regulation of the subsidiaries. In addition, disclosure is also provided in note D5 of the local capital requirements of each of the funds or group of companies.

### *iii Acquisition and disposal of subsidiaries*

2007

On 1 May 2007, Prudential completed the sale of Egg Banking plc to Citibank Overseas Investment Corporation, a subsidiary of Citigroup Inc.

On 9 November 2007, Prudential completed the sale of PPM Capital, its direct private equity business.

The PAC with-profits fund acquired a number of venture capital holdings through PPM Capital and M&G. Prior to November 2007, the Group was deemed to have a controlling interest in these venture capital holdings, in aggregate with, if applicable, other holdings held by, for example, the Prudential Staff Pension Scheme. In November 2007, the Group disposed of PPM Capital following which the Group no longer had a controlling interest in venture fund investment subsidiaries that it managed and consequently ceased to consolidate these investments from that date. The Group continues to consolidate, where applicable, the venture capital holdings managed by M&G.

The acquisitions made in 2007 were as follows:

- 71% of the voting equity interest of Orizon AG, an employment hiring agency, which was managed by PPM Capital; and
- 78% of the voting equity interest of Red Funnel, a ferry company, which was managed by M&G.

These acquisitions are considered individually immaterial and therefore all information relating to the acquisitions has been presented in aggregate in this note.

The results of the acquisitions have been included in the consolidated financial information of the Prudential Group and contributed a loss of £8.3 million to earnings within the income statement.

The table below identifies the net assets of these acquisitions and minor business purchases by existing venture holdings and reconciles the net assets to the consideration paid:

	<b>2007</b>
	<b>Fair Value on</b>
	<b>acquisition</b>
	<b>£m</b>
Cash and cash equivalents . . . . .	20
Other current assets . . . . .	26
Property, plant and equipment . . . . .	38
Intangible assets other than goodwill . . . . .	1
Other non-current assets . . . . .	3
Less liabilities, including current liabilities and borrowings . . . . .	<u>(304)</u>
Net assets acquired . . . . .	<u>(216)</u>
Goodwill . . . . .	<u>313</u>
Cash consideration . . . . .	<u>97</u>

Aggregate goodwill of £313 million was recognised for the excess of the cost over the Prudential Group's interest in the net fair value of the entities' assets, liabilities, and contingent liabilities acquired.

Following the disposal of PPM Capital, SUSPA, TJ Hughes, Sterigenics, Muller & Weygandt, TMF Group, JOST, Histoire D'or, Azzuri Communications, Paramount plc and Orizon AG ceased to be consolidated as subsidiary undertakings and goodwill and other intangible assets, net of amortisation, relating to these investments were derecognised accordingly.

2008

There were no acquisitions or disposals of subsidiaries during the year. There were no new acquisitions or disposals of venture capital investments in 2008. However, during the year, the holding in the voting equity interest of Red Funnel increased from 78% to 90%.

2009

During 2009, the holding in the voting equity interest of Red Funnel, owned by the PAC with-profits fund managed by M&G, increased from 90% to 100%.

## **I8: Commitments**

### *i Operating leases*

The Prudential Group leases various offices to conduct its business. Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Future minimum lease payments for non-cancellable operating leases fall due during the following periods:			
Not later than 1 year . . . . .	38	86	63
Later than 1 year and not later than 5 years . . . . .	126	199	178
Later than 5 years . . . . .	111	140	104

The total minimum future sublease rentals to be received on non-cancellable operating leases for land and buildings for the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, was £0.4 million, £0.2 million, and £nil.

Minimum lease rental payments for the year ended 31 December 2007, 31 December 2008 and 31 December 2009 respectively, of £50 million, £84 million and £105 million are included in the consolidated income statement.

### *ii Capital commitments*

The Prudential Group has provided, from time to time, certain guarantees and commitments to third-parties including funding the purchase or development of land and buildings and other related matters. At 31 December 2007, 31 December 2008 and 31 December 2009 respectively, the aggregate amount of contractual obligations to purchase and develop investment properties amounted to £64 million, £1 million, and £nil.

## **I9: Discontinued operations**

Discontinued banking operations in 2007 related entirely to UK banking operations following the sale on 1 May 2007 of Egg Banking plc to Citi. Consideration paid to Prudential was, net of expenses, £527 million cash. Cash and cash equivalents disposed of in 2007 were £1,065 million. Accordingly, the cash outflow for the Prudential Group in 2007 arising from the disposal of Egg, as shown in the consolidated cash flow statement, was £538 million.

The profit included in the 2007 income statement in respect of discontinued banking operations for the period of ownership was as follows:

	<u>2007</u>
	<u>£m</u>
Interest income . . . . .	261
Interest expense . . . . .	(148)
Net interest income . . . . .	113
Fee and commission income . . . . .	41
Fee and commission expense . . . . .	(8)
Operating income . . . . .	146
General administrative expenses . . . . .	(56)
Impairment losses on loans and cash advances to customers . . . . .	(149)
Other operating expenses . . . . .	(9)
Operating loss based on longer-term investment returns . . . . .	(68)
Profit on sale of Egg Banking plc . . . . .	290
Profit before tax . . . . .	222
Tax on operating loss based on longer-term investment returns . . . . .	19
Tax on profit on sale of Egg Banking plc . . . . .	—
Tax attributable to shareholders' profits . . . . .	19
Profit for the year . . . . .	241

The interest income on financial assets not at fair value through profit and loss for the period of ownership in 2007 was £241 million. The interest expense on financial liabilities not at fair value through profit and loss for the period of ownership in 2007 was £148 million.

Fee and commission income in 2007 includes £27 million relating to financial instruments held at amortised cost. These fees primarily related to balance transfer fees and late payment fees. Fee and commission expense in 2007 includes fee expenses relating to financial liabilities held at amortised cost of £4 million which related to treasury fees. Of the loss for the period of ownership in 2007, no loss was attributable to minority interests in Egg.

In 2009, a charge of £14 million, which is net of nil tax, reflects completion of adjustments for a previously disposed business.

## **I10: Cash flows**

Structural borrowings of shareholder-financed operations comprise core debt of the parent company and Jackson surplus notes. Core debt excludes 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.

Cash flows relating to discontinued operations in 2007, as detailed in note I9, are inflows of £157 million for the period of ownership in 2007. All of these related to cash flows from operating activities.

Structural borrowings of with-profits operations relate solely to the £100 million 8.5% undated subordinated guaranteed bonds which contribute to the solvency base of SAIF. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds are also included within cash flows from operating activities.

## **I11: Post balance sheet events**

### *i Acquisition of UOB Life Assurance Limited*

On 6 January 2010 the Prudential Group announced the acquisition from United Overseas Bank (UOB) of its 100% interest in UOB Life Assurance Limited in Singapore for total cash consideration of SGD428 million (£192 million) subject to a post-completion adjustment to reflect the net asset value as at the completion date. This acquisition accompanied the announcement of a long-term strategic partnership with UOB. Through this partnership the Prudential Group's life insurance products will be distributed through UOB Group's 414 bank branches across Singapore, Indonesia and Thailand.

The Prudential Group continues to complete its compilation of the acquisition balance and further details will be provided in the Prudential Group's 2010 half year results announcement.

*ii Japanese insurance subsidiary's closure to new business*

On 15 January 2010 the Prudential Group's Japanese insurance subsidiary announced its intention to suspend underwriting new policyholder contracts in Japan after 15 February 2010. The company reinforced its commitment to servicing its existing policyholder base, which comprised over 170,000 contracts as at 30 September 2009. This decision will be reviewed on an on-going basis in the light of changes to the business environment.

This decision does not affect the Prudential Group's asset management operations in Japan, which rank amongst the largest foreign asset managers in Japan.

*iii Agreement to acquire AIA Group Limited*

On 1 March 2010, Prudential announced that it had reached agreement with American International Group Inc. ("AIG"), on terms for the combination of Prudential and AIA Group Limited ("AIA"), a wholly-owned subsidiary of AIG (the "Transaction"). The AIA Group is a leading life insurance organisation in the Asia Pacific region which provides individuals and businesses with products and services for their insurance, protection, savings, investment and retirement needs in 15 geographical markets in the region. The combined group will be the leading life insurer in Hong Kong, Singapore, Malaysia, Indonesia, Vietnam, Thailand and the Philippines with the leading foreign life insurance business in China and India, a significantly enhanced presence in the high growth South East Asian life markets and strong operations in the US and UK.

The Transaction will be effected through the acquisition of both Prudential (by a scheme of arrangement, the "Scheme") and AIA by a new company ("New Prudential"). The new company will assume the name Prudential plc, be headquartered and incorporated in the UK, and traded on the main market of the London Stock Exchange with ADRs traded on the New York Stock Exchange. The existing Board of Prudential will become the Board of New Prudential.

AIG will receive total consideration of US\$35.5 billion, comprising US\$25.0 billion in cash (subject to reduction in an amount equal to the aggregate nominal value of any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter) and US\$10.5 billion in New Prudential shares and other securities, which will be increased by an amount equal to the aggregate nominal amount of any subordinated notes for which AIA Aurora subscribes under the Subordinated Note Commitment Letter. The cash component of the consideration will be financed through an underwritten rights issue, raising US\$20.0 billion (net of costs, fees and expenses) and through issuance of up to US\$5.0 billion subordinated notes (net of costs, fees and expenses). These issues have been agreed to be underwritten by certain banks. Subsequently, Prudential has entered into the Hybrid Capital Facility pursuant to which the Joint Lead Arrangers will, at the request of Prudential subscribe for Lower Tier 2 capital notes and/or Upper Tier 2 capital notes and/or advance Lower Tier 2 capital loans and/or advance Upper Tier 2 capital loans in an aggregate principal value of up to US\$5.4 billion to be issued by or advanced to Prudential. In addition to the Hybrid Capital Facility, Prudential has also entered into the Subordinated Note Commitment Letter under which, to the extent that the Joint Lead Arrangers are unable to procure subscriptions in full for the Bond Offerings for an aggregate amount equal to US\$5.4 billion, AIA Aurora has agreed to subscribe for subordinated debt securities in an aggregate amount equal to the lesser of: (i) US\$1.875 billion; and (ii) the amount required to make the aggregate amount of subordinated debt securities subscribed for under the Bond Offerings, the Hybrid Capital Facility and pursuant to the Subordinated Note Commitment Letter equal to US\$5.4 billion. The effectiveness of the Subordinated Note Commitment Letter is conditional on the consent of the Joint Lead Arrangers being obtained.

The Rights Issue and the Scheme will be subject to shareholder approval at the General Meeting. The Transaction is also subject to certain regulatory and anti-trust approvals including various regulatory approvals required on a change of control of Prudential as a result of the Scheme.

On 8 March 2010 Prudential confirmed that the Prudential Group had entered into foreign exchange hedging arrangements in respect of its requirement to convert the pounds sterling proceeds of the rights issue into US dollars, which is the currency in which Prudential must pay the cash element of the consideration.

*iv Change to the Prudential Group's holding in PruHealth and PruProtect*

On 11 May 2010, Discovery Holdings of South Africa announced that it has entered into an agreement to acquire the entire share capital of Standard Life Healthcare, a wholly-owned subsidiary of the Standard Life Group, for £138 million. Discovery will fund the purchase of the Standard Life Healthcare transaction, and intends to contribute Standard Life Healthcare to PruHealth as a capital investment. Once completed, Discovery intend to increase their shareholding in both PruHealth and PruProtect from the current level of 50 per cent, to 75 per cent. Prudential will have a 25 per cent shareholding in both companies within the joint venture, including Standard Life Healthcare. The transaction is subject to obtaining the necessary regulatory approvals from the Financial Services Authority (UK) and the South African Reserve Bank. The effective date of the transaction is expected to be 31 July 2010.

### C. European Embedded Value (EEV) basis supplementary information

This historical European Embedded Value basis supplementary information in relation to Prudential in this Section C of this Part XIV has, unless otherwise stated, been extracted without any modification from the European Embedded Value Basis Supplementary Information in the Annual Report and Accounts 2009. Any page references contained in this section relate to the relevant pages in the European Embedded Value Basis Supplementary Information in the Annual Report and Accounts 2009 and not to any pages within this Prospectus.

#### OPERATING PROFIT BASED ON LONGER-TERM INVESTMENT RETURNS<sup>(i)</sup>

##### Results analysis by business area

	<u>Note</u>	<u>2009</u> £m	<u>2008</u> £m
<b>Asian operations</b>			
New business . . . . .	2	713	634
Business in-force . . . . .	3	392	579
Long-term business . . . . .		1,105	1,213
Asset management . . . . .		55	52
Development expenses . . . . .		(6)	(26)
Total . . . . .		<u>1,154</u>	<u>1,239</u>
<b>US operations</b>			
New business . . . . .	2	664	293
Business in-force . . . . .	3	569	293
Long-term business . . . . .		1,233	586
Broker-dealer and asset management <sup>(ii)</sup> . . . . .		4	7
Total . . . . .		<u>1,237</u>	<u>593</u>
<b>UK operations</b>			
New business . . . . .	2	230	273
Business in-force . . . . .	3	640	764
Long-term business . . . . .		870	1,037
General insurance commission . . . . .		51	44
Total UK insurance operations . . . . .		921	1,081
M&G . . . . .		238	286
Total . . . . .		<u>1,159</u>	<u>1,367</u>
<b>Other income and expenditure</b>			
Investment return and other income . . . . .		22	89
Interest payable on core structural borrowings . . . . .		(209)	(172)
Corporate expenditure:			
Group Head Office . . . . .		(146)	(130)
Asia Regional Head Office . . . . .		(57)	(41)
Charge for share-based payments for Prudential schemes . . . . .		(5)	(6)
Charge for expected asset management margin <sup>(iii)</sup> . . . . .		(38)	(42)
Total . . . . .		<u>(433)</u>	<u>(302)</u>
Restructuring costs <sup>(iv)</sup> . . . . .		(27)	(32)
<b>Operating profit based on longer-term investment returns<sup>(v)</sup> . . . . .</b>		<b><u>3,090</u></b>	<b><u>2,865</u></b>
Analysed as profits (losses) from:			
New business . . . . .	2	1,607	1,200
Business in-force . . . . .	3	1,601	1,636
Long-term business . . . . .		3,208	2,836
Asset management . . . . .		297	345
Other results . . . . .		(415)	(316)
Total . . . . .		<u>3,090</u>	<u>2,865</u>

(i) EEV basis operating profit based on longer-term investment returns excludes short-term fluctuations in investment returns, the mark to market value movements on core borrowings, the shareholders' share of actuarial and other gains and losses on defined benefit pension

schemes, and the effect of changes in economic assumptions and changes in the time value of cost of options and guarantees arising from changes in economic factors. In addition, during the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail events on the Prudential Group IGD capital position. These contracts were in addition to the Prudential Group's regular operational hedging programmes. It also disposed of its Taiwan agency business. The effect of these items has been shown separately from operating profit based on longer-term investment returns. The treatment of the Taiwan agency business within the comparatives is discussed below. The amounts for these items are included in total EEV profit attributable to shareholders. Prudential believes that operating profit, as adjusted for these items, better reflects underlying performance. Profit before tax and basic earnings per share include these items together with actual investment returns. This basis of presentation has been adopted consistently throughout this supplementary information.

- (ii) The US broker-dealer and asset management result includes losses for Curian Capital LLC of £6 million (2008: £3 million).
- (iii) The value of future profits or losses from asset management and service companies that support the Group's covered businesses are included in the profits for new business and the in-force value of the Prudential Group's long-term business. The results of the Prudential Group's asset management operations include the profits from management of internal and external funds. For EEV basis reporting, Prudential Group shareholders' other income is adjusted to deduct the expected margin for the year on management of covered business. The deduction is on a basis consistent with that used for projecting the results for covered business. Prudential Group operating profit accordingly includes the variance between actual and expected profit in respect of covered business.
- (iv) Restructuring costs comprise the charge of £23 million recognised on an IFRS basis and an additional £4 million recognised on the EEV basis for the shareholders' share of restructuring costs incurred by the PAC with-profits fund.
- (v) In June 2009, the Prudential Group completed the previously announced sale of its Taiwan agency business. In order to facilitate comparisons of the results of the Prudential Group's retained businesses the effect of disposal and the results of the Taiwan agency business are shown separately. The presentation of the comparative results for full year 2008 has been adjusted accordingly as explained in note 18.
- (vi) Exchange translation  
The comparative results have been prepared using previously reported exchange rates.

## SUMMARISED CONSOLIDATED INCOME STATEMENT

	<u>Note</u>	<u>2009</u> £m	<u>2008</u> £m
<b>Operating profit based on longer-term investment returns</b>			
Asian operations . . . . .		1,154	1,239
US operations . . . . .		1,237	593
UK operations:			
UK insurance operations . . . . .		921	1,081
M&G . . . . .		238	286
		<b>1,159</b>	1,367
Other income and expenditure . . . . .		(433)	(302)
Restructuring costs . . . . .		(27)	(32)
<b>Operating profit based on longer-term investment returns</b> . . . . .		<b>3,090</b>	2,865
Short-term fluctuations in investment returns . . . . .	5	351	(4,967)
Mark to market value movements on core borrowings . . . . .	9	(795)	656
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .		(84)	(14)
Effect of changes in economic assumptions and time value of cost of options and guarantees . . . . .	6	(910)	(398)
Profit on sale and results for Taiwan agency business . . . . .	18	91	(248)
<b>Profit (loss) from continuing operations before tax (including actual investment returns)</b> . . . . .		<b>1,743</b>	(2,106)
Tax attributable to shareholders' profit (loss) . . . . .	11	(481)	771
<b>Profit (loss) from continuing operations after tax before minority interests</b> . . . . .		<b>1,262</b>	(1,335)
Discontinued operations (net of tax) . . . . .	4	(14)	—
<b>Profit (loss) for the year</b> . . . . .		<b>1,248</b>	(1,335)
Attributable to:			
Equity holders of Prudential . . . . .		1,245	(1,338)
Minority interests . . . . .		3	3
<b>Profit (loss) for the year</b> . . . . .		<b>1,248</b>	(1,335)
<b>Earnings per share (in pence)</b>			
	<u>Note</u>	<u>2009</u>	<u>2008</u>
From operating profit based on longer-term investment returns, after related tax and minority interests of £2,221m (2008: £2,103m) . . . . .	12	<b>88.8p</b>	85.1p
Based on profit (loss) after tax and minority interests of £1,245m (2008: £(1,338)m) . . . . .	12	<b>49.8p</b>	(54.1)p
<b>Dividends per share (in pence)</b>			
		<u>2009</u>	<u>2008</u>
Dividends relating to reporting year:			
Interim dividend (2009 and 2008) . . . . .		6.29p	5.99p
Final dividend (2009 and 2008) . . . . .		13.56p	12.91p
Total . . . . .		<b>19.85p</b>	18.90p
Dividends declared and paid in reporting year:			
Current year interim dividend . . . . .		6.29p	5.99p
Final dividend for prior year . . . . .		12.91p	12.30p
Total . . . . .		<b>19.20p</b>	18.29p

**MOVEMENT IN SHAREHOLDERS' EQUITY (EXCLUDING MINORITY INTERESTS)**

	<u>Note</u>	<u>2009</u>	<u>2008</u>
		£m	£m
Profit (loss) for the year attributable to equity shareholders . . . . .		<b>1,245</b>	(1,338)
Items taken directly to equity:			
Exchange movements on foreign operations and net investment hedges:			
Exchange movements arising during the year . . . . .		<b>(761)</b>	2,010
Related tax . . . . .		<b>11</b>	119
Dividends . . . . .		<b>(481)</b>	(453)
New share capital subscribed . . . . .		<b>141</b>	170
Reserve movements in respect of share-based payments . . . . .		<b>29</b>	18
Treasury shares:			
Movement in own shares held in respect of share-based payment plans . . . . .		<b>3</b>	3
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS . . . . .		<b>(3)</b>	(25)
Mark to market value movements on Jackson assets backing surplus and required capital (gross movement) . . . . .		<b>205</b>	(228)
Related tax . . . . .		<b>(72)</b>	80
Net increase in shareholders' equity . . . . .	10	<b>317</b>	356
Shareholders' equity at beginning of year (excluding minority interests) . . . . .	10	<b>14,956</b>	14,600
<b>Shareholders' equity at end of year (excluding minority interests)</b> . . . . .	7,10	<b><u>15,273</u></b>	<b><u>14,956</u></b>

	31 Dec 2009			31 Dec 2008		
	Long-term business operations	Asset management and other operations	Total £m	Long-term business operations	Asset management and other operations	Total £m
<b>Comprising:</b>						
Asian operations						
Net assets of operation . . . . .	5,781	161	5,942	5,264	167	5,431
Acquired goodwill . . . . .	80	61	141	111	61	172
	<u>5,861</u>	<u>222</u>	<u>6,083</u>	<u>5,375</u>	<u>228</u>	<u>5,603</u>
US operations						
Net assets of operation . . . . .	4,122	95	4,217	4,339	98	4,437
Acquired goodwill . . . . .	—	16	16	—	16	16
	<u>4,122</u>	<u>111</u>	<u>4,233</u>	<u>4,339</u>	<u>114</u>	<u>4,453</u>
UK insurance operations						
Net assets of operation . . . . .	5,439	37	5,476	4,919	—	4,919
M&G						
Net assets of operation . . . . .	—	173	173	—	147	147
Acquired goodwill . . . . .	—	1,153	1,153	—	1,153	1,153
	<u>—</u>	<u>1,326</u>	<u>1,326</u>	<u>—</u>	<u>1,300</u>	<u>1,300</u>
	<u>5,439</u>	<u>1,363</u>	<u>6,802</u>	<u>4,919</u>	<u>1,300</u>	<u>6,219</u>
Other operations						
Holding company net borrowings at market value . . . . .	—	(1,780)	(1,780)	—	(818)	(818)
Other net liabilities . . . . .	—	(65)	(65)	—	(501)	(501)
	<u>—</u>	<u>(1,845)</u>	<u>(1,845)</u>	<u>—</u>	<u>(1,319)</u>	<u>(1,319)</u>
Shareholders' equity at end of year (excluding minority interests) . . . .	<u>15,422</u>	<u>(149)</u>	<u>15,273</u>	<u>14,633</u>	<u>323</u>	<u>14,956</u>
Representing:						
Net assets . . . . .	15,342	(1,379)	13,963	14,522	(907)	13,615
Acquired goodwill . . . . .	80	1,230	1,310	111	1,230	1,341
	<u>15,422</u>	<u>(149)</u>	<u>15,273</u>	<u>14,633</u>	<u>323</u>	<u>14,956</u>
<b>Net Asset Value Per Share (in Pence)</b>				<b>2009</b>	<b>2008</b>	
Based on EEV basis shareholders' equity of £15,273m (2008: £14,956m) . . . . .				<b>603p</b>	599p	
Number of issued shares at year end (millions) . . . . .				<b>2,532</b>	2,497	
<b>Return on embedded value*</b> . . . . .				<b>14.9%</b>	14.4%	

\* Return on embedded value is based on EEV operating profit after tax and minority interests as a percentage of opening EEV basis shareholders' equity.

## SUMMARY STATEMENT OF FINANCIAL POSITION

	<u>Note</u>	<u>2009</u> £m	<u>2008</u> £m
<b>Total assets less liabilities, excluding insurance funds</b> . . . . .		<b>201,501</b>	186,209
Less insurance funds:*			
Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds . . . . .		<b>(195,230)</b>	(181,151)
Less shareholders' accrued interest in the long-term business . . . . .		<b>9,002</b>	9,898
		<b>(186,228)</b>	(171,253)
<b>Total net assets</b> . . . . .	10	<b>15,273</b>	14,956
Share capital . . . . .		127	125
Share premium . . . . .		1,843	1,840
IFRS basis shareholders' reserves . . . . .		4,301	3,093
Total IFRS basis shareholders' equity . . . . .	7	6,271	5,058
Additional EEV basis retained profit . . . . .	7	9,002	9,898
<b>Shareholders' equity (excluding minority interests)</b> . . . . .	7,10	<b>15,273</b>	14,956

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

The EEV basis supplementary information on pages 304 to 340 was approved by the Board on 8 March 2010 and signed on its behalf

**Harvey McGrath**  
Chairman

**Tidjane Thiam**  
Group Chief Executive

**Nic Nicandrou**  
Chief Financial Officer

## **NOTES ON THE EEV BASIS SUPPLEMENTARY INFORMATION**

### **1 Basis of preparation, methodology and accounting presentation**

The EEV basis results have been prepared in accordance with the EEV Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005. Where appropriate, the EEV basis results include the effects of adoption of International Financial Reporting Standards (IFRS).

The Directors are responsible for the preparation of the supplementary information in accordance with the EEV Principles.

#### ***a Covered business***

The EEV results for the Prudential Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Prudential Group's long-term insurance business for which the value of new and in-force contracts is attributable to shareholders. The EEV basis results for the Prudential Group's covered business are then combined with the IFRS basis results of the Prudential Group's other operations.

The definition of long-term business operations is consistent with previous practice and comprises those contracts falling under the definition of long-term insurance business 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. Under the EEV Principles, the results for covered business incorporate the projected margins of attaching internal asset management.

With two principal exceptions, covered business comprises the Prudential Group's long-term business operations. The principal exceptions are for the closed Scottish Amicable Insurance Fund (SAIF) and for the presentational treatment of the financial position of the Prudential Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS). A small amount of UK group pensions business is also not modelled for EEV reporting purposes.

SAIF is a ring-fenced sub-fund of the Prudential Assurance Company (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.

As regards PSPS, the deficit funding liability attaching to the shareholder-backed business is included in the total for Other operations, reflecting the fact that the deficit funding is being paid for by the parent company, Prudential plc.

#### ***b Methodology***

##### ***i Embedded value***

###### ***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 Prudential Group's long-term business comprises:

- present value of future shareholder cash flows from in-force covered business (value of in-force business), less a deduction for the cost of locked-in (encumbered) capital;
- locked-in (encumbered) capital; and
- shareholders' net worth in excess of encumbered 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 1c(iv)) no smoothing of market or account balance values, unrealised gains or investment return is applied in determining the embedded value or profit before tax. Separately, the analysis of profit is delineated between operating profit based on longer-term investment returns and other constituent items, as explained in note 1c(i).

###### ***Valuation of new business***

The contribution from new business represents profits determined by applying non-economic assumptions as at the end of the year.

In determining the new business contribution for UK immediate annuity and lifetime mortgage business, which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business is priced. For other business within the Prudential Group, end of period economic assumptions are used.

#### ***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 reflects 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 the IFRS basis.

However, in determining the movements on the additional shareholders' interest, the basis for calculating the Jackson EEV result 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 are broadly speaking 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 on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

#### ***Value of in-force business***

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency and mortality. 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.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same as that calculated under the IFRS basis. Since the embedded value basis reflects discounted future cash flows, under this methodology the profit emergence is advanced thus more closely aligning the timing of the recognition of profits with the efforts and risks of current management actions, particularly with regard to business sold during the year.

#### ***Cost of capital***

A charge is deducted from the embedded value for the cost of capital supporting the Prudential Group's long-term business. This capital is referred to as encumbered capital. 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 investment earnings (net of tax) 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 encumbered 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 release over time and no further adjustment is necessary in respect of encumbered capital.

#### ***Financial options and guarantees***

##### *Nature of options and guarantees in Prudential Group's long-term business*

#### ***Asian operations***

Subject to local market circumstances and regulatory requirements, the guarantee features described below in respect of UK business broadly apply to similar types of participating contracts principally written in the PAC Hong Kong branch, Singapore and Malaysia. Participating products have both guaranteed and non-guaranteed elements.

Non-participating long-term products are the only ones where the insurer is contractually obliged to provide guarantees on all benefits. Whole of life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequent with market conditions are written in the Korean life operations. This is to a much lesser extent than the policies written by the Taiwan Life business which was sold in the first half of 2009, as detailed in note 18.

### **US operations (Jackson)**

The principal options and guarantees in Jackson are associated with the fixed annuity 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 1.5% to 5.5% (2008: 1.5% to 5.5%), depending on the particular product, jurisdiction where issued, and date of issue. At 31 December 2009, 82% (2008: 83 %) of the account values on fixed annuities relates to policies with guarantees of 3% or less. The average guarantee rate is 3.0% (2008: 3.0%).

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 VA contracts where it contractually guarantees to the contract holder 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 at specified dates during the accumulation period (Guaranteed Minimum Withdrawal Benefit (GMWB)) and minimum accumulation, death and income benefits. Jackson hedges these risks using equity options and futures contracts.

These guarantees generally protect the policyholder's value in the event of poor equity market performance.

Jackson also issues fixed index annuities that enable policyholders to obtain a portion of an equity-linked return while providing a guaranteed minimum return. The guaranteed minimum returns would be of a similar nature to those described above for fixed annuities.

### **UK insurance operations**

The only significant financial options and guarantees in the UK insurance operations arise in the with-profits fund and SAIF. 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. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits fund held a provision on the Pillar I Peak 2 basis of £31 million (2008: £42 million) at 31 December 2009 to honour guarantees on a small amount of guaranteed annuity option products.

Beyond the generic features and the provisions held in respect of guaranteed annuities described above, there are very few explicit options or guarantees of the with-profits fund such as minimum investment returns, surrender values, or annuity values at retirement and any granted have generally been at very low levels.

The Group's main exposure to guaranteed annuity options in the UK is through SAIF and a provision on the Pillar I Peak 2 basis of £284 million (2008: £391 million) was held in SAIF at 31 December 2009 to honour the guarantees.

### **Time value**

The value of financial options and guarantees comprises two parts. One is given by a deterministic valuation on best estimate assumptions (the intrinsic value). The other 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 value of the in-force business including the cost of capital. A deterministic valuation of the in-force business is also derived using consistent assumptions and the time value of the financial options and guarantees is derived as the difference between the two.

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 Prudential 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 note 16.

## *ii Level of encumbered capital*

In adopting the EEV Principles, Prudential has based encumbered capital on its internal targets for economic capital subject to it being at least the local statutory minimum requirements. Economic capital is assessed using internal models but, when applying the EEV Principles, Prudential does not take credit for the significant diversification benefits that exist within the group. 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 encumbered capital requirements. For shareholder-backed business the following capital requirements apply:

- Asian operations: the level of encumbered capital has been set at the higher of local statutory requirements and the economic capital requirement;
- US operations: the level of encumbered capital has been set to an amount at least equal to 235% of the risk-based capital required by the National Association of Insurance Commissioners (“NAIC”) at the Company Action Level (“CAL”), and
- UK insurance operations: the capital requirements are set at the higher of Pillar I and Pillar II requirements for shareholder-backed business of UK insurance operations as a whole, which for 2009 and 2008 was Pillar I.

## *iii 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 equal to risk-free rates plus a risk margin. 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. Prudential has selected a granular approach to better reflect differences in market risk inherent in each product group. The risk discount rate so derived does not reflect an overall Prudential Group market beta but instead reflects the expected volatility associated with the cash flows for each product category in the embedded value model.

Since financial options and guarantees are explicitly valued under the EEV methodology, 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. The majority of non-market and non-credit risks are considered to be diversifiable.

### ***Market risk allowance***

The allowance for market risk represents the multiple of beta x equity risk premium. Except for UK shareholder-backed annuity business (as explained below) such an approach has been used for all of the Prudential 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 are calculated each year. They are combined with the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

### ***Additional credit risk allowance***

The Prudential Group’s methodology is to allow appropriately for credit risk. The allowance for credit risk is to cover:

- expected long-term defaults;
- credit risk premium (to reflect the volatility in 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 which are 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.

#### *Asian operations*

For Asian operations, the allowance for credit risk incorporated in the projected rates of return and the market risk allowance are sufficient. Accordingly no additional allowance for credit risk is required.

#### *US business*

For Jackson business, the allowance for long-term defaults is reflected in the risk margin reserve charge which is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

For 2009 the risk discount rate incorporates an additional allowance for credit risk premium and short-term defaults. The allowance for 2009 is 150 basis points for spread-based business and 30 basis points for variable annuity business to reflect the fact that a proportion of the variable annuity business is allocated to the general account.

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. For 2008 and previously, allowance for these elements of credit risk was recognised only in the risk margin reserve charge and to the extent implicit within the market risk allowance.

#### *UK business*

##### ***a) Shareholder-backed annuity business***

For the Prudential Group's UK 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, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on Prudential's assessment of the expected return on the assets backing the annuity liabilities after allowing for expected long-term defaults, credit risk premium and short-term downgrades and defaults. For the purposes of presentation in the EEV, results the results on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for expected long-term defaults and, where necessary, an additional allowance for an element of short-term downgrades and defaults to bring the allowance in the earned rate up to best estimate levels. The allowances for credit risk premium and additional short-term default allowance are incorporated into the risk margin included in the discount rate.

##### ***b) With-profit fund PAL annuity business***

For UK annuity business written by PAL for 2008 the allowance for credit risk was for best estimate defaults. For 2009, the basis for determining the appropriate aggregate allowance for credit risk has been aligned with that of UK shareholder-backed annuity business so as also to include provision for short-term defaults. The allowance for credit risk in PAL is taken into account in determining the projected cash flows to the with-profits fund, which are in turn discounted at the risk discount rate applicable to all of the projected cash flows of the fund.

##### ***c) With-profit fund holdings of debt securities***

The UK with-profits fund holds debt securities as part of its investment portfolio backing policyholder liabilities and unallocated surplus. For 2008, given the expectation that the widening of credit spreads observed in 2008 would not be maintained, Prudential considered it appropriate to assume an unchanged level of credit spreads, an unchanged level of default allowance and an unchanged risk discount rate methodology relative to those used at 31 December 2007. For 2009, the approach for with-profit holdings has been refined. For equities and properties the projected earned rate is defined as the risk-free rate plus a long-term risk premium. Under the revised methodology

a similar approach is adopted for corporate bonds i.e. the assumed earned rate is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults.

#### *Allowance for non-diversifiable non-market risks*

Finance theory cannot be used to determine the appropriate component of beta for non-diversifiable non-market risks since there is no observable risk premium associated with it that is akin to the equity risk premium. Recognising this, a pragmatic approach has been applied.

For UK shareholder-backed annuity business, a margin of 100 basis points is used to cover the non-diversifiable non-market risks associated with the business. For the Prudential Group's other business a margin of 50 basis points is applied with, where necessary, an additional allowance for emerging market risk. The additional 50 basis points for UK annuities business reflects the longevity risk which is of particular relevance.

#### *iv Management actions*

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, the following areas:

- investment allocation decisions;
- levels of reversionary bonuses and credited rates; and
- total claim values.

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.

#### *v 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%. 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 those few extreme 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-profit funds of the Prudential Group's Asian operations.

#### *vi Pension costs*

The Prudential Group operates three defined benefit schemes in the UK. The principal scheme is the Prudential Staff Pension Scheme (PSPS). The other two, much smaller, schemes are the Scottish Amicable and M&G schemes. There is also a small scheme in Taiwan, but as part of the sale of the Taiwan agency business completed in June 2009, the Prudential Group settled the majority of the obligations under the scheme as a significant number of employees were transferred out.

Under IFRS the surpluses or deficits attaching to these schemes are accounted for in accordance with the provisions of IAS 19 that apply the principles of IFRIC 14, which was adopted in 2008 providing guidance on assessing the limit in IAS 19 on the amount of surplus in a defined benefit pension scheme that can be recognised as an asset.

Under the EEV basis the IAS 19 basis surpluses (to the extent not restricted under IFRIC 14) or deficits are initially allocated in the same manner. The shareholders' 10% interest in the PAC with-profits fund estate is determined after inclusion of the portion of the IAS 19 basis surpluses or deficits attributable to the fund. Adjustments under EEV in respect of accounting for surpluses or deficits on the Scottish Amicable Pension Scheme are reflected as part of UK operations and for other defined benefit schemes the adjustments are reflected as part of 'Other operations', as shown in note 7.

Separately, the projected cash flows of in-force covered business include the cost of contributions to the defined benefit schemes for future service based on the contribution basis applying to the schemes at the time of the preparation of the results.

*vii Debt capital*

Core structural debt liabilities are carried at market value. As the liabilities are generally held to maturity or for the long-term, no deferred tax asset or liability has been established on the difference, compared to the IFRS carrying value. Accordingly, no deferred tax credit or charge is recorded in the results for the reporting period in respect of the mark to market value adjustment.

*viii Foreign currency translation*

Foreign currency profits and losses have been translated at average exchange rates for the year. Foreign currency assets and liabilities have been translated at year end rates of exchange. The purpose of translating the profits and losses at average exchange rates, notwithstanding the fact that EEV profit represents the incremental value added on a discounted cash flow basis, is to maintain consistency with the methodology applied for IFRS basis reporting.

***c Accounting presentation***

*i Analysis of profit before tax*

To the extent applicable, presentation of the EEV profit for the year is consistent with the basis that the Prudential Group applies for analysis of IFRS basis profits before shareholder taxes between operating and non-operating results. Operating results reflect the underlying results including longer-term investment returns and, except as explained in note (iv) below, the unwind of discount on the value of in-force business. Operating results include the impact of routine changes of estimates and non-economic assumptions. Non operating results comprise short-term fluctuations in investment returns, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes, the mark to market value movements on core borrowings and the effect of changes in economic assumptions and changes in the time value of cost of options and guarantees arising from changes in economic factors. In 2009, during the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Prudential Group incurred non-recurrent costs from an exceptional short dated hedge to protect against tail events on the Prudential Group IGD capital position in addition to regular operational hedging programs. These costs have been shown separately within short-term fluctuations in investment returns. Also, in June 2009, the Prudential Group completed the disposal of the Taiwan agency business. The effect of this disposal and the results of the Taiwan agency business have been presented separately outside of the operating result.

*ii 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 purposes of calculating the longer-term investment return to be included in the operating result of the PAC with-profits fund of UK operations, where assets backing the liabilities and unallocated surplus are subject to market volatility, values of assets at the beginning of the reporting period are adjusted to remove the effects of short-term market movements.

For the purposes of determining the long-term returns for debt securities of US operations for fixed annuity and other general account business, a risk margin 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 year-end risk-free rates and equity risk premium. For US variable annuity separate account business, operating profit includes the unwind of discount on the opening value of in-force adjusted to reflect year-end projected rates of return with the excess or deficit of the actual return recognised within non-operating profit, together with the 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 reflected in the result for the year. In general, the effect is booked in operating results. However, in 2008 the element due to the exceptional spread widening in the market since 31 December 2006 was booked in the effect of change in economic assumptions.

*iii Effect of changes in operating assumptions*

Operating profits include the effect of changes to operating assumptions on the value of in-force business at the end of the period. For presentational purposes, the effect of change is delineated to show the effect on the opening value of in-force with the experience variance being determined by reference to the end of period assumptions.

*iv Unwind of discount and other expected returns*

The unwind of discount and other expected returns is determined by reference to the value of in-force business, required capital and surplus assets at the start of the period as adjusted for the effect of changes in economic and operating assumptions reflected in the current period. For UK insurance operations the amount included within operating results based on longer-term returns represents the unwind of discount on the value of in-force business at the beginning of the period (adjusted for the effect of current period assumption changes), the unwind of discount on additional value representing the shareholders' share of smoothed surplus assets retained within the PAC with-profits fund (as explained in note 1b(v) above), and the expected return on shareholders' assets held in other UK long-term business operations. Surplus assets retained within the PAC with-profits fund are smoothed for this purpose to remove the effects of short-term investment volatility from operating results. In the summary statement of financial position and for total profit reporting, asset values and investment returns are not smoothed.

*v Pension costs*

***Profit before tax***

Movements on the shareholders' share of surpluses (to the extent not restricted by IFRIC 14) and deficits of the Group's defined benefit pension schemes adjusted for contributions paid in the year are recorded within the income statement. Consistent with the basis of distribution of bonuses and the treatment of the estate described in note 1b(iv) and (v), the shareholders' share incorporates 10% of the proportion of the financial position attributable to the PAC with-profits fund. The financial position is determined by applying the requirements of IAS 19.

***Actuarial and other gains and losses***

For pension schemes in which the IAS 19 position reflects the difference between the assets and liabilities of the scheme, actuarial and other gains and losses comprise:

- the difference between actual and expected return on the scheme assets;
- experience gains and losses on scheme liabilities;
- the impact of altered economic and other assumptions on the discounted value of scheme liabilities; and
- for pension schemes where the IAS 19 position reflects a deficit funding obligation, actuarial and other gains and losses reflect the movement in estimates of deficit funding requirements.

These items are recorded in the income statement but, consistent with the IFRS basis of presentation, are excluded from operating results.

*vi Effect of changes in economic assumptions and time value of cost of options and guarantees*

Movements in the value of in-force business at the beginning of the period caused by changes in economic assumptions and the time value of cost of options and guarantees resulting from changes in economic factors are recorded in non-operating results.

*vii Taxation*

The EEV profit for the year for covered business is in most cases calculated initially at the post-tax level. The post-tax profit is then grossed up for presentation purposes at the effective rate of tax. In general, the effective rate corresponds to the corporation tax rate on shareholder profits of the business concerned.

*viii Inter-company arrangements*

The EEV results for covered business incorporate the effect of the reinsurance arrangement of non-profit immediate pension annuity liabilities of SAIF (which is not covered business) to PRIL. In addition, the analysis of free surplus and value of in-force business takes account of the impact of contingent loan arrangements between Prudential Group companies.



- (ii) In determining the EEV basis value of new business written in the period the policies incept, 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.
- (iii) New business contributions represent profits determined by applying non-economic assumptions as at the end of the year. In general, the use of point of sale or end of period economic assumptions is not significant in determining the new business contribution for different types of business and across financial reporting periods. However, to obtain proper measurement of the new business contribution for business which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business was priced. In practice, the only area within the Prudential Group where this has a material effect is for UK shareholder-backed annuity and lifetime mortgage business. For other business within the Prudential Group end of period economic assumptions are used.
- (iv) The tables above include new business for the Taiwan bank distribution operation. New business of the Taiwan agency business, which was sold in June 2009 is excluded from the tables but included in the result for the sold Taiwan agency business, shown separately in the analysis of profit, as shown in note 18. Comparative figures have been adjusted accordingly.
- (v) The increase in new business margin for US operations for 2009 reflects the significant changes to target spread for Fixed Annuity and Fixed Index Annuity business primarily as a result of the exceptional combined benefit of high investment yields on new assets and lower crediting rates, as described in note 16b, and the increasing proportion of variable annuity business, for which margins have benefited from the increased projected separate account return, revised benefits and higher take-up rates on the higher margin guaranteed withdrawal benefits.

### 3 Operating profit from business in-force

#### Group Summary

	Asian operations (note iv)	US operations (note v)	UK Operations (note vi)	Total
	£m	£m	£m	£m
<b>2009</b>				
Unwind of discount and other expected returns <sup>(note i)</sup> . . . . .	489	344	588	1,421
Effect of change in operating assumptions <sup>(note ii)</sup> . . . . .	(12)	101	—	89
Experience variances and other items <sup>(note iii)</sup> . . . . .	(85)	124	52	91
Total . . . . .	<u>392</u>	<u>569</u>	<u>640</u>	<u>1,601</u>
<b>2008</b>				
Unwind of discount and other expected returns . . . . .	409	233	569	1,211
Effect of change in operating assumptions . . . . .	165	(17)	—	148
Experience variances and other items . . . . .	5	77	195	277
Total . . . . .	<u>579</u>	<u>293</u>	<u>764</u>	<u>1,636</u>

#### Notes

(i) **Unwind of discount and other expected returns**

The increase in unwind of discount and other expected returns from £1,211 million for 2008 to £1,421 million for 2009 mainly arises in the US, primarily reflecting an increase in the discount rate applied to the value of in-force business (as adjusted for the effects of changes in operating and non-operating assumptions) and in Asian operations as a result of higher start of year value of in-force business, reflecting the increasing growth of this business.

(ii) **Effect of change in operating assumptions**

The charge of £(12) million for Asian operations in 2009 primarily represents a charge of £(78) million for the effect of strengthening persistency assumptions, offset by a credit of £69 million relating to altered projected net of tax cash flows arising from a regulatory reclassification of health and protection products in Hong Kong. The change in persistency assumptions are mainly as a direct consequence of the impact on policyholders' savings behaviour from adverse economic and market conditions, arising primarily for investment related products, principally in Korea (£(25) million) and Hong Kong (£(12) million), mostly due to premium holidays, and in Indonesia (£(24) million), reflecting recent experience.

The credit of £101 million for US operations in 2009 primarily reflects the positive impact of altered assumptions arising from beneficial policyholder behaviour for Guaranteed Minimum Withdrawal Benefits on Variable Annuity business, as explained in note v(1) below.

(iii) **Experience variances and other items**

The £(85) million charge for Asian operations in 2009 primarily represents the effects of adverse persistency of £(76) million, as customers have withdrawn from investment related products (for which assumptions have been strengthened, as explained in note ii above). The residual £(9) million charge reflects a combination of adverse expense experience of £(43) million, offset by the favourable mortality and morbidity experience of £52 million, (as explained in notes iv(5) and iv(6) below) and a charge of £(18) million for other items.

The £124 million credit in US operations in 2009 primarily represents £59 million for the amortisation of interest-related realised gains and losses, £40 million for lower than expected levels of expenses and £32 million for favourable mortality experience as detailed in note v(7) below.

The credit of £52 million for UK insurance operations is detailed in note vi below.

## Analysis by business unit

### (iv) Asian operations

	<u>2009</u>	<u>2008</u>
	£m	£m
Unwind of discount and other expected returns	489	409
Effect of change in operating assumptions:		
Mortality and morbidity <sup>(1)</sup>	26	41
Expense <sup>(2)</sup>	(32)	30
Persistency <sup>(3)</sup>	(78)	79
Other <sup>(4)</sup>	72	15
	<u>(12)</u>	165
Experience variances and other items:		
Mortality and morbidity <sup>(5)</sup>	52	34
Expense <sup>(6)</sup>	(43)	(37)
Persistency <sup>(7)</sup>	(76)	16
Other	(18)	(8)
	<u>(85)</u>	<u>5</u>
	<u>392</u>	<u>579</u>

#### Notes

- (1) The favourable effect of £26 million in 2009 for mortality and morbidity assumption changes primarily arises in Indonesia of £24 million reflecting recent experience. The benefit of £41 million for 2008 mainly relates to Singapore of £34 million and Hong Kong of £15 million, which reflect actual experience across most products, offset by a charge in Malaysia of £(19) million which reflects negative morbidity experience on health and protection products.
- (2) The charge of £(32) million for strengthened expense assumptions arises principally in Hong Kong of £(23) million with the balance across the regions.
- (3) The negative effect of the change in persistency assumptions of £(78) million in 2009 arises mostly with investment related products, principally in Korea (£(25) million), Indonesia (£(24) million) and Hong Kong (£(12) million).  
The favourable effect of the change in persistency assumptions of £79 million in 2008 predominately arose in Singapore (£90 million), Hong Kong (£28 million) (principally for health and protection products) and in Malaysia (£21 million) which reflected improved lapse rates, based on recent experience, offset by a charge in Korea (£(44) million) mainly relating to premium holidays.
- (4) The effect of other assumption changes for 2009 of £72 million comprises the one-off positive impact of £69 million for altered projected net of tax cash flows arising from a regulatory reclassification of health and protection products in Hong Kong, a credit of £13 million for the effect of altered application of the Group's EEV methodology and a net charge of £(10) million for other items. The £13 million effect comprises adjustments for asset management margins in Indonesia and Korea of £37 million and a charge of £(24) million to better align the assumed capital requirement with internal management and pricing bases, primarily in China, Indonesia, Philippines and Vietnam, and other minor adjustments with a neutral net effect.
- (5) The favourable effects of £52 million in 2009 and £34 million in 2008 relating to mortality and morbidity experience variances reflect better than expected experience across the territories.
- (6) The charge of £(43) million for expense experience variance arises across the territories, principally in Korea (£(10) million) reflecting the lower level of sales in the current year, £(8) million in Taiwan, following the sale of the Agency business during the year and £(16) million for expense overruns for operations which are at a relatively early stage of development, for which actual expenses are in excess of those factored into the product pricing.  
The 2008 negative expense experience variance of £(37) million includes a charge of £(11) million arising in Korea, also reflecting lower sales.
- (7) The charge of £(76) million in 2009 relating to negative persistency experience arises across the region with the largest impacts in Korea (£(29) million), India (£(11) million) and Japan (£(9) million).

(v) US operations

	<u>2009</u>	<u>2008</u>
	£m	£m
Unwind of discount and other expected returns	344	233
Effect of changes in operating assumptions:		
Guaranteed Minimum Withdrawal Benefit (GMWB) policyholder behaviour <sup>(1)</sup>	156	—
Mortality <sup>(2)</sup>	33	31
Variable Annuity (VA) fees <sup>(3)</sup>	(13)	29
Effect of adjustments for application of EEV methodology for certain reserves and required capital <sup>(4)</sup>	—	(61)
Other <sup>(5)</sup>	(75)	(16)
	<b>101</b>	<b>(17)</b>
Experience variances and other items:		
Spread experience variance <sup>(6)</sup>	(3)	54
Amortisation of interest-related realised gains and losses <sup>(6)</sup>	59	28
Other <sup>(7)</sup>	68	(5)
	<b>124</b>	<b>77</b>
	<b>569</b>	<b>293</b>

Notes

- (1) The positive impact of the change in GMWB policyholder behaviour assumptions of £156 million reflects the altered assumptions relating to the utilisation of withdrawal features available to policyholders on VA contracts which have been modified to take account of the more recent experience of policyholder behaviour when benefits are “in the money”. Previously, policyholder behaviour for the utilisation of GMWB was assumed to be largely driven by the extent to which benefits were in the money. For 2009, the assumption has been altered to take account of recent experience which shows that the attained age of the policyholder is the key factor in determining utilisation levels.
- (2) The £33 million credit for mortality for 2009 primarily reflects lower mortality rates for the Life of Georgia business, based upon actual experience since the acquisition of the business in 2005.
- (3) The effect of the change of assumption for VA fees represents the capitalised value of the change in the projected level of policyholder advisory fees, which vary according to the size and mix of VA funds. The charge of £(13) million for 2009 reflects a reduction in the projected level of fees paid by policyholders, according to the current fund mix. The positive effect of the change in 2008 of £29 million represents an overall reassessment of the assumed fees, reflecting recent experience at that date.
- (4) The effect of the adjustments in 2008 for the application of EEV methodology for certain reserves and required capital of £(61) million are as follows:

	<u>2008</u>
	£m
Effect of adjustments for application of EEV methodology for certain reserves and required capital:	
Interest Maintenance Reserve (IMR) <sup>(a)</sup>	(10)
Variable Annuity Statutory Reserves <sup>(b)</sup>	(68)
Required Capital <sup>(c)</sup>	17
	<u>(61)</u>

- (a) The IMR is a statutory liability in respect of realised gains on the sale of bonds which, on a regulatory basis, are amortised to income over time in line with the duration of the bonds sold.
- (b) The statutory reserves are primarily in respect of guarantees on variable annuity products in excess of the surrender value.
- (c) The adjustment in respect of required capital represents a current year refinement to reduce the required capital to align the amount with the required level which has been set as an amount at least equal to 235% of the risk-based capital required by the National Association of Insurance Commissioners at the Company Action Level.
- (5) The effect of other changes in assumptions in 2009 of £(75) million primarily represents the negative impact of changes in persistency assumptions of £(53) million, reflecting an increase in the assumed utilisation of the partial withdrawal option on Variable and Fixed Annuity business of £(29) million and £(24) million for the effect of other altered lapse rates, in line with experience.
- (6) The spread assumption for Jackson is determined on a longer-term basis, net of provision for defaults. The charge of £(3) million for spread experience variance in 2009 is better assessed in the context of both spread and amortisation of interest-related realised gains and losses. Amortisation of interest-related gains and losses reflects the same treatment applied to the supplementary analysis of IFRS profit. When bonds that are neither impaired nor deteriorating are sold and reinvested there will be a consequent change in the investment yield. To reflect better the longer-term returns on operating profits the realised gain or loss is amortised into the result over the period when the bonds would have otherwise matured. The net effect on the EEV results of these two items is a credit of £56 million for 2009 and £82 million for 2008.
- (7) The credit of £68 million for other items for 2009 primarily represents favourable expense experience variance of £40 million relating to marketing expenses and positive mortality experience of £32 million primarily relating to life products.

(vi) *UK insurance operations*

	<u>2009</u>	<u>2008</u>
	£M	£M
Unwind of discount and other expected returns	588	569
Other items:		
Effect of asset rebalancing <sup>note</sup>	22	118
Release of certain annuity business reserves	—	56
Other	30	21
	<u>52</u>	<u>195</u>
	<u>640</u>	<u>764</u>

**Note**

For UK annuity business, the effects of rebalancing the asset portfolio backing the liabilities to policyholders are normally reflected in full in the operating result for the year. These effects arise from the altered value arising from the revised projected yield and allowances for default risk.

During 2007 and 2008, exceptional credit spread widening took place. Accordingly in 2008, to better reflect performance reporting, the effect of asset rebalancing reflected in the operating result was determined by reference to investment conditions at 31 December 2006. The excess effect of asset rebalancing was included in non-operating results, as described in note 6.

**4 Discontinued operations**

The charge of £(14) million, which is net of nil tax, reflects completion adjustments for a previously disposed business.

**5 Short-term fluctuations in investment returns**

	<u>2009</u>	<u>2008</u>
	£m	£m
Insurance operations:		
Asia <sup>(note i)</sup>	437	(903)
US <sup>(note ii)</sup>	(401)	(1,344)
UK <sup>(note iii)</sup>	445	(2,407)
Other operations:		
IGD hedge costs <sup>(note iv)</sup>	(235)	—
Other <sup>(note v)</sup>	105	(313)
Total	<u>351</u>	<u>(4,967)</u>

**Notes**

**i Asian operations**

	<u>2009</u>	<u>2008</u>
	£m	£m
Singapore	159	(310)
Hong Kong	113	(284)
Vietnam	(47)	(82)
Other operations	212	(227)
	<u>437</u>	<u>(903)</u>

The short-term fluctuations in investment returns in Asia for 2009 of £437 million reflect the effect of strong equity market performance in particular for participating business and unit-linked business where the in-force value benefits from increases in shareholder transfers and from the capitalisation of increased projected fees due to the higher asset base at the end of the year.

For 2008, the short-term fluctuations in investment returns for Asian operations of £(903) million arose primarily in Singapore and Hong Kong, reflecting the effect of substantial equity market falls on unit-linked and with-profits business. For unit-linked business, the short-term fluctuation in investment returns reflects the reduction in the value of the asset base and the consequent effect on the projection of future management fees. For with-profits business, the short-term fluctuation in investment returns reflects the difference between the shareholders' ten % interest in the value movements on the assets and the unwind of discount on the opening shareholders' interest in the surplus.

## ii US operations

The fluctuations for US operations comprise the following items:

	<u>2009</u>	<u>2008</u>
	£m	£m
Actual realised losses less default assumption and amortisation of interest-related gains and losses for fixed income securities and related swap transactions <sup>(1)</sup> . . . . .	(367)	(463)
Actual less long-term return on equity based investments and other items <sup>(2)</sup> . . . . .	(144)	(148)
Investment return related gain (loss) due primarily to changed expectation of profits on in-force variable annuity business in future periods based on current period equity returns, net of related hedging activity for equity related products <sup>(3)</sup> . . . . .	110	(733)
Total Jackson . . . . .	<u>(401)</u>	<u>(1,344)</u>

### Notes

- (1) The charge of £(367) million in 2009 relating to fixed income securities primarily represents the excess of the impairment losses in the year on the US statutory basis over the amortisation of interest-related gains and longer-term default assumption included within operating profit.
- (2) The charge in 2009 of £(144) million for actual less long-term return on equity based investments and other items primarily relates to the shortfall of actual return against the expected return on investments in limited partnerships.
- (3) This gain (loss) arises due to the market returns being higher (lower) than the assumed longer-term rate of return. This gives rise to higher (lower) than expected year end values of variable annuity assets under management with a resulting effect on the projected value of future account values and hence future profitability from altered fees. For 2009, the US equity market returns were approximately positive 24% compared to the assumed longer-term rate of return of 7.4%. For 2008, the US equity market returns were approximately negative 38.5% compared to the assumed longer-term rate of return of 5.8%.

## iii UK insurance operations

The short-term fluctuations in investment returns for UK insurance operations for 2009 represents:

	<u>2009</u>	<u>2008</u>
	£m	£m
With-profits <sup>(1)</sup> . . . . .	430	(2,083)
Shareholder-backed annuity <sup>(2)</sup> . . . . .	(40)	(213)
Unit-linked and other <sup>(3)</sup> . . . . .	55	(111)
	<u>445</u>	<u>(2,407)</u>

### Notes

- (1) For with-profits business the credit for 2009 of £430 million (2008: charge of £(2,083) million) reflects the positive variance of 8.6% (2008: negative 25.3%) against the assumed long-term return for the investments covering policyholder liabilities and unallocated surplus.
- (2) Short-term fluctuations in investment returns on shareholder-backed annuity business for 2009 of £(40) million primarily represents mismatching losses arising from a fall in yields on assets of £(105) million, partially offset by better than expected default experience of £22 million. The remaining balance of £43 million consists of positive movements in other asset values partially offset by losses on surplus assets relative to the expected return. The charge for 2008 of £(213) million primarily represented an unrealised loss on surplus assets and default experience.
- (3) The credit of £55 million relates primarily to unit-linked business representing the increase in capitalised value of future fees arising from the positive movements in market values experienced during the year.

## iv IGD hedge costs

During the severe equity market conditions experienced in the first quarter of 2009, coupled with historically high equity volatility, the Prudential Group entered into exceptional short-dated hedging contracts to protect against potential tail-events on the IGD capital position, in addition to its regular operational hedging programmes. The hedge contracts have expired and have not been renewed.

## v Other operations

Short-term fluctuations in investment returns of Other operations, in addition to the previously discussed IGD hedge costs, arise from:

	<u>2009</u>	<u>2008</u>
	£m	£m
Sale of investment in India mutual fund in May 2008 giving rise to a transfer to operating profit of £47m for the crystallised gain, and value reduction in the year, prior to sale, of £24m . . . . .	—	(71)
Unrealised value movements on swaps held centrally to manage Group assets and liabilities . . . . .	28	(38)
Unrealised value movements on Prudential Capital bond portfolio . . . . .	66	(190)
Unrealised value movements on investments held by Other operations . . . . .	11	(14)
	<u>105</u>	<u>(313)</u>

## 6 Effect of changes in economic assumptions and time value of cost of options and guarantees

The effects of changes in economic assumptions and time value of cost of options and guarantees resulting from changes in economic factors for in-force business included within the profit (loss) from continuing operations before tax (including actual investment returns) arise as follows:

	2009			2008		
	Change in economic assumptions	Change in time value of cost of options and guarantees	Total £m	Change in economic assumptions	Change in time value of cost of options and guarantees	Total £m
Asian operations <sup>(note i)</sup> . . . . .	(165)	(9)	(174)	157	—	157
US operations <sup>(note ii)</sup> . . . . .	(528)	10	(518)	267	11	278
UK insurance operations <sup>(notes iii,iv)</sup> . . . . .	(270)	52	(218)	(783)	(50)	(833)
Total . . . . .	<u>(963)</u>	<u>53</u>	<u>(910)</u>	<u>(359)</u>	<u>(39)</u>	<u>(398)</u>

### Notes

(i) The effect of changes in economic assumptions in Asia for 2009 of a charge of £(165) million primarily reflects increases in risk discount rates and fund earned rates (as shown in note 16b), with the largest impact arising for Hong Kong US dollar denominated business arising from the increase in US dollar government bond yields. The £(165) million charge is net of a credit of £96 million for the effect of altered economic assumptions for Indonesia and Korea arising from a change in the application of the Prudential Group's methodology for these operations (as discussed in note 16b).

The effect of changes in economic assumptions in Asia for 2008 of a credit of £157 million reflects the impact of the reduction in risk discount rates across most territories.

(ii) The charge of £(528) million for the effect of changes in economic assumptions for US operations for 2009 reflects the following:

	2009 £m	2008 £m
Effect of changes in 10-year treasury rates, beta and equity risk premium <sup>(note)</sup>		
Fixed annuity and other general account business . . . . .	(410)	385
Variable Annuity (VA) business . . . . .	183	(118)
Increase in risk margin allowance for credit risk <sup>note</sup> . . . . .	(301)	—
	<u>(528)</u>	<u>267</u>

### Note

For Jackson, the charge for the effect of changes in economic assumptions represents the aggregate of the effects of changes to projected returns and the risk discount rate. The risk discount rate, as discussed in note 1b(iii), represents the aggregate of the risk-free rate and margin for market risk, credit risk and non-diversifiable non-market risk.

For fixed annuity and other general account business the effect of changes to the risk-free rate, which is defined as the 10-year treasury rate, is reflected in the risk discount rate. This discount rate is in turn applied to projected cash flows which principally reflect projected spread, which is largely insensitive to changes in the risk-free rate. For 2009, the effect of these changes resulted in an overall charge for fixed annuity and other general account business of £(410) million, reflecting the increase in the risk-free rate of 1.6% (as shown in note 16b). For 2008, the effect of the change in economic assumptions on this business was a credit of £385 million, which reflects the decrease in the risk-free rate of 1.8%.

For VA business, changes to the risk-free rate are also reflected in determining the risk discount rate. However, the projected cash flows are also reassessed for altered investment returns on the underlying separate account assets from which fees are charged. For 2009, the effect of both of these changes resulted in an overall credit on VA business of £183 million, reflecting the increase in the risk-free rate of 1.6% (as shown in note 16b). For 2008, the effect of the change in economic assumptions on VA business of a charge of £(118) million reflects the decrease in the risk-free rate of 1.8%.

In 2009, the Group has included an additional allowance for credit risk. In determining this allowance a number of factors were considered. These factors, in particular, include:

- How much of the credit spread on debt securities represents an increased credit risk not reflected in the RMR long-term default assumptions, and how much is liquidity premium. In assessing this effect consideration has been given to a number of approaches to estimating the liquidity premium by considering statistical data over the four years from 2006 to 2009, 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 loss to policyholders (subject to guarantee features) through lower crediting rates. Consequently, it is only necessary to allow for the balance of the credit risk in the risk discount rate.

After taking these and other more detailed factors into account and, based on market conditions in late 2009, the risk discount rate for spread business has been increased by 150 basis points as an additional allowance for credit risk. For VA business, the additional allowance increase has been set at 20% of the non-VA business increase to reflect the fact that a proportion of the VA business is allocated to general account holdings of debt securities.

The additional allowance to be applied in future reporting periods will be altered, as necessary, for future credit conditions and as the business in-force alters over time. Accordingly, a simple formulaic approach for the future allowance is not possible and does not apply. However, as a guide the current allowance can be summarised as broadly reflecting that 50 % of the increase in credit spread since 31 December 2006 can be attributed to credit risk and 50% to liquidity premium, and that management actions can be used to absorb some 50 basis points of credit losses without adversely impacting value.

(iii) The effect of changes in economic assumptions of a charge of £(270) million for UK insurance operations comprises the effect of:

	2009			2008		
	Shareholder-backed annuity business (note 1)	With-profits and other business (note 2)	Total	Shareholder-backed annuity business (note 1)	With-profits and other business (note 2)	Total
	£m			£m		
(Decrease) increase in expected long-term rates of return	(284)	191	(93)	83	(1,082)	(999)
Decrease (increase) in risk discount rates	240	(311)	(71)	(394)	668	274
Other changes	25	(131)	(106)	(6)	(52)	(58)
	<u>(19)</u>	<u>(251)</u>	<u>(270)</u>	<u>(317)</u>	<u>(466)</u>	<u>(783)</u>

#### Notes

- (1) In 2008, the £(317) million charge comprises £(400) million for the effect of strengthening credit risk assumptions, offset by a credit of £231 million for the effect of rebalancing the asset portfolio calculated by reference to the exceptional changes in credit spreads from 31 December 2006 to 31 December 2008, and an underlying charge of £(148) million for regular changes in yields and discount rates. In 2009, the charge of £(19) million reflects the effects of regular economic assumption changes. However, the amounts for the component line items shown above reflect a change in the composition of the default allowance between best estimate levels (which are reflected in the long-term rates of return) and allowance for credit risk premium and additional short-term defaults reflected in the risk discount rate.
- (2) In 2009, the charge of £(251) million for with-profits and other business reflects the fact that the risk discount rate has increased significantly more than the earned rate as a result of the revised correlation assumptions, lower equity backing ratio and very low cash return. In 2008, the charge of £(466) million for the effects of the decrease in expected long-term rates of return and risk discount rates primarily reflect the reduction in gilt rates of (0.85)%.
- (iv) The effect of changes in time value of cost of options and guarantees of a credit of £52 million for UK insurance operations primarily relates to with-profits business reflecting the effect of the improved investment return achieved in 2009, combined with an overall beneficial impact arising from changes in economic assumptions. In 2008, the charge of £(50) million primarily related to with-profits business reflecting the effect of the reduction in the expected long-term rates of return as described in note (2) above.

## 7 Shareholders' funds — segmental analysis

	2009	2008
	£m	£m
<b>Asian operations</b>		
Long-term business:		
Net assets of operations — EEV basis shareholders' funds	5,781	5,264
Acquired goodwill	80	111
	<u>5,861</u>	<u>5,375</u>
Asset management: <sup>(note i)</sup>		
Net assets of operations	161	167
Acquired goodwill	61	61
	<u>222</u>	<u>228</u>
	<u>6,083</u>	<u>5,603</u>
<b>US operations</b>		
Jackson — EEV basis shareholders' funds (net of surplus note borrowings of £158m (2008: £154m))	4,122	4,339
Broker-dealer and asset management operations: <sup>(note i)</sup>		
Net assets of operations	95	98
Acquired goodwill	16	16
	<u>111</u>	<u>114</u>
	<u>4,233</u>	<u>4,453</u>

	<u>2009</u>	<u>2008</u>
	£m	£m
<b>UK operations</b>		
Insurance operations:		
Long-term business operations:		
Smoothed shareholders' funds . . . . .	5,547	5,437
Actual shareholders' funds less smoothed shareholders' funds . . . . .	(108)	(518)
EEV basis shareholders' funds . . . . .	5,439	4,919
Other . . . . .	37	—
	<u>5,476</u>	<u>4,919</u>
M&G: <sup>(note i)</sup>		
Net assets of operations . . . . .	173	147
Acquired goodwill . . . . .	1,153	1,153
	<u>1,326</u>	<u>1,300</u>
	<u>6,802</u>	<u>6,219</u>
<b>Other operations</b>		
Holding company net borrowings at market value <sup>(9)</sup> . . . . .	(1,780)	(818)
Other net liabilities <sup>(note i)</sup> . . . . .	(65)	(501)
	<u>(1,845)</u>	<u>(1,319)</u>
Total . . . . .	<u>15,273</u>	<u>14,956</u>

Representing:

	<u>2009</u>			<u>2008</u>		
	Statutory IFRS basis shareholders' Equity	Additional retained profit on an EEV basis	EEV basis shareholders' equity £m	Statutory IFRS basis shareholders' equity	Additional retained profit on an EEV basis	EEV basis shareholders' equity £m
Asian operations . . . . .	1,462	4,399	5,861	2,167	3,208	5,375
US operations . . . . .	3,011	1,111	4,122	1,698	2,641	4,339
UK insurance operations . . . . .	1,902	3,537	5,439	1,655	3,264	4,919
Total long-term business . . . . .	6,375	9,047	15,422	5,520	9,113	14,633
operations						
Other operations <sup>(note ii)</sup> . . . . .	(104)	(45)	(149)	(462)	785	323
Group total . . . . .	<u>6,271</u>	<u>9,002</u>	<u>15,273</u>	<u>5,058</u>	<u>9,898</u>	<u>14,956</u>

**Notes**

(i) With the exception of the share of the Prudential Staff Pension Scheme (PSPS) deficit attributable to the PAC with-profits fund, which is included in 'Other operations' net liabilities, these amounts have been determined on the statutory IFRS basis. The overall pension scheme deficit, net of tax, attributable to shareholders relating to PSPS is determined as shown below:

	<u>2009</u>	<u>2008</u>
	£m	£m
IFRS basis deficit (relating to shareholder-backed operations) . . . . .	(16)	(31)
Additional EEV deficit (relating to shareholders' 10% share of the IFRS basis deficit attributable to the PAC with-profits fund) . . . . .	(5)	(6)
EEV basis* . . . . .	<u>(21)</u>	<u>(37)</u>

\* For 2008, the EEV basis deficit of £(37) million for other operations includes the shareholders' share of the deficit on the Scottish Amicable Pension Scheme, which for 2009 is included within the shareholders' funds of UK long-term business operations.

(ii) The additional retained profit on an EEV basis for Other operations represents the mark to market value difference on holding company net borrowings of a charge of £(26) million (2008: credit of £802 million) and the effect of accounting for pension costs for the Prudential Staff Pension Scheme.

## 8 Analysis of movement in free surplus

Free surplus is the market value of the net worth in excess of the capital required to support the covered business. Where appropriate, adjustments are made to the regulatory basis net worth from the local regulatory basis so as to include backing assets movements at fair value rather than cost so as to comply with the EEV principles. The Prudential Group has based required capital on its internal targets for economic capital subject to it being at least the local statutory minimum requirements, as described in note 1b(ii).

	2009		
<u>Long-Term Business and Asset Management Operations</u> <sup>(Note i)</sup>	<u>Long-term business (Note 13)</u>	<u>Asset management and UK general insurance commission (Note ii)</u>	<u>Free surplus of long-term business, asset management and UK general insurance commission</u>
			£m
Underlying movement:			
New business . . . . .	(675)	—	(675)
Business in-force:			
Expected in-force cash flows (including expected return on net assets) . . . . .	1,657	257	1,914
Effects of changes in operating assumptions, operating experience variances and other operating items . . . . .	<u>175</u>	<u>—</u>	<u>175</u>
	1,157	257	1,414
Changes in non-operating items <sup>(note iii)</sup> . . . . .	(239)	41	(198)
Profit on sale and results for Taiwan agency business . .	<u>987</u>	<u>—</u>	<u>987</u>
	1,905	298	2,203
Net cash flows to parent company <sup>(note iv)</sup> . . . . .	(506)	(182)	(688)
Exchange movements, timing differences and other items <sup>(note v)</sup> . . . . .	<u>219</u>	<u>(62)</u>	<u>157</u>
<b>Net movement in free surplus</b> . . . . .	<b>1,618</b>	<b>54</b>	<b>1,672</b>
Balance at 1 January 2009 . . . . .	<u>447</u>	<u>412</u>	<u>859</u>
<b>Balance at 31 December 2009</b> . . . . .	<b><u>2,065</u></b>	<b><u>466</u></b>	<b><u>2,531</u></b>
Representing:			
Asian operations <sup>(13)</sup> . . . . .	801	161	962
US operations <sup>(13)</sup> . . . . .	749	95	844
UK insurance operations <sup>(13)</sup> . . . . .	<u>515</u>	<u>210</u>	<u>725</u>
	<u>2,065</u>	<u>466</u>	<u>2,531</u>
<u>1 January 2009</u>			
Representing:			
Asian operations <sup>(13)</sup> . . . . .	(240)	167	(73)
US operations <sup>(13)</sup> . . . . .	501	98	599
UK insurance operations <sup>(13)</sup> . . . . .	<u>186</u>	<u>147</u>	<u>333</u>
	<u>447</u>	<u>412</u>	<u>859</u>

### Notes

- (i) All figures are shown net of tax.
- (ii) For the purposes of this analysis, free surplus for asset management operations and the UK general insurance commission is taken to be IFRS basis shareholders' funds as shown in note 7.
- (iii) Changes in non-operating items.  
This represents short-term fluctuations in investment returns, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes and the effect of changes in economic assumptions for long-term business operations.  
Short-term fluctuations in investment returns primarily reflect temporary market movements on the portfolio of investments held by the Group's shareholder-backed operations together with the shareholders' 10% interest in the value movements on the assets in the with-profits funds.  
The effect of changes in economic assumptions on free surplus includes the impact of an increase in required capital for Jackson of £168 million driven by impairments and credit downgrades. Separately, short-term fluctuations in investment returns include the effect of impairments and credit downgrades in excess of the expected longer-term level reflected within operating profit.
- (iv) Net cash flows to parent company reflect the flows for long-term business operations as included in the holding company cash flow at transaction rates.

v Exchange movements, timing differences and other items represent:

	<u>Long-term business</u>	<u>Asset management and UK general insurance commission</u>	<u>Total</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Exchange movements . . . . .	(75)	(30)	(105)
Mark to market value movements on Jackson assets backing surplus and required capital <sup>(13)</sup> . . . . .	133	—	133
Other . . . . .	<u>161</u>	<u>(32)</u>	<u>129</u>
	<u>219</u>	<u>(62)</u>	<u>157</u>

## 9 Holding Company net borrowings

### a Balance sheet

	<u>2009</u>			<u>2008</u>		
	<u>IFRS basis</u>	<u>Mark to market value adjustment (note b)</u>	<u>EEV basis at market value</u>	<u>IFRS basis</u>	<u>Mark to market value adjustment (note b)</u>	<u>EEV basis at market value</u>
			<u>£m</u>			<u>£m</u>
Holding company* cash and short-term investments . . . . .	<b>(1,486)</b>	—	<b>(1,486)</b>	(1,165)	—	(1,165)
Core structural borrowings — central funds <sup>(note)</sup> . . . . .	<b>3,240</b>	<b>26</b>	<b>3,266</b>	2,785	(802)	1,983
Holding company net borrowings . . .	<b>1,754</b>	<b>26</b>	<b>1,780</b>	1,620	(802)	818
Core structural borrowings — Jackson . . . . .	<b>154</b>	<b>4</b>	<b>158</b>	173	(19)	154
	<u><b>1,908</b></u>	<u><b>30</b></u>	<u><b>1,938</b></u>	<u>1,793</u>	<u>(821)</u>	<u>972</u>

\* Including central finance subsidiaries.

#### Note

EEV basis holding company borrowings comprise:

	<u>2009</u>	<u>2008</u>
	<u>£m</u>	<u>£m</u>
Perpetual subordinated capital securities (Innovative Tier 1) . . . . .	<b>1,351</b>	513
Subordinated debt (Lower Tier 2) . . . . .	<b>1,372</b>	737
Senior debt . . . . .	<b>543</b>	733
	<u><b>3,266</b></u>	<u>1,983</u>

In May 2009, Prudential repaid maturing £249 million senior debt and in the same month Prudential issued £400 million subordinated notes in part to replace the maturing debt.

In July 2009, Prudential issued US\$750 million perpetual subordinated capital securities.

In accordance with the EEV Principles, core borrowings are carried at market value. As the liabilities are generally held to maturity or for the long-term, no deferred tax asset or liability has been established on the market value adjustment above.

### b Results and movements in equity

	<u>2009</u>	<u>2008</u>
	<u>£m</u>	<u>£m</u>
Loss (profit) included in consolidated income statement . . . . .	<b>795</b>	(656)
Foreign exchange effects . . . . .	<b>56</b>	(181)
1 January 2009 . . . . .	<u><b>(821)</b></u>	<u>16</u>
31 December 2009 . . . . .	<u><b>30</b></u>	<u>(821)</u>

The loss (profit) recorded in the consolidated income statement represents a charge of £774 million (2008: credit of £(619) million) in respect of central funds and a charge of £21 million (2008: credit of £(37) million) in respect of Jackson.

10 Reconciliation of movement in shareholders' funds

2009

	Long-Term Business Operations					Group total £m
	Asian operations	US operations	UK insurance operations	Total long-term business operations	Other operations	
<b>Operating profit (based on longer-term investment returns)</b>						
Long-term business:						
New business <sup>(2)</sup> . . . . .	713	664	230	1,607	—	1,607
Business in-force <sup>(3)</sup> . . . . .	392	569	640	1,601	—	1,601
	<u>1,105</u>	<u>1,233</u>	<u>870</u>	<u>3,208</u>	<u>—</u>	<u>3,208</u>
Asia development expenses . . . . .	(6)	—	—	(6)	—	(6)
UK general insurance commission . . . . .	—	—	—	—	51	51
M&G . . . . .	—	—	—	—	238	238
Asian asset management operations . . . . .	—	—	—	—	55	55
US broker-dealer and asset management . . . . .	—	—	—	—	4	4
Other income and expenditure . . . . .	—	—	—	—	(433)	(433)
Restructuring costs . . . . .	—	—	(20)	(20)	(7)	(27)
<b>Operating profit based on longer-term investment returns</b> . . . . .	<b>1,099</b>	<b>1,233</b>	<b>850</b>	<b>3,182</b>	<b>(92)</b>	<b>3,090</b>
Short-term fluctuations in investment returns <sup>(5)</sup> . . . . .	437	(401)	445	481	(130)	351
Mark to market value movements on core borrowings <sup>(9)</sup> . . . . .	—	(21)	—	(21)	(774)	(795)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	(52)	(52)	(32)	(84)
Effect of changes in economic assumptions and time value of cost of options and guarantees <sup>(6)</sup> . . . . .	(174)	(518)	(218)	(910)	—	(910)
Profit on sale and results for Taiwan agency business <sup>(18)</sup> . . . . .	148	—	—	148	(57)	91
<b>Profit (loss) from continuing operations before tax (including actual investment returns)</b> . . . . .	<b>1,510</b>	<b>293</b>	<b>1,025</b>	<b>2,828</b>	<b>(1,085)</b>	<b>1,743</b>
Tax (charge) credit attributable to shareholders' profit (loss) <sup>(11)</sup> . . . . .	(239)	(416)	(245)	(900)	34	(866)
Tax on operating profit . . . . .	(76)	165	(124)	(35)	61	26
Tax on short-term fluctuations in investment returns . . . . .	—	—	14	14	9	23
Tax on shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	—	—	14	14	9	23
Tax on effect of changes in economic assumptions and time value of cost of options and guarantees . . . . .	94	181	61	336	—	336
Total tax (charge) credit . . . . .	<u>(221)</u>	<u>(70)</u>	<u>(294)</u>	<u>(585)</u>	<u>104</u>	<u>(481)</u>
Discontinued operations (net of tax) <sup>(4)</sup> . . . . .	—	—	—	—	(14)	(14)
Minority interests . . . . .	—	—	—	—	(3)	(3)
<b>Profit (loss) for the year</b> . . . . .	<b>1,289</b>	<b>223</b>	<b>731</b>	<b>2,243</b>	<b>(998)</b>	<b>1,245</b>
Exchange movements on foreign operations and net investment hedges <sup>(note i)</sup> . . . . .	(435)	(483)	—	(918)	157	(761)
Related tax . . . . .	—	—	—	—	11	11
Intra group dividends (including statutory transfer) . . . . .	(553)	(39)	(206)	(798)	798	—
External dividends . . . . .	—	—	—	—	(481)	(481)

	Long-Term Business Operations					Group total £m
	Asian operations	US operations	UK insurance operations	Total long-term business operations	Other operations	
Reserve movements in respect of share-based payments	—	—	—	—	29	29
Investment in operations <sup>(note ii)</sup>	219	—	27	246	(246)	—
Other transfers <sup>(note iv)</sup>	(3)	(51)	(32)	(86)	86	—
Movement in own shares held in respect of share-based payment plans	—	—	—	—	3	3
Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS	—	—	—	—	(3)	(3)
New share capital subscribed	—	—	—	—	141	141
Mark to market value movements on Jackson assets backing surplus and required capital (net of related tax of £72m) <sup>(13)</sup>	—	133	—	133	—	133
Net increase (decrease) in shareholders' equity	517	(217)	520	820	(503)	317
Shareholders' equity at 1 January 2009 <sup>(note iii, 7)</sup>	5,264	4,339	4,919	14,522	434	14,956
<b>Shareholders' equity at 31 December 2009<sup>(note iii, 7)</sup></b>	<b>5,781</b>	<b>4,122</b>	<b>5,439</b>	<b>15,342</b>	<b>(69)</b>	<b>15,273</b>

#### Notes

- (i) Profits are translated at average exchange rates, consistent with the method applied for statutory IFRS basis results. The amounts recorded above for exchange rate movements reflect the difference between 2009 and 2008 exchange rates as applied to shareholders' funds at 1 January 2009 and the difference between 31 December 2009 and average 2009 rates for profits.
- (ii) Investment in operations reflects increases in share capital. This includes certain non-cash items.
- (iii) For the purposes of the table above, goodwill related to Asia long-term operations (as shown in note 7) is included in Other operations.
- (iv) Other transfers (from) to long-term business operations to Other operations in 2009 represent:

	Asian operations £m	US operations £m	UK insurance operations £m	Total long-term business operations £m
Adjustment for net of tax asset management projected profits of covered business	(7)	(3)	(17)	(27)
Other adjustments	4	(48)	(15)	(59)
	<u>(3)</u>	<u>(51)</u>	<u>(32)</u>	<u>(86)</u>

## 11 Tax attributable to shareholders' profit (loss)

The tax charge (credit) comprises:

	<u>2009</u>	<u>2008</u>
	£m	£m
<b>Tax charge on operating profit based on longer-term investment returns:</b>		
Long-term business: <sup>(note i)</sup>		
Asian operations <sup>(note ii)</sup> . . . . .	239	322
US operations . . . . .	416	205
UK insurance operations <sup>(note ii)</sup> . . . . .	<u>245</u>	<u>269</u>
	900	796
Other operations . . . . .	<u>(34)</u>	<u>(38)</u>
Total tax charge on operating profit based on longer-term investment returns . . . . .	<u>866</u>	<u>758</u>
<b>Tax credit on items not included in operating profit:</b>		
Tax credit on short-term fluctuations in investment returns . . . . .	(26)	(1,432)
Tax credit on shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(23)	(2)
Tax credit on effect of changes in economic assumptions and time value of cost of options and guarantees . . . . .	(336)	(79)
Tax credit on profit on sale and results of sold Taiwan agency business . . . . .	—	(16)
Total tax credit on items not included in operating profit . . . . .	<u>(385)</u>	<u>(1,529)</u>
Tax charge (credit) on profit (loss) on ordinary activities from continuing operations (including tax on actual investment returns) . . . . .	<u>481</u>	<u>(771)</u>

### Notes

- (i) The profit for the year for covered business is in most cases calculated initially at the post-tax level. The post-tax profit for covered business is then grossed up for presentation purposes at the effective rates of tax applicable to the countries and periods concerned. In the UK, the effective rate is the UK corporation tax rate of 28% which took effect from 1 April 2008. For Jackson, the US federal tax rate of 35% is applied to gross up movements on the value of in-force business. Effects on statutory tax for the period affect the overall tax rate. For Asia, similar principles apply subject to the availability of taxable profits.
- (ii) Including tax relief on Asia development expenses and restructuring costs borne by UK insurance operations.

## 12 Earnings per share (EPS)

	<u>2009</u>	<u>2008</u>
	£m	£m
Operating EPS:		
Operating profit before tax . . . . .	3,090	2,865
Tax . . . . .	(866)	(758)
Minority interests . . . . .	<u>(3)</u>	<u>(4)</u>
Operating profit after tax and minority interests . . . . .	2,221	2,103
Operating EPS (pence) . . . . .	<u>88.8p</u>	<u>85.1p</u>
Total EPS:		
Profit (loss) from continuing operations before tax . . . . .	1,743	(2,106)
Tax . . . . .	(481)	771
Discontinued operations (net of tax) . . . . .	(14)	—
Minority interests . . . . .	<u>(3)</u>	<u>(3)</u>
Total profit (loss) after tax and minority interests . . . . .	1,245	(1,338)
Total EPS (pence) . . . . .	<u>49.8p</u>	<u>(54.1)p</u>
Average number of shares (millions) . . . . .	<u>2,501</u>	<u>2,472</u>

The average number of shares reflects the average number in issue adjusted for shares held by employee trusts and consolidated unit trusts and OEICs which are treated as cancelled.

### 13 Reconciliation of net worth and value of in-force business<sup>(note i)</sup>

	2009 £m				
	Free surplus (note 8)	Required capital	Total net worth	Value of in-force business (note iv)	Total long-term business
<b>Group</b>					
<b>Shareholders' equity at 1 January 2009</b> . . . . .	447	4,117	4,564	9,958	14,522
New business contribution <sup>(notes ii, iii)</sup> . . . . .	(675)	451	(224)	1,355	1,131
Existing business — transfer to net worth . . . . .	1,551	(434)	1,117	(1,117)	—
Expected return on existing business . . . . .	106	100	206	856	1,062
Changes in operating assumptions and experience variances . . . . .	175	50	225	(136)	89
Profit on sale and results for Taiwan agency business . . .	987	(1,232)	(245)	393	148
Increase in capital requirements for US operations arising from impairments and credit downgrades . . . . .	(168)	168	—	—	—
Changes in non-operating assumptions and experience variances and minority interests . . . . .	(71)	42	(29)	(158)	(187)
<b>Profit after tax and minority interests from long-term business</b> . . . . .	<b>1,905</b>	<b>(855)</b>	<b>1,050</b>	<b>1,193</b>	<b>2,243</b>
Exchange movements on foreign operations and net investment hedges . . . . .	(75)	(268)	(343)	(575)	(918)
Intra-group dividends (including statutory transfer) and investment in operations <sup>(note v)</sup> . . . . .	(259)	—	(259)	(293)	(552)
Mark to market value movements on Jackson assets backing surplus and required capital . . . . .	133	—	133	—	133
Other transfers from net worth . . . . .	(86)	—	(86)	—	(86)
<b>Shareholders' equity at 31 December 2009</b> . . . . .	<b><u>2,065</u></b>	<b><u>2,994</u></b>	<b><u>5,059</u></b>	<b><u>10,283</u></b>	<b><u>15,342</u></b>
<b>Representing:</b>					
<b>Asian operations</b>					
<b>Shareholders' equity at 1 January 2009</b> . . . . .	(240)	1,789	1,549	3,715	5,264
New business contribution <sup>(notes ii,iii)</sup> . . . . .	(246)	69	(177)	710	533
Existing business — transfer to net worth . . . . .	377	5	382	(382)	—
Expected return on existing business . . . . .	86	5	91	322	413
Changes in operating assumptions and experience variances <sup>(note vi)</sup> . . . . .	(98)	85	(13)	(73)	(86)
Profit on sale and results for Taiwan agency business . . .	987	(1,232)	(245)	393	148
Changes in non-operating assumptions and experience variances and minority interests . . . . .	101	(26)	75	206	281
<b>Profit after tax and minority interests from long-term business</b> . . . . .	<b>1,207</b>	<b>(1,094)</b>	<b>113</b>	<b>1,176</b>	<b>1,289</b>
Exchange movements on foreign operations and net investment hedges . . . . .	(12)	(110)	(122)	(313)	(435)
Intra-group dividends (including statutory transfer) and investment in operations <sup>(note v)</sup> . . . . .	(151)	—	(151)	(183)	(334)
Other transfers from net worth . . . . .	(3)	—	(3)	—	(3)
<b>Shareholders' equity at 31 December 2009</b> . . . . .	<b><u>801</u></b>	<b><u>585</u></b>	<b><u>1,386</u></b>	<b><u>4,395</u></b>	<b><u>5,781</u></b>

	2009 £m				
	Free surplus (note 8)	Required capital	Total net worth	Value of in-force business (note iv)	Total long-term business
<b>US operations</b>					
<b>Shareholders' equity at 1 January 2009</b> .....	501	1,400	1,901	2,438	4,339
New business contribution <sup>(notes ii,iii)</sup> .....	(326)	300	(26)	458	432
Existing business — transfer to net worth .....	706	(359)	347	(347)	—
Expected return on existing business .....	18	55	73	151	224
Changes in operating assumptions and experience variances .....	115	(12)	103	58	161
Increase in capital requirements for US operations arising from impairments and credit downgrades .....	(168)	168	—	—	—
Changes in non-operating assumptions and experience variances and minority interests .....	(77)	11	(66)	(528)	(594)
<b>Profit after tax and minority interests from long-term business</b> .....	268	163	431	(208)	223
Exchange movements on foreign operations and net investment hedges .....	(63)	(158)	(221)	(262)	(483)
Intra-group dividends (including statutory transfer) and investment in operations .....	(39)	—	(39)	—	(39)
Mark to market value movements on Jackson assets backing surplus and required capital .....	133	—	133	—	133
Other transfers from net worth .....	(51)	—	(51)	—	(51)
<b>Shareholders' equity at 31 December 2009</b> .....	<u>749</u>	<u>1,405</u>	<u>2,154</u>	<u>1,968</u>	<u>4,122</u>
	2009 £m				
	Free surplus (Note 8)	Required capital	Total net worth	Value of in-force business (Note Iv)	Total long-term business
<b>UK insurance operations</b>					
<b>Shareholders' equity at 1 January 2009</b> .....	186	928	1,114	3,805	4,919
New business contribution <sup>(notes ii,iii)</sup> .....	(103)	82	(21)	187	166
Existing business — transfer to net worth .....	468	(80)	388	(388)	—
Expected return on existing business .....	2	40	42	383	425
Changes in operating assumptions and experience variances .....	158	(23)	135	(121)	14
Changes in non-operating assumptions and experience variances and minority interests .....	(95)	57	(38)	164	126
<b>Profit after tax and minority interests from long-term business</b> .....	430	76	506	225	731
Intra-group dividends (including statutory transfer) and investment in operations <sup>(note v)</sup> .....	(69)	—	(69)	(110)	(179)
Other transfers from net worth .....	(32)	—	(32)	—	(32)
<b>Shareholders' equity at 31 December 2009</b> .....	<u>515</u>	<u>1,004</u>	<u>1,519</u>	<u>3,920</u>	<u>5,439</u>

#### Notes

- (i) All figures are shown net of tax.  
(ii) The movements arising from new business contribution are as follows:

	2009 £m			2008 £m		
	Pre-tax new business contribution (Note 2)	Tax	Post-tax new business contribution	Pre-tax new business contribution (Note 2)	Tax	Post-tax new business contribution
Asian operations . . . . .	713	(180)	533	634	(166)	468
US operations . . . . .	664	(232)	432	293	(103)	190
UK insurance operations . . . . .	230	(64)	166	273	(76)	197
	<u>1,607</u>	<u>(476)</u>	<u>1,131</u>	<u>1,200</u>	<u>(345)</u>	<u>855</u>

	2009 £m	2008 £m
Free surplus . . . . .	(675)	(806)
Required capital . . . . .	451	472
Total net worth . . . . .	(224)	(334)
Value of in-force business . . . . .	<u>1,355</u>	<u>1,189</u>
Total long-term business . . . . .	<u>1,131</u>	<u>855</u>

(iii) New business capital usage

	2009			2008		
	Free surplus invested in new business	Post-tax new business contribution (Note ii)	Post-tax new business contribution per £1m free surplus invested	Free surplus invested in new business	Post-tax new business contribution (Note ii)	Post-tax new business contribution per £1m free surplus invested
	£m			£m		
Asian operations . . . . .	(246)	533	2.2	(224)	468	2.1
US operations . . . . .	(326)	432	1.3	(289)	190	0.7
UK insurance operations . . . . .	(103)	166	1.6	(293)	197	0.7
	<u>(675)</u>	<u>1,131</u>	<u>1.7</u>	<u>(806)</u>	<u>855</u>	<u>1.1</u>

(iv) The value of in-force business includes the value of future margins from current in-force business less the cost of holding encumbered capital and represents:

	2009 £m				2008 £m			
	Value of in-force business before deduction of cost of capital and of guarantees	Cost of capital	Cost of time value of guarantees	Net value of in-force business	Value of in-force business before deduction of cost of capital and of guarantees	Cost of capital	Cost of time value of guarantees	Net value of in-force business
Asian operations <sup>(note vii)</sup> . . . . .	4,605	(198)	(12)	4,395	4,590	(869)	(6)	3,715
US operations . . . . .	2,351	(175)	(208)	1,968	2,838	(18)	(382)	2,438
UK insurance operations . . . . .	4,181	(221)	(40)	3,920	4,263	(372)	(86)	3,805
	<u>11,137</u>	<u>(594)</u>	<u>(260)</u>	<u>10,283</u>	<u>11,691</u>	<u>(1,259)</u>	<u>(474)</u>	<u>9,958</u>

- (v) The amounts shown in respect of free surplus and the value of in-force business for UK and Asian operations for intragroup dividends and investment in operations include the impact of contingent loan funding.
- (vi) For Asian operations, the effect of changes in operating assumptions and experience variances in 2009 includes the impact of changes in the assumed capital requirement to better align with internal management and pricing bases. This primarily arises in China, Indonesia, Philippines and Vietnam, with a consequent reduction in free surplus and increase in required capital of £73 million.
- (vii) The change in the cost of capital for Asian operations from £(869) million in 2008 to £(198) million in 2009 primarily reflects the effect of the disposal of the Taiwan agency business.

## 14 Expected transfer of value of in-force business to free surplus

The discounted value of in-force business and required capital can be reconciled to the analysis of free surplus crystallisation as follows:

	<u>2009</u>	<u>2008</u>
	£m	£m
Required capital <sup>(13)</sup> .....	2,994	4,117
Value of in-force (VIF) <sup>(13)</sup> .....	10,283	9,958
Add back: deduction for cost of time value of guarantees <sup>(13)</sup> .....	260	474
Other items <sup>(note)</sup> .....	<u>(865)</u>	<u>(181)</u>
	<u>12,672</u>	<u>14,368</u>

### Note

Other items includes the deduction of the value of the shareholders' interest in the estate, the value of which is derived by increasing final bonus rates so as to exhaust the estate over the lifetime of the in-force with-profits business. This is an assumption to give an appropriate valuation. To be conservative this item is excluded from the expected free surplus generation profile below. Also included in "other items" are amounts which are deducted in full against VIF, as they represent the Prudential Group's best estimate of amounts that will be paid in the future, but for which there is no definitive timeframe for when the payments will actually be made.

Cash flows are projected on a deterministic basis and are discounted at the appropriate risk discount rate. The modelled cash flows use the same methodology underpinning the Prudential Group's embedded value reporting and so is subject to the same assumptions and sensitivities.

The table below shows how the VIF generated by the in-force business and the associated required capital is modelled as emerging into free surplus over future years.

	2009 total as shown above	2009				
		Expected period of conversion of future post tax distributable earnings and required capital flows to free surplus				
		1-5 years	6-10 years	11-15 years	16-20 years	20+ years
		£m				
Asian operations .....	4,911	1,716	1,121	687	455	932
US operations .....	3,739	2,129	980	364	153	113
UK insurance operations .....	<u>4,022</u>	<u>1,591</u>	<u>1,035</u>	<u>653</u>	<u>401</u>	<u>342</u>
<b>Total</b> .....	<u>12,672</u>	<u>5,436</u>	<u>3,136</u>	<u>1,704</u>	<u>1,009</u>	<u>1,387</u>
	100%	43%	25%	13%	8%	11%
	2008 Total as shown above	2008				
		Expected period of conversion of future post tax distributable earnings and required capital flows to free surplus				
		1-5 years	6-10 years	11-15 years	16-20 years	20+ years
		£m				
Asian operations .....	5,373	1,746	1,150	859	564	1,054
US operations .....	4,374	2,415	1,167	460	180	152
UK insurance operations .....	<u>4,621</u>	<u>2,297</u>	<u>975</u>	<u>600</u>	<u>389</u>	<u>360</u>
<b>Total</b> .....	<u>14,368</u>	<u>6,458</u>	<u>3,292</u>	<u>1,919</u>	<u>1,133</u>	<u>1,566</u>
	100%	45%	23%	13%	8%	11%

## 15 Sensitivity of results to alternative assumptions

### a Sensitivity analysis — economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2009 (31 December 2008) and the new business contribution after the effect of encumbered capital for 2009 and 2008 to:

- 1% increase in the discount rates;
- 1% increase and decrease in interest rates, including all consequential changes (assumed investment returns for all asset classes, market values of fixed interest assets, risk discount rates);
- 1% rise in equity and property yields;

- 10% fall in market value of equity and property assets (not applicable for new business contribution);
- holding company statutory minimum capital (by contrast to economic capital);
- five basis point increase in long-term expected defaults; and
- 10 basis point increase in the liquidity premium for UK shareholder-backed annuities (2009 only).

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions.

	2009 £m				
	Asian operations (excluding sold Taiwan agency business)	US operations	UK insurance operations	Total long-term business operations	
<b>New business profit for 2009</b>					
As reported <sup>(2)</sup> . . . . .	713	664	230	1,607	
Discount rates — 1% increase . . . . .	(91)	(48)	(43)	(182)	
Interest rates — 1% increase . . . . .	(3)	8	(7)	(2)	
Interest rates — 1% decrease . . . . .	3	(12)	8	(1)	
Equity/property yields — 1% rise . . . . .	31	39	11	81	
Long-term expected defaults — 5 bps increase . . . . .	—	—	(9)	(9)	
Liquidity premium — 10 bps increase . . . . .	—	—	18	18	
<b>Embedded value of long-term operations at 31 December 2009</b>					
As reported <sup>(10)</sup> . . . . .	5,781	4,122	5,439	15,342	
Discount rates — 1% increase . . . . .	(522)	(146)	(401)	(1,069)	
Interest rates — 1% increase . . . . .	(183)	(137)	(231)	(551)	
Interest rates — 1% decrease . . . . .	231	55	298	584	
Equity/property yields — 1% rise . . . . .	255	82	213	550	
Equity/property market values — 10% fall . . . . .	(147)	(10)	(298)	(455)	
Statutory minimum capital . . . . .	28	123	6	157	
Long-term expected defaults — 5 bps increase . . . . .	—	—	(76)	(76)	
Liquidity premium — 10 bps increase . . . . .	—	—	152	152	
				2008 £m	
	Asian operations (excluding sold Taiwan agency business)	US operations	UK insurance operations	Total long-term business operations	Total long-term business operations (as previously published)
<b>New business profit for 2008</b>					
As reported <sup>(2)</sup> . . . . .	634	293	273	1,200	1,307
Discount rates — 1% increase . . . . .	(74)	(25)	(52)	(151)	(165)
Interest rates — 1% increase . . . . .	(19)	21	(5)	(3)	(4)
Interest rates — 1% decrease . . . . .	23	(47)	6	(18)	(18)
Equity/property yields — 1% rise . . . . .	26	28	15	69	73
<b>Embedded value of long-term operations at 31 December 2008</b>					
As reported <sup>(10)</sup> . . . . .	5,487	4,339	4,919	14,745	(223)
Discount rates — 1% increase . . . . .	(454)	(170)	(361)	(985)	(110)
Interest rates — 1% increase . . . . .	(126)	(123)	(98)	(347)	126
Interest rates — 1% decrease . . . . .	146	19	121	286	(182)
Equity/property yields — 1% rise . . . . .	240	114	276	630	54
Equity/property market values — 10% fall . . . . .	(94)	(117)	(381)	(592)	(35)
Statutory minimum capital . . . . .	1	11	5	17	512
					529

**b Sensitivity analysis — non-economic assumptions**

The tables below show the sensitivity of the embedded value as at 31 December 2009 (31 December 2008) and the new business contribution after the effect of encumbered capital for 2009 and 2008 to:

- 10% proportionate decrease in maintenance expenses (a 10% sensitivity on a base assumption of £10 per annum would represent an expense assumption of £9 per annum);
- 10% proportionate decrease in lapse rates (a 10% sensitivity on a base assumption of 5% would represent a lapse rate of 4.5% per annum); and
- 5% proportionate decrease in base mortality and morbidity rates (i.e. increased longevity).

	2009 £m			
	Asian operations (excluding sold Taiwan agency business)	US operations	UK insurance operations	Total long-term business operations
<b>New business profit for 2009</b>				
As reported <sup>(2)</sup> . . . . .	713	664	230	1,607
Maintenance expenses — 10% decrease . . . . .	19	9	8	36
Lapse rates — 10% decrease . . . . .	56	34	11	101
Mortality and morbidity — 5% decrease . . . . .	37	7	(11)	33
Change representing effect on:				
Life business . . . . .	37	7	1	45
UK annuities . . . . .	—	—	(12)	(12)
<b>Embedded value of long-term operations at 31 December 2009</b>				
As reported <sup>(10)</sup> . . . . .	5,781	4,122	5,439	15,342
Maintenance expenses — 10% decrease . . . . .	77	33	43	153
Lapse rates — 10% decrease . . . . .	232	141	70	443
Mortality and morbidity — 5% decrease . . . . .	169	78	(157)	90
Change representing effect on:				
Life business . . . . .	169	78	11	258
UK annuities . . . . .	—	—	(168)	(168)

						2008
	Asian operations (excluding sold Taiwan agency business)	US operations	UK insurance operations	Total long-term business operations	Taiwan agency business	Total long-term business operations (as previously published) £m
<b>New business profit for 2008</b>						
As reported <sup>(2)</sup> . . . . .	<u>634</u>	<u>293</u>	<u>273</u>	<u>1,200</u>	<u>107</u>	<u>1,307</u>
Maintenance expenses — 10% decrease . . . . .	19	6	7	32	3	35
Lapse rates — 10% decrease . . . . .	53	23	11	87	9	96
Mortality and morbidity — 5% decrease . . . . .	23	6	(20)	9	4	13
Change representing effect on:						
Life business . . . . .	23	6	—	29	4	33
UK annuities . . . . .	—	—	(20)	(20)	—	(20)
<b>Embedded value of long-term operations at 31 December 2008</b>						
As reported <sup>(10)</sup> . . . . .	<u>5,487</u>	<u>4,339</u>	<u>4,919</u>	<u>14,745</u>	<u>(223)</u>	<u>14,522</u>
Maintenance expenses — 10% decrease . . . . .	74	45	36	155	18	173
Lapse rates — 10% decrease . . . . .	192	177	80	449	2	451
Mortality and morbidity — 5% decrease . . . . .	139	121	(71)	189	33	222
Change representing effect on:						
Life business . . . . .	139	121	5	265	33	298
UK annuities . . . . .	—	—	(76)	(76)	—	(76)

## 16 Assumptions

### a 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.

### b Principal economic assumptions

#### Deterministic assumptions

In most countries, the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on cash or fixed interest securities. For the Prudential Group's Asian operations, the active basis is appropriate for business written in Japan, Korea and US dollar denominated business written in Hong Kong. Except in respect of the projected returns of holdings of Asian debt and equity securities for those countries where long-term fixed interest markets are less established, the 'active' basis of assumption setting has been applied in preparing the results of all the Prudential Group's US and UK long-term business operations.

For countries where long-term fixed interest markets are less established, investment return assumptions and risk discount rates are based on an assessment of longer-term economic conditions. Except for the countries listed above, this basis is appropriate for the Prudential Group's Asian operations. Similarly, the projected returns on holdings of Asian securities in these territories by other Prudential Group businesses are set on the same basis.

Expected returns on equity and property asset classes in respect of each territory are derived by adding a risk premium, based on the long-term view of the Prudential Group's economists, to the risk-free rate. In Asia, equity risk premiums range from 3.0% to 8.35% (2008: 3.0% to 7.0%). In the US and the UK, the equity risk premium is 4.0% (2008: 4.0%).

Assumed investment returns reflect the expected future returns on the assets held and allocated to the covered business at the valuation date.

The tables below summarise the principal financial assumptions:

Asian operations	31 Dec 2009%						31 Dec 2008%					
	China (note iv)	Hong Kong (notes ii,iii)	India	Indonesia (note iv)	Japan	Korea (note Iv)	China (note iv)	Hong Kong (notes ii,iii)	India	Indonesia	Japan	Korea
Risk discount rate:												
New business . . . . .	11.75	5.5	14.25	13.8	5.1	8.2	11.75	3.8	14.25	15.25	4.8	8.2
In-force . . . . .	11.75	5.7	14.25	13.8	5.1	8.4	11.75	3.9	14.25	15.25	4.8	8.2
Expected long-term rate of inflation . . . . .	4.0	2.25	5.0	6.0	0.0	2.75	4.0	2.25	5.0	6.0	0.7	2.75
Government bond yield . . .	8.25	3.9	9.25	10.25	1.9	5.5	8.25	2.3	9.25	10.25	1.6	4.3

Asian operations	31 Dec 2009%						31 Dec 2008%					
	Malaysia (note iii)	Philippines (note iv)	Singapore (note iii)	Taiwan	Thailand	Vietnam (note iv)	Malaysia (note iii)	Philippines	Singapore (note iii)	Taiwan	Thailand	Vietnam
Risk discount rate:												
New business . . . . .	9.4	15.75	5.7	7.5	13.0	16.75	9.1	15.75	6.15	9.1	13.0	16.75
In-force . . . . .	9.5	15.75	6.8	7.5	13.0	16.75	9.0	15.75	6.85	9.7	13.0	16.75
Expected long-term rate of inflation . . . . .	2.75	5.0	1.75	2.25	3.0	6.0	2.75	5.0	1.75	2.25	3.0	6.0
Government bond yield . . . . .	6.5	9.25	4.25	5.5	6.75	10.25	6.5	9.25	4.25	5.5	6.75	10.25
									<b>31 Dec 2009</b>			<b>31 Dec 2008</b>
									<b>Asia total%</b>			<b>Asia total%</b>

Weighted risk discount rate: <sup>(Note i)</sup>

New business (excluding Taiwan agency business) . . . . .	9.1	8.7
In-force (excluding Taiwan agency business) . . . . .	8.8	8.0
In-force (including Taiwan agency business) . . . . .	N/A	7.8

#### Notes

- (i) The weighted risk discount rates for Asian operations shown above have been determined by weighting each country's risk discount rates by reference to the EEV basis new business result and the closing value of in-force business.
- (ii) The assumptions shown are for US dollar denominated business which comprises the largest proportion of the in-force Hong Kong business.
- (iii) The mean equity return assumptions for the most significant equity holdings in the Asian operations were:

	31 Dec 2009 %	31 Dec 2008 %
Hong Kong . . . . .	7.9	6.2
Malaysia . . . . .	12.4	12.5
Singapore . . . . .	10.2	10.2

To obtain the mean, an average over all simulations of the accumulated return at the end of the projection period is calculated. The annual average return is then calculated by taking the root of the average accumulated return minus 1.

- (iv) In 2009, the Prudential Group reconsidered the application of the Prudential Group's methodology for certain less established operations, with a consequent change in the risk discount rates used for Indonesia and Korea and a change in the assumed capital requirement to better align with internal management and pricing bases, primarily in China, Indonesia, Philippines and Vietnam. The change in the risk discount rate for Indonesia from 2008 to 2009 reflects a more granular assessment of the risks when determining the beta.

<b>US operations (Jackson)</b>	<b>31 Dec 2009</b>	<b>31 Dec 2008</b>
	<b>%</b>	<b>%</b>
Assumed spread margins <sup>(Note iii)</sup>		
New business <sup>(Note i)</sup>		
Assumed long-term spread between earned rate and rate credited to policyholders for new tranches of Fixed Annuity business <sup>(Note i)</sup>	<b>see note i below</b>	1.75
In-force	<b>1.75</b>	1.75
Risk discount rate: <sup>(Note ii)</sup>		
New business	<b>7.8</b>	4.6
In-force	<b>7.2</b>	3.9
US 10-year treasury bond rate at end of period	<b>3.9</b>	2.3
Pre-tax expected long-term nominal rate of return for US equities	<b>7.9</b>	6.3
Expected long-term rate of inflation	<b>2.4</b>	1.5

#### Notes

- (i) The expected spread for new tranches in 2009 of fixed annuity business (including the proportion of variable annuity new business invested in the general account) and fixed index annuity business are as follows:

<b>Assumed spread on new business</b>	<b>Fixed Annuity business*</b>		<b>Fixed index annuity business</b>
	<b>First 5 years</b>	<b>Long-term assumption**</b>	
	<b>%</b>	<b>%</b>	<b>%</b>
First six months of 2009	2.75	2.0	3.5
Second six months of 2009	2.25	2.0	2.5
2008	n/a	1.75	2.2

\* Including the proportion of variable annuity business invested in the general account.

\*\* For new tranches of business in 2009, the expected spread is assumed to grade back to the long-term assumption over the next ten years.

The increases in the spread assumptions are due primarily to the exceptional combined benefit of high investment yields with a net annualised yield on new assets of 6.4% during 2009 and lower crediting rates. These revised assumptions include a provision that crediting rates and spreads will normalise in the future. Thus, the assumption for new business spreads shown above for fixed annuities and the proportion of variable annuity business invested in the general account is set at the higher new level for the first five years before reducing over the following 10 years. As before, the valuation of new business takes into account an assumed associated risk of increased lapse under certain interest rate scenarios.

- (ii) The risk discount rates as at 31 December 2009 for new business and business in-force for US operations reflect weighted rates based on underlying rates of 8.2% (2008: 6.2%) for Variable Annuity (VA) business and 6.2% (2008: 3.0%) for other business. The increase in the weighted discount rates reflects the increase in the US 10-year treasury bond rate of 160 bps, the additional credit risk allowance of 30 bps for VA business and 150 bps for other business, as explained in notes 1b(iii) and 6, and a change in the product mix reflecting the increased proportion of VA business.

- (iii) Credit risk treatment

The projected cash flows incorporate the expected long-term spread between the earned rate and the rate credited to policyholders. The projected earned rates reflect book value yields which are adjusted over time to reflect projected reinvestment rates. Positive net cash flows are assumed to be reinvested in a mix of corporate bonds, commercial mortgages and limited partnerships. The yield on those assets is assumed to grade from the current level to a yield that allows for a long-term assumed credit spread of 1.25% over 10 years. The expected spread for 2009 has been determined after allowing for a Risk Margin Reserve ("RMR") allowance of 28 basis points for longer-term defaults as described in note 1b(iii). The RMR of 28 bps represents the allowance, as at 31 December 2009, applied in the cash flow projections of the value of the in-force business.

In the event that longer-term default levels are higher than, unlike for UK annuity business where policyholder benefits are not changeable, Jackson has some discretion to adjust crediting rates, subject to contract guarantee levels and general market competition considerations. The results for Jackson reflect the application of the discount rates shown above, which for 2009 reflect the inclusion of an additional allowance for a combination of credit risk premium and short-term default allowance as described in note 1b(iii) and note 6. In the event that US 10-year treasury rates increase, the altered embedded value results would reflect a lower contribution from fixed annuity business and a partially offsetting increase for variable annuity business as the projected earned rate, as well as the discount rate, would increase for this type of business.

At 31 December 2008, the book value yields, net of RMR allowance, were in excess of the risk discount rate. To correct for the anomalous effect that would otherwise occur no credit was taken in the financial information for full year 2008 for the cost of capital benefit that this feature would have given rise to for fixed annuity business. As interest rates have subsequently risen such that the risk discount rate exceeds book value yield as at 31 December 2009 no such adjustment is needed for the year.

<u>UK insurance operations</u> <sup>(Note iv)</sup>	<u>31 Dec 2009</u> %	<u>31 Dec 2008</u> %
<b>Shareholder-backed annuity business:</b>		
Risk discount rate: <sup>(notes i, iv)</sup>		
New business . . . . .	<b>8.7</b>	9.6
In-force . . . . .	<b>10.2</b>	12.0
Pre-tax expected long-term nominal rate of return for shareholder-backed annuity business: <sup>(Note iii)</sup>		
Fixed annuities . . . . .	<b>5.6</b>	6.7
Inflation-linked annuities . . . . .	<b>5.8</b>	5.8
<b>Other business:</b>		
Risk discount rate: <sup>(notes ii, iv)</sup>		
New business . . . . .	<b>7.7</b>	6.7
In-force . . . . .	<b>7.4</b>	6.75
Pre-tax expected long-term nominal rates of investment return:		
UK equities . . . . .	<b>8.4</b>	7.7
Overseas equities . . . . .	<b>7.9 to 10.3</b>	6.3 to 10.25
Property . . . . .	<b>6.7</b>	6.0
Gilts . . . . .	<b>4.4</b>	3.7
Corporate bonds <sup>(Note iv)</sup> . . . . .	<b>6.1</b>	5.2
Expected long-term rate of inflation . . . . .	<b>3.7</b>	3.0
Post-tax expected long-term nominal rate of return for the PAC with-profits fund:		
Pension business (where no tax applies). . . . .	<b>6.9</b>	6.6
Life business . . . . .	<b>6.0</b>	5.8

**Notes**

- (i) The risk discount rate applied to new shareholder-backed annuity business for 2009 has been determined after allowing for credit risk on the backing assets.
- (ii) The risk discount rates for new business and business in-force for UK insurance operations other than shareholder-backed annuities reflect weighted rates based on the type of business.
- (iii) The pre-tax rates of return for shareholder-backed annuity business are based on the gross redemption yield on the backing assets net of a best estimate allowance for future defaults.
- (iv) Credit spread treatment  
For with-profits business, the embedded value reflects the discounted value of future shareholder transfers. These transfers are directly affected by the level of projected rates of return on investments, including debt securities. For 2008, Prudential considered that in light of the current market conditions, it would be appropriate to assume an unchanged level of default allowance and an unchanged discount rate methodology relative to those at 31 December 2007.

For 2009, the approach for with-profit holdings has been refined. For equities and properties the projected earned rate is defined as the risk-free rate plus a long-term risk premium. Under the revised methodology a similar approach is adopted for corporate bonds i.e. the assumed earned rate is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of best estimate defaults.

For UK shareholder-backed annuity business, different dynamics apply both in terms of the nature of the business and the EEV methodology applied. For this type of business the assets are generally held to maturity to match long duration liabilities. It is therefore appropriate under EEV methodology to include a liquidity premium in the economic basis used. The appropriate EEV risk discount rate is set in order to equate the EEV with a 'market consistent embedded value' including liquidity premium. The liquidity premium in the 'market consistent embedded value' is derived from the yield on the assets held after deducting an appropriate allowance for credit risk. The risk discount rate in EEV reflects the excess of the total allowance for credit risk over the best estimate default assumptions. For Prudential Retirement Income Limited (PRIL), which has approximately 90% of UK shareholder-backed annuity business, the allowance for credit risk at 31 December 2009 is made up of:

- a 20 bps for fixed annuities and 15 bps for inflation-linked annuities in respect of long-term expected defaults. This is derived by applying Moody's data from 1970 to 2004 uplifted by between 100% (B) and 200% (AAA) according to credit rating, to the asset portfolios.
- b 13 bps for fixed annuities and 10 bps for inflation-linked annuities in respect of long-term credit risk premium for the potential volatility in default levels. This is derived by applying the 95th worst percentile from Moody's data from 1970 to 2004, to the asset portfolios.
- c 41 bps for fixed annuities and 34 bps for inflation-linked annuities in respect of additional short-term credit risk, reflecting short-term credit rating downgrades and defaults in excess of the long-term assumptions. At 31 December 2008, this was derived as 25 % of the increase in credit spreads over swaps that has occurred since 31 December 2006 based on a set of externally published indices weighted to reflect the asset mix. During 2009, this element of the overall credit assumption has not been derived by reference to credit spreads; rather it has been reduced in order to offset the impact of actual downgrades during the period on the long-term assumptions in (a) and (b) above and increased to eliminate the positive experience variance that would otherwise have arisen from the small number of actual defaults that were experienced in the period. In addition, the assumptions have been updated to reflect changes in the asset mix, arising particularly from the sale of subordinated financial debt and the addition of higher credit quality new business assets to the portfolio.

The credit assumptions used and the residual liquidity premium element of the bond spread over swap rates is as follows:

	<u>2009</u>	<u>2008</u>
	(bps)	(bps)
Bond spread over swap rates . . . . .	<u>175</u>	<u>323</u>
Credit risk allowance		
Long-term expected defaults . . . . .	19	15
Long-term credit risk premium . . . . .	13	11
Short-term allowance for credit risk . . . . .	<u>39</u>	<u>54</u>
Total credit risk allowance . . . . .	<u>71</u>	<u>80</u>
Liquidity premium . . . . .	<u>104</u>	<u>243</u>

The overall allowance for credit risk is prudent by comparison with historic rates of default and would be sufficient to withstand a wide range of extreme credit events over the expected lifetime of the annuity business.

#### *Stochastic assumptions*

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations described above. Assumptions specific to the stochastic calculations, such as the volatilities of asset returns, reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of longer-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 allowance for correlation between the various asset classes.

Details are given below of the key characteristics and calibrations of each model.

#### *Asian operations*

- The same asset return models as used in the UK, appropriately calibrated, have been used for the Asian operations as described for UK insurance operations below. The principal asset classes are government and corporate bonds. Equity holdings are much lower than in the UK whilst property holdings do not represent a significant investment asset.
- The stochastic cost of guarantees is primarily only of significance for the Hong Kong, Korea, Malaysia and Singapore operations.
- The mean stochastic returns are consistent with the mean deterministic returns for each country. The expected volatility of equity returns for 2009 ranges from 18% to 35% (2008: 18% to 30%), and the volatility of government bond yields ranges from 1.3% to 2.4% (2008: 1.4% to 2.4%).

#### *US operations (Jackson)*

- Interest rates are projected using a log-normal generator calibrated to the market yield curve at the valuation date;
- Corporate bond returns are based on Treasury securities plus a spread that has been calibrated to current market conditions and varies by credit quality; and
- Variable annuity equity and bond returns have been stochastically generated using a log-normal model with parameters determined by reference to historical data. The volatility of equity fund returns for both 2009 and 2008 ranges from 18.6% to 28.1%, depending on risk class, and the standard deviation of bond returns ranges from 1.4% to 1.6% (2008: 1.5% to 1.6%).

#### *UK insurance operations*

- Interest rates are projected using a two-factor model calibrated to the initial market yield curve;
- The risk premium on equity assets is assumed to follow a log-normal distribution;
- The corporate bond return is calculated as the return on a zero-coupon bond plus a spread. The spread process is a mean reverting stochastic process; and

- Property returns are modelled in a similar fashion to corporate bonds, namely as the return on a riskless bond, plus a risk premium, plus a process representative of the change in residual values and the change in value of the call option on rents.

Mean returns have been derived as the annualised arithmetic average return across all simulations and durations.

For each projection year, standard deviations have been calculated by taking the square root of the annualised variance of the returns over all the simulations. These have been averaged over all durations in the projection. For equity and property, the standard deviations relate to the total return on these assets. The standard deviations applied to 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
	%	%
Equities:		
UK .....	<b>18.0</b>	18.0
Overseas .....	<b>18.0</b>	16.0
Property .....	<b>15.0</b>	15.0

### *c 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.

### *d Expense assumptions*

Expense levels, including those of service companies that support the Prudential Group's long-term business operations, are based on internal expense analysis investigations and are appropriately allocated to acquisition of new business and renewal of in-force business. Exceptional expenses are identified and reported separately. It is Prudential's policy not to take credit for future cost reduction programmes until the savings have been delivered.

For Asian life 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.

Expenditure of the Regional Head Office that is not allocated to the covered business or asset management operations is charged as incurred. These costs are primarily for corporate related activities. Development expenses are also charged as incurred.

Corporate expenditure for Group Head Office, to the extent not allocated to the PAC with-profits fund, is charged to EEV basis results as incurred.

### *e Taxation and other legislation*

Current taxation and other legislation have been assumed to continue unaltered except where changes have been announced and the relevant legislation passed.

## **17 New business premiums and contributions**<sup>(notes i, iii)</sup>

	Single		Regular		Annual premium and contribution equivalents (APE)		Present value of new business premiums (PVNBP)	
	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Asian operations</b> <sup>(note ii)</sup>								
China (Group's 50% interest) .....	<b>72</b>	63	<b>38</b>	32	<b>45</b>	38	<b>253</b>	230
Hong Kong .....	<b>94</b>	507	<b>232</b>	154	<b>241</b>	205	<b>1,414</b>	1,612
India (Group's 26% interest) .....	<b>47</b>	60	<b>163</b>	202	<b>168</b>	208	<b>581</b>	747
Indonesia .....	<b>41</b>	94	<b>186</b>	167	<b>190</b>	176	<b>671</b>	649
Japan .....	<b>57</b>	115	<b>46</b>	30	<b>52</b>	42	<b>263</b>	217
Korea .....	<b>38</b>	78	<b>118</b>	211	<b>122</b>	219	<b>568</b>	1,097
Malaysia .....	<b>63</b>	28	<b>140</b>	99	<b>146</b>	102	<b>814</b>	570
Singapore .....	<b>297</b>	341	<b>98</b>	78	<b>128</b>	112	<b>1,033</b>	961
Taiwan <sup>(Note ii)</sup> .....	<b>104</b>	36	<b>97</b>	55	<b>107</b>	58	<b>427</b>	237

	Single		Regular		Annual premium and contribution equivalents (APE)		Present value of new business premiums (PVNBP)	
	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m
Other . . . . .	<u>29</u>	<u>18</u>	<u>59</u>	<u>54</u>	<u>62</u>	<u>56</u>	<u>221</u>	<u>188</u>
<b>Total Asian operations (all retail)</b> . . . . .	<b><u>842</u></b>	<b><u>1,340</u></b>	<b><u>1,177</u></b>	<b><u>1,082</u></b>	<b><u>1,261</u></b>	<b><u>1,216</u></b>	<b><u>6,245</u></b>	<b><u>6,508</u></b>
<b>US operations</b>								
Fixed annuities . . . . .	<u>1,053</u>	<u>1,724</u>	<u>—</u>	<u>—</u>	<u>105</u>	<u>172</u>	<u>1,053</u>	<u>1,724</u>
Fixed index annuities . . . . .	<u>1,433</u>	<u>501</u>	<u>—</u>	<u>—</u>	<u>143</u>	<u>50</u>	<u>1,433</u>	<u>501</u>
Variable annuities . . . . .	<u>6,389</u>	<u>3,491</u>	<u>—</u>	<u>—</u>	<u>639</u>	<u>349</u>	<u>6,389</u>	<u>3,491</u>
Life . . . . .	<u>10</u>	<u>7</u>	<u>24</u>	<u>24</u>	<u>25</u>	<u>25</u>	<u>173</u>	<u>230</u>
<b>Total US operations — retail</b> . . . . .	<b><u>8,885</u></b>	<b><u>5,723</u></b>	<b><u>24</u></b>	<b><u>24</u></b>	<b><u>912</u></b>	<b><u>596</u></b>	<b><u>9,048</u></b>	<b><u>5,946</u></b>
Guaranteed Investment Contracts . . . . .	<u>—</u>	<u>857</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>86</u>	<u>—</u>	<u>857</u>
GIC — Medium Term Notes . . . . .	<u>—</u>	<u>337</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>34</u>	<u>—</u>	<u>337</u>
<b>Total US operations</b> . . . . .	<b><u>8,885</u></b>	<b><u>6,917</u></b>	<b><u>24</u></b>	<b><u>24</u></b>	<b><u>912</u></b>	<b><u>716</u></b>	<b><u>9,048</u></b>	<b><u>7,140</u></b>
<b>UK insurance operations</b>								
<b>Product summary</b>								
Internal vesting annuities . . . . .	<u>1,357</u>	<u>1,600</u>	<u>—</u>	<u>—</u>	<u>136</u>	<u>160</u>	<u>1,357</u>	<u>1,600</u>
Direct and partnership annuities . . . . .	<u>590</u>	<u>703</u>	<u>—</u>	<u>—</u>	<u>59</u>	<u>70</u>	<u>590</u>	<u>703</u>
Intermediated annuities . . . . .	<u>242</u>	<u>497</u>	<u>—</u>	<u>—</u>	<u>24</u>	<u>50</u>	<u>242</u>	<u>497</u>
<b>Total individual annuities</b> . . . . .	<b><u>2,189</u></b>	<b><u>2,800</u></b>	<b><u>—</u></b>	<b><u>—</u></b>	<b><u>219</u></b>	<b><u>280</u></b>	<b><u>2,189</u></b>	<b><u>2,800</u></b>
Income drawdown . . . . .	<u>91</u>	<u>75</u>	<u>—</u>	<u>—</u>	<u>9</u>	<u>8</u>	<u>91</u>	<u>75</u>
Equity release . . . . .	<u>127</u>	<u>242</u>	<u>—</u>	<u>—</u>	<u>13</u>	<u>24</u>	<u>127</u>	<u>242</u>
Individual pensions . . . . .	<u>198</u>	<u>115</u>	<u>7</u>	<u>3</u>	<u>27</u>	<u>14</u>	<u>218</u>	<u>124</u>
Corporate pensions . . . . .	<u>81</u>	<u>221</u>	<u>86</u>	<u>88</u>	<u>94</u>	<u>110</u>	<u>547</u>	<u>645</u>
Unit-linked bonds . . . . .	<u>122</u>	<u>109</u>	<u>—</u>	<u>—</u>	<u>12</u>	<u>11</u>	<u>122</u>	<u>109</u>
With-profit bonds . . . . .	<u>1,264</u>	<u>869</u>	<u>—</u>	<u>—</u>	<u>126</u>	<u>87</u>	<u>1,264</u>	<u>869</u>
Protection . . . . .	<u>—</u>	<u>—</u>	<u>17</u>	<u>6</u>	<u>17</u>	<u>6</u>	<u>110</u>	<u>38</u>
Offshore products . . . . .	<u>317</u>	<u>551</u>	<u>3</u>	<u>4</u>	<u>35</u>	<u>59</u>	<u>336</u>	<u>573</u>
PruHealth . . . . .	<u>—</u>	<u>—</u>	<u>11</u>	<u>16</u>	<u>11</u>	<u>16</u>	<u>111</u>	<u>146</u>
<b>Total retail retirement</b> . . . . .	<b><u>4,389</u></b>	<b><u>4,982</u></b>	<b><u>124</u></b>	<b><u>117</u></b>	<b><u>563</u></b>	<b><u>615</u></b>	<b><u>5,115</u></b>	<b><u>5,621</u></b>
Corporate pensions . . . . .	<u>111</u>	<u>227</u>	<u>105</u>	<u>116</u>	<u>116</u>	<u>139</u>	<u>460</u>	<u>653</u>
Other products . . . . .	<u>79</u>	<u>132</u>	<u>17</u>	<u>21</u>	<u>25</u>	<u>34</u>	<u>138</u>	<u>219</u>
DWP rebates . . . . .	<u>127</u>	<u>153</u>	<u>—</u>	<u>—</u>	<u>13</u>	<u>15</u>	<u>127</u>	<u>153</u>
<b>Total mature life and pensions</b> . . . . .	<b><u>317</u></b>	<b><u>512</u></b>	<b><u>122</u></b>	<b><u>137</u></b>	<b><u>154</u></b>	<b><u>188</u></b>	<b><u>725</u></b>	<b><u>1,025</u></b>
<b>Total UK retail</b> . . . . .	<b><u>4,706</u></b>	<b><u>5,494</u></b>	<b><u>246</u></b>	<b><u>254</u></b>	<b><u>717</u></b>	<b><u>803</u></b>	<b><u>5,840</u></b>	<b><u>6,646</u></b>
Wholesale annuities . . . . .	<u>39</u>	<u>1,417</u>	<u>—</u>	<u>—</u>	<u>4</u>	<u>142</u>	<u>39</u>	<u>1,417</u>
Credit life . . . . .	<u>23</u>	<u>18</u>	<u>—</u>	<u>—</u>	<u>2</u>	<u>2</u>	<u>23</u>	<u>18</u>
<b>Total UK insurance operations</b> . . . . .	<b><u>4,768</u></b>	<b><u>6,929</u></b>	<b><u>246</u></b>	<b><u>254</u></b>	<b><u>723</u></b>	<b><u>947</u></b>	<b><u>5,902</u></b>	<b><u>8,081</u></b>
<b>Channel summary</b>								
Direct and partnership . . . . .	<u>1,814</u>	<u>2,352</u>	<u>201</u>	<u>215</u>	<u>382</u>	<u>450</u>	<u>2,667</u>	<u>3,268</u>
Intermediated . . . . .	<u>2,765</u>	<u>2,990</u>	<u>45</u>	<u>39</u>	<u>322</u>	<u>338</u>	<u>3,046</u>	<u>3,226</u>
Wholesale . . . . .	<u>62</u>	<u>1,434</u>	<u>—</u>	<u>—</u>	<u>6</u>	<u>144</u>	<u>62</u>	<u>1,434</u>
<b>Sub-total</b> . . . . .	<b><u>4,641</u></b>	<b><u>6,776</u></b>	<b><u>246</u></b>	<b><u>254</u></b>	<b><u>710</u></b>	<b><u>932</u></b>	<b><u>5,775</u></b>	<b><u>7,928</u></b>
DWP rebates . . . . .	<u>127</u>	<u>153</u>	<u>—</u>	<u>—</u>	<u>13</u>	<u>15</u>	<u>127</u>	<u>153</u>
<b>Total UK operations</b> . . . . .	<b><u>4,768</u></b>	<b><u>6,929</u></b>	<b><u>246</u></b>	<b><u>254</u></b>	<b><u>723</u></b>	<b><u>947</u></b>	<b><u>5,902</u></b>	<b><u>8,081</u></b>
<b>Group total</b> . . . . .	<b><u>14,495</u></b>	<b><u>15,186</u></b>	<b><u>1,447</u></b>	<b><u>1,360</u></b>	<b><u>2,896</u></b>	<b><u>2,879</u></b>	<b><u>21,195</u></b>	<b><u>21,729</u></b>

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.

Annual premiums and contribution equivalents are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. PVNBPs are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution. 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. Department of Work and

Pensions (DWP) rebate business is classified as single recurrent business. Internal vesting business is classified as new business where the contracts include an open market option.

- (ii) The table above includes new business for the Taiwan bank distribution operation. New business of the Taiwan agency business, which was sold in June 2009 (as explained in note 18) is excluded from the table. Comparative figures have been adjusted accordingly.
- (iii) The 2008 comparatives shown in the table are translated at average exchange rates for the year.

## 18 Sale of legacy agency book and agency force in Taiwan to China Life Insurance of Taiwan

	<u>2009</u>	<u>2008</u>
	£m	£m
Profit on sale and results for Taiwan agency business . . . . .	<u>91</u>	<u>(248)</u>

### *a 2009*

On 20 February 2009, the Prudential Group announced that it had entered into an agreement to sell the assets and liabilities of its agency business and its agency force in Taiwan to China Life Insurance Company Ltd of Taiwan for the nominal sum of NT\$1. The economic transfer date for the purpose of determining the net assets transferred was 28 February 2009. The sale was completed, following regulatory approval, on 19 June 2009.

The profit on sale and results for the period of ownership comprise:

	<u>£m</u>
Proceeds . . . . .	—
Net asset value attributable to equity holders of Company at 1 January 2009 and provision for restructuring costs . . . . .	134
Goodwill written off . . . . .	<u>(44)</u>
Estimate as announced on 20 February 2009 . . . . .	90
Plus: effect of completion and other adjustments . . . . .	<u>1</u>
	<u>91</u>
Representing:	
Profit arising on sale and result for long-term business operations <sup>(10)</sup> . . . . .	148
Goodwill written off . . . . .	<u>(44)</u>
Adjustments in respect of restructuring costs borne by non-covered business . . . . .	<u>(13)</u>
	<u>91</u>

### *b 2008 comparative results*

The results for 2008 of £(248) million comprise the total result for the sold business i.e. including operating profit, short-term fluctuations in investment returns and the effect of changes in economic assumptions and the time value of cost of options and guarantees.

In order to facilitate comparisons of the Prudential Group's retained businesses, the presentation of the EEV basis results has been adjusted to show separately the result of the sold Taiwan agency business, as explained below:

	<b>2008</b>		
	<u>As previously published</u>	<u>Adjustment</u>	<u>Adjusted</u>
	£m	£m	£m
APE new business . . . . .	3,025	(146)	2,879
New business profit . . . . .	1,307	(107)	1,200
In-force profit . . . . .	1,625	11	1,636
Asset management . . . . .	345	—	345
Other results . . . . .	(316)	—	(316)
Operating profit based on longer-term investment returns . . . . .	2,961	(96)	2,865
Short-term fluctuations in investment returns . . . . .	(5,127)	160	(4,967)
Mark to market value movements on core borrowings . . . . .	656	—	656
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes . . . . .	(15)	1	(14)
Effect of changes in economic assumptions and the time value of cost of options and guarantees . . . . .	(581)	183	(398)
Result of sold Taiwan agency business . . . . .	<u>Included above</u>	<u>(248)</u>	<u>(248)</u>
Loss before tax . . . . .	<u>(2,106)</u>	<u>—</u>	<u>(2,106)</u>

## **19 Post balance sheet events**

### ***a Acquisition of UOB Life Assurance Limited***

On 6 January 2010 the Prudential Group announced the acquisition from United Overseas Bank Limited (UOB) of its 100% interest in UOB Life Assurance Limited in Singapore for total cash consideration of SGD428 million (£192 million) subject to a post-completion adjustment to reflect the net asset value as at the completion date. This acquisition accompanied the announcement of a long-term strategic partnership with UOB. Through this partnership the Prudential Group's life insurance products will be distributed through UOB Group's 414 bank branches across Singapore, Indonesia and Thailand.

The Prudential Group continues to complete its compilation of the acquisition balance sheet and further details will be provided in the Prudential Group's 2010 half year results announcement.

### ***b Japanese insurance subsidiary's suspension of writing new business***

On 15 January 2010 the Prudential Group's Japanese insurance subsidiary announced its intention to suspend writing new policyholder contracts in Japan after 15 February 2010. Prudential reinforced its commitment to servicing its existing policyholder base, which comprised over 170,000 contracts as at 30 September 2009. This decision will be reviewed on an on-going basis in light of changes to the business environment.

This decision does not affect the Prudential Group's asset management operations in Japan, which ranks among the largest foreign asset managers.

### ***c Agreement to acquire AIA Group Limited***

On 1 March 2010, Prudential plc announced that it had reached agreement with American International Group Inc. ("AIG"), on terms for the combination of the Prudential Group and AIA Group Limited ("AIA"), a wholly-owned subsidiary of AIG (the "Transaction"). The AIA Group is a leading life insurance organisation in the Asia Pacific region which provides individuals and businesses with products and services for their insurance, protection, savings, investment and retirement needs in 15 geographical markets in the region. The combined group will be the leading life insurer in Hong Kong, Singapore, Malaysia, Indonesia, Vietnam, Thailand and the Philippines with the leading foreign life insurance business in China and India, a significantly enhanced presence in the high growth South East Asian life markets and strong operations in the US and UK.

The Transaction will be effected through the acquisition of both Prudential (by a scheme of arrangement, the "Scheme") and AIA by a new company ("New Prudential"). The new company will assume the name Prudential plc, be headquartered and incorporated in the UK, and traded on the main market of the London Stock Exchange with ADRs traded on the New York Stock Exchange. The existing Board of Prudential will become the Board of New Prudential.

AIG will receive total consideration of US\$35.5 billion, comprising US\$25.0 billion in cash and US\$10.5 billion in New Prudential shares and other securities. The cash component of the consideration will be financed through an underwritten rights issue, raising US\$2.0 billion (net of fees and expenses) and through issuance of US\$5.0 billion senior notes (net of fees and expenses). These issues have been agreed to be underwritten by certain banks.

The Rights Issue and the Scheme will be subject to shareholder approval at the General Meeting. The Transaction is also subject to certain regulatory and anti-trust approvals including various regulatory approvals required on a change of control of Prudential as a result of the Scheme.

On 8 March 2010 Prudential confirmed that the Prudential Group had entered into foreign exchange hedging arrangements in respect of its requirement to convert the pounds sterling proceeds of the Rights Issue into US dollars, which is the currency in which Prudential must pay the cash element of the consideration.

**Statement of directors' responsibilities in respect of the European Embedded Value (EEV)  
basis supplementary information**

The directors have chosen to prepare supplementary information in accordance with the EEV Principles issued in May 2004 by the European CFO Forum as supplemented by the Additional Guidance on EEV Disclosures issued in October 2005.

When compliance with the EEV Principles is stated, those principles require the directors to prepare supplementary information in accordance with the Embedded Value Methodology (EVM) contained in the EEV Principles and to disclose and explain any non-compliance with the EEV guidance included in the EEV Principles.

In preparing the EEV supplementary information, the directors have:

- prepared the supplementary information in accordance with the EEV Principles;
- identified and described the business covered by the EVM;
- applied the EVM consistently to the covered business;
- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to any relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent; and
- described the basis on which business that is not covered business has been included in the supplementary information, including any material departures from the accounting framework applicable to the Prudential Group's financial statements.

**Independent auditor's report to Prudential plc on the European Embedded Value (EEV)  
basis supplementary information**

We have audited the EEV basis supplementary information ("the supplementary information") of Prudential plc for the year ended 31 December 2009 set out on pages 304 to 340. The financial reporting framework that has been applied in the supplementary information is the European Embedded Value Principles issued in May 2004 by the European CFO Forum as supplemented by the Additional Guidance on European Embedded Value Disclosures issued in October 2005 (together 'the EEV Principles') using the methodology and assumptions set out on pages 308 to 312 and 333 to 337 respectively. The supplementary information should be read in conjunction with the group financial statements which are set out on pages 119 to 301.

This report is made solely to Prudential in accordance with the terms of our engagement. Our audit work has been undertaken so that we might state to Prudential 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 Prudential for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of directors and auditor**

As explained more fully in the statement of directors' responsibilities, the directors have accepted responsibility for the preparation of the supplementary information on the EEV basis in accordance with the EEV Principles.

Our responsibility is to audit the supplementary information in accordance with the terms of our engagement and having regard to International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

**Scope of the audit of the supplementary information**

An audit involves obtaining evidence about the amounts and disclosures in the supplementary information to give reasonable assurance that the supplementary information is free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Prudential Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the supplementary information.

**Opinion on supplementary information**

In our opinion, the EEV basis supplementary information for the year ended 31 December 2009 has been properly prepared in accordance with the EEV Principles using the methodology and assumptions set out on pages 308 to 312 and 333 to 337 respectively.

G Bainbridge  
for and on behalf of KPMG Audit Plc  
*Chartered Accountants*  
London  
08 March 2010

## PART XV

### HISTORICAL FINANCIAL INFORMATION FOR AIA GROUP

#### A. Accountant's report on AIA Group Historical Financial Information

*The following is the text of a report received from AIA's reporting accountant, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong, for the purpose of incorporation in this prospectus.*



羅兵咸永道會計師事務所

PricewaterhouseCoopers  
22nd Floor, Prince's Building  
Central, Hong Kong

The Directors  
Prudential plc  
Laurence Pountney Hill,  
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EC4R OHH  
United Kingdom

Credit Suisse Securities (Europe) Limited  
One Cabot Square  
London  
E14 4QJ  
United Kingdom

HSBC Bank plc  
8 Canada Square  
London  
E14 5HQ  
United Kingdom

J.P. Morgan Securities Ltd.  
125 London Wall  
London  
EC2Y 5 AJ  
United Kingdom

17 May 2010

Dear Sirs

#### **AIA Group Limited**

We report on the financial information set out in Section B of this Part XV (the “**AIA Group Historical Financial Information**”). The AIA Group Historical Financial Information has been prepared for inclusion in the prospectus dated 17 May 2010 (the “**Prospectus**”) of Prudential plc (the “**Company**”) on the basis of the accounting policies set out in note 2 to the AIA Group Historical Financial Information. This report is required by item 20.1 of Annex I to the PD Regulation and is given for the purpose of complying with that item and for no other purpose.

#### **Responsibilities**

The Directors of the Company are responsible for preparing the AIA Group Historical Financial Information in accordance with International Financial Reporting Standards as adopted by the European Union.

It is our responsibility to form an opinion as to whether the AIA Group Historical Financial Information gives a true and fair view, for the purposes of the Prospectus and to report our opinion to you.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and for any responsibility arising under item 5.5.3R(2)(f) of the Prospectus Rules to any person as and to the extent there

provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with item 23.1 of Annex I to the PD Regulation, consenting to its inclusion in the Prospectus.

### **Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to AIA Group Limited's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing standards generally accepted in the United States of America or auditing standards of the Public Company Accounting Oversight Board (United States) and accordingly should not be relied upon as if it had been carried out in accordance with those standards.

### **Opinion**

In our opinion, the AIA Group Historical Financial Information gives, for the purposes of the Prospectus dated 17 May 2010, a true and fair view of the state of affairs of AIA Group Limited as at 30 November 2009 and of the state of affairs of the AIA Group as at the dates stated and of its profits, cash flows and changes in equity for the periods then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

### **Declaration**

For the purposes of Prospectus Rule 5.5.3R(2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with item 1.2 of Annex I to the PD Regulation.

Yours faithfully

**PricewaterhouseCoopers**  
*Certified Public Accountants*  
Hong Kong

**B. AIA Financial Information for FY 2007, 2008, 2009**

**I. FINANCIAL INFORMATION**

**1. CONSOLIDATED INCOME STATEMENT**

	Notes	Year Ended 30 November 2007	Year Ended 30 November 2008	Year Ended 30 November 2009 US\$m
<b>Revenue</b>				
<i>Turnover</i>				
Premiums and fee income . . . . .		9,573	10,674	10,433
Premiums ceded to reinsurers . . . . .		<u>(833)</u>	<u>(392)</u>	<u>(331)</u>
Net premiums and fee income . . . . .		8,740	10,282	10,102
Investment return . . . . .	8	6,548	(7,021)	9,070
Other operating revenue . . . . .	8	<u>77</u>	<u>526</u>	<u>71</u>
<b>Total revenue</b> . . . . .		<b><u>15,365</u></b>	<b><u>3,787</u></b>	<b><u>19,243</u></b>
<b>Expenses</b>				
Insurance and investment contract benefits . . . . .		11,050	1,357	13,880
Insurance and investment contract benefits ceded . . . . .		<u>(653)</u>	<u>(248)</u>	<u>(251)</u>
<b>Net insurance and investment contract benefits</b> . . . . .		<b>10,397</b>	<b>1,109</b>	<b>13,629</b>
Commission and other acquisition expenses . . . . .		947	1,563	1,648
Operating expenses . . . . .		951	1,094	975
Restructuring and separation costs . . . . .		—	10	89
Investment management expenses . . . . .		88	101	87
Finance costs . . . . .		203	159	50
Change in third party interests in consolidated investment funds . . . . .		<u>80</u>	<u>(319)</u>	<u>164</u>
<b>Total expenses</b> . . . . .	9	<b><u>12,666</u></b>	<b><u>3,717</u></b>	<b><u>16,642</u></b>
<b>Profit before share of loss from associates and joint ventures</b> . . . . .		<b>2,699</b>	<b>70</b>	<b>2,601</b>
Share of profit/(loss) from associates and joint ventures . . . . .		<u>99</u>	<u>(28)</u>	<u>(21)</u>
<b>Profit before tax</b> . . . . .		<b><u>2,798</u></b>	<b><u>42</u></b>	<b><u>2,580</u></b>
Income tax (expense)/credit attributable to policyholders' returns . . . . .		<u>(70)</u>	<u>90</u>	<u>(137)</u>
<b>Profit before tax attributable to shareholders' profits</b> . . . . .		<b><u>2,728</u></b>	<b><u>132</u></b>	<b><u>2,443</u></b>
Tax (expense)/credit . . . . .	10	(649)	437	(643)
Less: tax attributable to policyholders' returns . . . . .		70	(90)	137
Tax (expense)/credit attributable to shareholders' profits . . . . .		<u>(579)</u>	<u>347</u>	<u>(506)</u>
<b>Net profit</b> . . . . .		<b><u>2,149</u></b>	<b><u>479</u></b>	<b><u>1,937</u></b>
<i>Net profit attributable to:</i>				
Shareholders of AIA . . . . .		2,133	473	1,916
Non-controlling interests . . . . .		16	6	21
<b>Earnings per share (US\$)</b>				
Basic and diluted . . . . .	12	0.18	0.04	0.16

## 2. CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	<u>Notes</u>	<u>Year Ended 30 November 2007</u>	<u>Year Ended 30 November 2008</u>	<u>Year Ended 30 November 2009</u>
				US\$m
<b>Net profit</b> .....		<b>2,149</b>	<b>479</b>	<b>1,937</b>
Fair value (losses)/gains on available for sale financial assets (net of tax of: 2007: US\$181m; 2008: US\$(22)m; 2009 US\$(139)m) .....		(1,244)	(4,788)	2,898
Fair value (gains)/losses on available for sale financial assets transferred to income on disposal and impairment (net of tax of: 2007: nil; 2008: US\$10m; 2009: US\$6m) .....		(1)	222	223
Foreign currency translation adjustments .....		<u>332</u>	<u>(783)</u>	<u>696</u>
Other comprehensive income .....		<u>(913)</u>	<u>(5,349)</u>	<u>3,817</u>
<b>Total comprehensive income</b> .....		<b><u>1,236</u></b>	<b><u>(4,870)</u></b>	<b><u>5,754</u></b>
<i>Total comprehensive income attributable to:</i>				
Shareholders of AIA .....		1,216	(4,830)	5,687
Non-controlling interests .....		20	(40)	67

### 3. CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	30 November 2007	30 November 2008	30 November 2009 US\$m
<b>Assets</b>				
Intangible assets . . . . .	14	200	232	233
Investments in associates and joint ventures . . . . .	15	63	47	53
Property, plant and equipment . . . . .	16	352	335	395
Investment property . . . . .	17, 18	1,458	1,410	1,592
Reinsurance assets . . . . .	19	2,668	147	284
Deferred acquisition and origination costs . . . . .	20	10,044	10,047	10,976
<b>Financial investments:</b> . . . . .	21, 23			
Loans and receivables . . . . .		5,665	4,002	4,648
Available for sale				
Debt securities . . . . .		30,955	29,934	37,722
Equity securities — shares in AIG . . . . .		2,520	87	62
At fair value through profit or loss				
Debt securities . . . . .		13,449	12,389	14,479
Equity securities . . . . .		17,619	8,660	16,116
Derivative financial instruments . . . . .	22	422	252	453
		70,630	55,324	73,480
Other assets . . . . .	24	917	972	1,069
Cash and cash equivalents . . . . .	25	2,583	4,164	3,405
Assets of disposal groups held for sale . . . . .	11	—	—	58
<b>Total assets</b> . . . . .		<b>88,915</b>	<b>72,678</b>	<b>91,545</b>
<b>Liabilities</b>				
Insurance contract liabilities . . . . .	26	57,735	52,564	63,803
Investment contract liabilities . . . . .	27	6,505	4,898	7,780
Borrowings . . . . .	29	1,461	661	688
Obligations under securities lending and repurchase				
agreements . . . . .	30	5,395	2,718	284
Derivative financial instruments . . . . .	22	47	138	71
Provisions . . . . .	32	140	181	285
Deferred tax liabilities . . . . .	10	1,392	517	1,047
Current tax liabilities . . . . .		269	218	185
Other liabilities . . . . .	33	2,294	1,587	2,012
Liabilities of disposal groups held for sale . . . . .	11	—	—	58
<b>Total liabilities</b> . . . . .		<b>75,238</b>	<b>63,482</b>	<b>76,213</b>
<b>Equity</b>				
Issued share capital and shares yet to be issued . . . . .	34	12,000	12,000	12,044
Share premium . . . . .	34	1,914	1,914	1,914
Other reserves . . . . .		(13,215)	(12,480)	(12,110)
Retained earnings . . . . .		9,632	9,760	11,651
Fair value reserve . . . . .		2,956	(1,564)	1,511
Foreign currency translation reserve . . . . .		329	(454)	242
Amounts reflected in other comprehensive income . . . . .		3,285	(2,018)	1,753
<i>Total equity attributable to:</i>				
Shareholders of AIA . . . . .		13,616	9,176	15,252
Non-controlling interests . . . . .	35	61	20	80
<b>Total equity</b> . . . . .		<b>13,677</b>	<b>9,196</b>	<b>15,332</b>
<b>Total liabilities and equity</b> . . . . .		<b>88,915</b>	<b>72,678</b>	<b>91,545</b>

#### 4. CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Notes	Issued share capital, shares yet to be issued and share premium	Other reserves	Retained earnings	Fair value reserve	Foreign currency translation reserve	Non-controlling interests	Total Equity US\$m
<b>Balance at 1 December 2006</b>		<b>13,914</b>	<b>(13,376)</b>	<b>7,792</b>	<b>4,193</b>	—	<b>84</b>	<b>12,607</b>
Net Profit		—	—	2,133	—	—	16	2,149
Other comprehensive income		—	—	—	(1,249)	332	4	(913)
Capital contributions		—	164	—	—	—	—	164
Dividends	13	—	—	(259)	—	—	(2)	(261)
Acquisition of non-controlling interest		—	—	(34)	12	(3)	(41)	(66)
Share based compensation		—	(3)	—	—	—	—	(3)
<b>Balance at 30 November 2007</b>		<b>13,914</b>	<b>(13,215)</b>	<b>9,632</b>	<b>2,956</b>	<b>329</b>	<b>61</b>	<b>13,677</b>
Net Profit		—	—	473	—	—	6	479
Other comprehensive income		—	—	—	(4,520)	(783)	(46)	(5,349)
Capital contributions		—	731	—	—	—	—	731
Dividends	13	—	—	(345)	—	—	(1)	(346)
Share based compensation		—	4	—	—	—	—	4
<b>Balance at 30 November 2008</b>		<b>13,914</b>	<b>(12,480)</b>	<b>9,760</b>	<b>(1,564)</b>	<b>(454)</b>	<b>20</b>	<b>9,196</b>
Net profit		—	—	1,916	—	—	21	1,937
Other comprehensive income		—	—	—	3,075	696	46	3,817
Capital contributions		44	364	—	—	—	—	408
Dividends	13	—	—	(25)	—	—	—	(25)
Acquisition of subsidiary		—	—	—	—	—	44	44
Disposal of subsidiary		—	—	—	—	—	(51)	(51)
Share based compensation		—	6	—	—	—	—	6
<b>Balance at 30 November 2009</b>		<b>13,958</b>	<b>(12,110)</b>	<b>11,651</b>	<b>1,511</b>	<b>242</b>	<b>80</b>	<b>15,332</b>

## 5. CONSOLIDATED STATEMENT OF CASH FLOWS

Cash flows presented in this statement cover all the AIA Group's activities and include flows from both investment-linked contracts and participating funds, and shareholder activities.

	Notes	Year Ended 30 November 2007	Year Ended 30 November 2008	Year Ended 30 November 2009 US\$m
<b>Cash flows from operating activities</b>				
<b>Profit before tax</b>		<b>2,798</b>	<b>42</b>	<b>2,580</b>
Gain on reinsurance recapture	5	—	(447)	—
Financial instruments	21	(11,934)	10,054	(11,044)
Insurance and investment contract liabilities	26	9,641	(3,142)	10,274
Obligations under securities lending and purchase agreements	30	1,609	(3,162)	(2,505)
Other non-cash operating items, including investment income		(2,478)	(3,615)	(2,930)
Operating cash items:				
Interest received		2,462	2,933	2,798
Dividends received		185	201	147
Interest paid		(203)	(159)	(50)
Tax paid		(446)	(418)	(371)
<b>Net cash provided by/(used in) operating activities</b>		<b><u>1,634</u></b>	<b><u>2,287</u></b>	<b><u>(1,101)</u></b>
<b>Cash flows from investing activities</b>				
Payments for investments in associates	15	(8)	(48)	(24)
Disposals of investments in associates	15	217	17	1
Acquisitions of subsidiaries, net of cash acquired	4	(207)	—	(28)
Disposal of a subsidiary, net of cash disposed		—	—	(2)
Payments for investment property and property, plant and equipment	16, 17	(61)	(114)	(39)
Proceeds from sale of investment property and property, plant and equipment		9	15	8
Payments for intangible assets	14	(22)	(38)	(36)
Proceeds from sale of intangible assets		—	—	22
<b>Net cash used in investing activities</b>		<b><u>(72)</u></b>	<b><u>(168)</u></b>	<b><u>(98)</u></b>
<b>Cash flows from financing activities</b>				
Dividends paid during the year	13	(261)	(346)	(25)
Proceeds from borrowings	29	101	50	21
Repayment of borrowings	29	—	(849)	(49)
Purchase of non-controlling interest		(66)	—	—
Capital contributions		164	731	401
<b>Net cash (used in)/provided by financing activities</b>		<b><u>(62)</u></b>	<b><u>(414)</u></b>	<b><u>348</u></b>
Net increase/(decrease) in cash held		1,500	1,705	(851)
Cash and cash equivalents at beginning of the financial year		1,035	2,583	4,164
Effect of exchange rate changes on cash		48	(124)	92
<b>Cash and cash equivalents at the end of the financial year</b>	25	<b><u>2,583</u></b>	<b><u>4,164</u></b>	<b><u>3,405</u></b>

## II NOTES TO THE FINANCIAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES

### 1. Corporate information and group reorganisation

AIA Group Limited (“AIA”) was established as a company with limited liability incorporated in Hong Kong on 24 August 2009. The address of its registered office is 35/F, AIA Central, 1 Connaught Road, Central, Hong Kong.

AIA Group Limited and its subsidiaries (collectively “the AIA Group”) is a life insurance based financial services provider operating in 15 jurisdictions throughout the Asia Pacific region. The AIA Group’s principal activity is the writing of life insurance business, providing life, pensions and accident and health insurance throughout Asia, and distributing related investment and other financial services products to its customers.

The AIA Group was formed following several steps in the reorganisation of the Asia Pacific life insurance operations of American International Group, Inc. (“AIG”). These included the reorganisation steps required under the purchase agreement dated 25 June 2009 between AIG, American International Reinsurance Company, Ltd (“AIRCO”), AIA’s immediate parent company prior to the completion of the reorganisation and a fellow subsidiary of AIG, and the Federal Reserve Bank of New York (the “FRBNY”) (“the FRBNY Agreement”) under which AIG agreed to contribute the equity of American International Assurance Company, Limited (“AIA Co”) to a special purpose vehicle, AIA Aurora LLC, the details of which are set out in Note 44, Immediate and ultimate controlling party. The main steps in the reorganisation are summarised as follows:

- on 19 February 2009, AIA Co entered into a series of agreements with AIRCO in respect of the transfer of American International Assurance Company (Bermuda) Limited (“AIA-B”), AIA Australia Limited (previously known as American International Assurance Company (Australia) Limited) (“AIA Australia”) and AIA Pension and Trustee Co. Ltd (including, as of the transaction date, all of their subsidiaries, joint ventures and associates, and other investments) to AIA Co. These transactions completed on 28 February 2009;
- on 1 June 2009, American Life Insurance Company (“ALICO”), a fellow subsidiary of AIG, transferred its Taiwan branch together with the branch’s life insurance and related business to AIA-B;
- on 13 August 2009, AIA-B entered into an agreement with AIG in respect of the transfer of AIG Global Investment Corporation (Asia) Limited to AIG. This transaction completed on 25 November 2009;
- on 24 August 2009, AIA Co entered into an agreement with AIG and ALICO in respect of the transfer of The Philippine American Life and General Insurance Company (“Philam”) (including, as of the date of acquisition, all of its subsidiaries, joint ventures and associates, and other investments) to AIA Co. Philam’s shares were transferred to AIA Co in exchange for a promissory note issued by AIA Co, with a principal amount of US\$586m (“the AIA Co promissory note”). The AIA Co promissory note was transferred by AIG and ALICO to AIA’s then immediate parent company, AIRCO, which contributed the AIA Co promissory note to AIA in exchange for shares in AIA Co, following which the AIA Co promissory note was extinguished. This transaction completed on 3 November 2009;
- on 24 August 2009, AIA Group Limited was formed by AIA Aurora LLC pursuant to the terms of the FRBNY Agreement;
- on 23 September 2009, TH Central Holdings Limited, a wholly-owned subsidiary of AIA Co, entered into an agreement with AIRCO to acquire certain ownership interests in fellow subsidiaries of AIG. These entities perform service functions and hold property in Thailand. These transactions completed on 15 October 2009;
- on 27 November 2009, AIA Group Limited entered into an agreement with AIG and AIRCO, which completed on 30 November 2009, in respect of the transfer of AIA Co (including, as of the transaction date, all of its subsidiaries, joint ventures and associates, and other investments) to AIA Group Limited. AIRCO transferred AIA Co to AIA Group Limited in exchange for a promissory note issued by AIA Group Limited, with a principal amount of US\$13,964m (“the AIG Group promissory note”). AIRCO transferred the AIA Group promissory note to AIA Aurora LLC, which contributed the note to AIA Group Limited in exchange for shares (comprising issued share capital of US\$12,000m and share premium of US\$1,914m) and a further US\$50m promissory note from AIA Group Limited, upon receipt of which the first AIA Group promissory note was extinguished.

The group reorganisation and business combinations arising from transfers of interests in entities that are under the common control of AIG throughout all periods presented in the AIA Group Historical Financial Information, have been accounted for as if they had occurred at the beginning of the earliest period presented. The components of equity of the acquired entities are added to the same components within consolidated equity, except that any share capital of the acquired entities is recognised as part of other reserves.

Accordingly, the AIA Group Historical Financial Information presents the results of operations of the AIA Group as if it had been in existence throughout the period from 1 December 2006 to date. All entities now comprising the AIA Group, including joint ventures and associates, have adopted 30 November as their financial year end date for AIA Group reporting purposes.

## **2. Significant accounting policies**

### **2.1 Basis of preparation and statement of compliance**

The AIA Group Historical Financial Information has been prepared in accordance with IFRS as adopted by the European Union and IFRS as issued by the International Accounting Standards Board. References to IFRS, IAS and IFRIC in the AIA Group Historical Financial Information should be read as referring to standards and interpretations as adopted by the European Union.

IFRS 1, *First Time Adoption of International Financial Reporting Standards* has been applied in preparing the AIA Group Historical Financial Information. The AIA Group Historical Financial Information is the first set of financial information for the AIA Group prepared in accordance with IFRS.

The consolidated AIA Group Historical Financial Information has been prepared using the historical cost convention, as modified by the revaluation of available for sale financial assets, certain financial assets and liabilities designated at fair value through profit or loss, derivative financial instruments and investment properties, all of which are carried at fair value.

All IFRS standards and interpretations effective for accounting periods starting on or after 1 December 2008 have been applied consistently from the date of transition to IFRS on 1 December 2006, unless otherwise stated.

The following new standards, amendments to standards and interpretations have been early adopted by the AIA Group and applied consistently in preparing the AIA Group Historical Financial Information:

- Revised IAS 1, *Presentation of Financial Statements*;
- IFRS 8, *Operating Segments*; and
- Revised IAS 23R, *Borrowing Costs*.

The following new standards, amendments and interpretations which are not effective for the year ended 30 November 2009 have not been adopted in the AIA Group Historical Financial Information:

- IFRS 9, *Financial Instruments*;
- Amendment to IFRS 7, *Financial Instruments: Disclosures*;
- Revised IFRS 3, *Business Combinations*;
- Amendment to IAS 27, *Consolidated and Separate Financial Statements*; and
- Amendments to IFRS 1, *First-time Adoption of International Financial Reporting Standards: Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters*.

The following new interpretations have not been applied because they have no material impact for the AIA Group:

- IFRIC 9, *Reassessment of Embedded Derivatives*;
- IFRIC 12, *Service Concession Arrangements*;
- IFRIC 13, *Customer Loyalty Programmes*;
- IFRIC 14, *IAS 19, The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*;
- IFRIC 15, *Agreements for the Construction of Real Estate*;
- IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*;
- IFRIC 17, *Distributions of Non-cash Assets to Owners*;
- IFRIC 18, *Transfers of Assets from Customers*; and
- IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*.

IFRIC 16 can only be applied by the AIA Group prospectively and hence has no impact for the AIA Group in the current period.

The following amendments to standards have no material impact for the AIA Group:

- Amendments to IAS 24, *Related Party Disclosure: Revised definition of Related Parties*;
- Amendments to IFRS 2, *Share Based Payments, Vesting Conditions and Cancellations*;
- Amendments to IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*: Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations;
- Amendments to IFRS 7, *Financial Instruments: Disclosures, Reclassifications of Financial Assets* and IAS 39, *Financial Instruments*;
- Amendments to IAS 32, *Financial Instruments: Presentation* and IAS 1, *Presentation of Financial Instruments, Puttable Financial Instruments and Obligations Arising on Liquidations*;
- Amendments to IAS 39, *Financial Instruments: Recognition and Measurement, Eligible Hedged Items* (see note 2.6.4);
- Amendments to IAS 38, *Intangible Assets*: Additional consequential amendments arising from revised IFRS 3 and measuring the fair value of an intangible asset acquired in a business combination;
- Amendments to IAS 7, *Statement of Cash Flows*: Classification of expenditure on unrecognised assets;
- Amendments to IAS 17, *Leases*: Classification of leases of land and buildings;
- Amendments to IAS 36, *Impairment of Assets*: Unit of accounting for goodwill impairment test; and
- Amendments to IAS 40, *Investment Property*.

Items included in AIA Group Historical Financial Information of each of the AIA Group's entities are measured in the currency of the primary economic environment in which that entity operates (the functional currency). The AIA Group Historical Financial Information is presented in millions of US Dollars (US\$m) unless otherwise stated, which is AIA's functional currency, and the presentation currency of the AIA Group.

The significant accounting policies adopted in the preparation of the AIA Group Historical Financial Information are set out below. These policies have been applied consistently in all periods presented.

## **2.2 Operating profit**

The long term nature of much of the AIA Group's operations means that, for management's decision making and internal performance management purposes, the AIA Group evaluates its results and its operating segments using a financial performance measure referred to as 'operating profit'. The AIA Group defines operating profit before and after tax respectively as profit excluding the following non-operating items:

- investment experience (which consists of realised gains and losses, foreign exchange gains and losses, impairments and unrealised gains and losses on investments held at fair value through profit or loss);
- investment income related to investment-linked and pension contracts (consisting of dividends, interest income and rental income);
- investment management expenses related to investment-linked contracts;
- corresponding changes in insurance and investment contract liabilities in respect of investment-linked contracts and participating funds (see note 2.3) and changes in third party interests in consolidated investment funds resulting from the above; and
- other significant items that management considers to be non-operating income and expenses (see note 5).

Whilst these excluded non-operating items are significant components of the AIA Group's profit, the AIA Group considers that the presentation of operating profit enhances the understanding and comparability of its performance and that of its operating segments. The AIA Group considers that trends can be more clearly identified without the fluctuating effects of these non-operating items, many of which are largely dependent on market factors.

Operating profit is provided as additional information to assist in the comparison of business trends in different reporting periods on a consistent basis and enhance overall understanding of financial performance.

In the notes to the AIA Group Historical Financial Information, investment-linked contracts are presented together with pensions contracts for disclosure purposes.

### 2.3 Critical accounting policies and the use of estimates

#### *Critical accounting policies*

The preparation of the AIA Group Historical Financial Information requires the selection of accounting policies and making estimates and assumptions that affect items reported in the consolidated income statement, consolidated statement of financial position, other primary statements and notes to the AIA Group Historical Financial Information. Critical accounting policies are considered to be those where a diverse range of accounting treatments is permitted by IFRS and significant judgments and estimates are required.

#### *Product classification*

IFRS 4, *Insurance Contracts*, requires contracts written by insurers to be classified either as insurance contracts or investment contracts, depending on the level of insurance risk. Insurance contracts are those contracts that transfer significant insurance risk, while investment contracts are those contracts without significant insurance risk. Some insurance and investment contracts, referred to as participating business, have discretionary participation features, or DPF, which may entitle the customer to receive, as a supplement to guaranteed benefits, additional non-guaranteed benefits, such as policyholder dividends or bonuses. The AIA Group applies the same accounting policies for the recognition and measurement of obligations arising from investment contracts with DPF as it does for insurance contracts.

Accordingly, the AIA Group performs a product classification exercise covering its portfolio of contracts to determine the classification of contracts to these categories. Product classification requires the exercise of significant judgment to determine whether there is a scenario (other than those lacking commercial substance) in which an insured event would require the AIA Group to pay significant additional benefits to its customers. In the event the AIA Group has to pay significant additional benefits to its customers, the contract is accounted for as an insurance contract. For investment contracts that do not contain DPF, IAS 39, *Financial Instruments: Measurement and Recognition*, and, if the contract includes an investment management element, IAS 18, *Revenue Recognition*, are applied. IFRS 4 permits the continued use of previously applied accounting policies for insurance contracts and investment contracts with DPF, and this basis has been adopted by the AIA Group in accounting for such contracts, except for participating business written in participating funds where in addition to policy liabilities a liability is recorded for the net assets of the participating fund.

The judgments exercised in determining the level of insurance risk deemed to be significant in product classification affect the amounts recognised in the AIA Group Historical Financial Information as insurance and investment contract liabilities and deferred acquisition and origination costs.

#### *Insurance contract liabilities (including liabilities in respect of investment contracts with DPF)*

IFRS 4 permits a wide range of accounting treatments to be adopted for the recognition and measurement of insurance contract liabilities, including liabilities in respect of insurance and investment contracts with DPF. The AIA Group calculates insurance contract liabilities for traditional life insurance using a net level premium valuation method, whereby the liability represents the present value of estimated future policy benefits to be paid, less the present value of estimated future net premiums to be collected from policyholders. This method uses best estimate assumptions adjusted for a provision for the risk of adverse deviation for mortality, morbidity, expected investment yields, policyholder dividends (for other participating business), surrenders and expenses set at the policy inception date. These assumptions remain locked in thereafter, unless a deficiency arises on liability adequacy testing. Interest rate assumptions can vary by geographical market, year of issuance and product. Mortality, surrender and expense assumptions are based on actual experience by each geographical market, modified to allow for variations in policy form. The AIA Group exercises significant judgment in making appropriate assumptions.

For contracts with an explicit account balance, such as universal life and investment-linked contracts, insurance contract liabilities represent the accumulation value, which represents premiums received and investment returns credited to the policy less deductions for mortality and morbidity costs and expense charges. Significant judgment is exercised in making appropriate estimates of gross profits, which are also regularly reviewed by the AIA Group.

Participating business, consisting of contracts with DPF, is distinct from other insurance and investment contracts as the AIA Group has discretion as to either the amount or the timing of the benefits declared. In some geographical markets, participating business is written in a participating fund which is distinct from the other assets of the operating unit or branch. The allocation of benefits from the assets held in such participating funds is subject to minimum policyholder participation mechanisms which are established by applicable regulations. The extent of such policyholder participation may change over time.

The AIA Group accounts for insurance contract liabilities for participating business written in participating funds by establishing a liability for the present value of guaranteed benefits less estimated future net premiums to be collected from policyholders. In addition, an insurance liability is recorded for the net assets of participating funds. As such, income is recognised only when dividend or bonus declarations are made, to the extent that a portion of such declarations is attributable to the AIA Group. Establishing these liabilities requires the exercise of significant judgment. In addition, the assumption that all relevant performance is declared as a policyholder dividend may not be borne out in practice. The AIA Group accounts for other participating business by establishing a liability for the present value of guaranteed benefits and non-guaranteed participation, less estimated future net premiums to be collected from policyholders.

The judgments exercised in the valuation of insurance contract liabilities (including contracts with DPF) affect the amounts recognised in the AIA Group Historical Financial Information as insurance contract benefits and insurance contract liabilities.

#### *Deferred policy acquisition and origination costs*

The costs of acquiring new insurance contracts, including commission, underwriting and other policy issue expenses which vary with and are primarily related to the production of new business or renewal of existing business, are deferred as an asset. Deferred acquisition costs are assessed for recoverability in the year of policy issue to ensure that these costs are recoverable out of the estimated future margins to be earned on the policy. Deferred acquisition costs are assessed for recoverability at least annually thereafter. Future investment income is also taken into account in assessing recoverability. To the extent that acquisition costs are not considered to be recoverable at inception or thereafter, these costs are expensed in the consolidated income statement.

Deferred acquisition costs for traditional life insurance and annuity policies are amortised over the expected life of the contracts as a constant percentage of expected premiums. Expected premiums are estimated at the date of policy issue and are applied consistently throughout the life of the contract unless a deficiency occurs when performing liability adequacy testing.

Deferred acquisition costs for universal life and investment-linked contracts are amortised over the expected life of the contracts on a constant percentage of the present value of estimated gross profits expected to be realised over the life of the contract or on a straight-line basis. Estimated gross profits include expected amounts for mortality, administration, investment and surrenders, less benefit claims in excess of policyholder balances, administrative expenses and interest credited. The interest rate used to compute the present value of estimates of expected gross profits is based on the AIA Group's estimate of the investment performance of the assets held to match these liabilities. Estimates of gross profits are revised regularly. Deviations of actual results from estimated experience are reflected in earnings. The expensing of acquisition costs is accelerated following adverse investment performance. Likewise, in periods of favourable investment performance, previously expensed acquisition costs are reversed, not exceeding the amount initially deferred.

The costs of acquiring investment contracts with investment management services, including commissions and other incremental expenses directly related to the issue of each new contract, are deferred and amortised over the period that investment management services are provided. Such deferred origination costs are tested for recoverability at each reporting date. The costs of acquiring investment contracts without investment management services are included as part of the effective interest rate used to calculate the amortised cost of the related investment contract liabilities.

The judgments exercised in the deferral and amortisation of acquisition and origination costs affect amounts recognised in the AIA Group Historical Financial Information as deferred acquisition and origination costs and insurance and investment contract benefits.

#### *Liability adequacy testing*

The AIA Group evaluates the adequacy of its insurance and investment contract liabilities at least annually. Liability adequacy is assessed by portfolio of contracts in accordance with the AIA Group's manner of acquiring, servicing and measuring the profitability of its insurance contracts. The AIA Group performs liability adequacy testing separately for each geographical market in which it operates.

For traditional life insurance contracts, insurance contract liabilities, reduced by deferred acquisition costs and value of business acquired on acquired insurance contracts are compared with the gross premium valuation calculated on a best estimate basis, as of the valuation date. If there is a deficiency, the unamortised balance of deferred acquisition costs and value of business acquired on acquired insurance contracts are written down to the

extent of the deficiency. If, after writing down deferred acquisition costs for the specific portfolio of contracts to nil, a deficiency still exists, the net liability is increased by the amount of the remaining deficiency.

For universal life and investment contracts, deferred acquisition costs, net of unearned revenue liabilities, are compared to estimated gross profits. If a deficiency exists, deferred acquisition costs are written down.

Significant judgment is exercised in determining the level of aggregation at which liability adequacy testing is performed and in selecting best estimate assumptions. The judgments exercised in liability adequacy testing affect amounts recognised in the AIA Group Historical Financial Information as commission and other acquisition expenses, deferred acquisition costs and insurance contract benefits and insurance and investment contract liabilities.

#### *Financial assets at fair value through profit or loss*

The AIA Group designates financial assets at fair value through profit or loss if this eliminates or reduces an accounting mismatch between the recognition and measurement of its assets and liabilities, or if the related assets and liabilities are actively managed on a fair value basis. This is the case for:

- financial assets held to back investment-linked contracts and held by participating funds;
- financial assets managed on a fair value basis; and
- compound instruments containing an embedded derivative which would otherwise require bifurcation.

#### *Available for sale financial assets*

The available for sale category of financial assets is used where the relevant investments are not managed on a fair value basis. These assets principally consist of the AIA Group's holding of shares of AIG and the AIA Group's portfolio of debt securities (other than those backing participating fund liabilities and investment-linked contracts). Available for sale financial assets are initially recognised at fair value plus attributable transaction costs and are subsequently measured at fair value. Changes in the fair value of available for sale securities, except for impairment losses and foreign exchange gains and losses on monetary items, are recorded in a separate fair value reserve within total equity, until such securities are disposed of.

The classification and designation of financial assets, either as at fair value through profit or loss, or as available for sale, determines whether movements in fair value are reflected in the consolidated income statement or in the consolidated statement of comprehensive income respectively.

#### *Fair values of financial assets*

The AIA Group determines the fair values of financial assets traded in active markets using quoted bid prices as of each reporting date. The fair values of financial assets that are not traded in active markets are typically determined using a variety of other valuation techniques, such as prices observed in recent transactions and values obtained from current bid prices of comparable investments. More judgment is used in measuring the fair value of financial assets for which market observable prices are not available or are available only infrequently.

Changes in the fair value of financial assets held by the AIA Group's participating funds affect not only the value of financial assets, but are also reflected in corresponding movements in insurance and investment contract liabilities. This is due to an insurance liability being recorded for the net assets of participating funds as described above. Both of the foregoing changes are reflected in the consolidated income statement.

Changes in the fair value of financial assets held to back the AIA Group's investment-linked contracts result in a corresponding change in insurance and investment contract liabilities. Both of the foregoing changes are also reflected in the consolidated income statement.

#### *Impairment of financial assets*

Financial assets, other than those at fair value through profit or loss, are assessed for impairment regularly. This requires the exercise of significant judgment. A financial investment is impaired if its carrying value exceeds the estimated recoverable amount and there is objective evidence of impairment to the investment.

### *Use of estimates*

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and predictions of future events and actions. Actual results can always differ from those estimates, possibly significantly.

The table below sets out those items we consider particularly sensitive to changes in estimates and assumptions, and the relevant accounting policy.

<u>Item</u>	<u>Accounting policy</u>
Insurance and investment contract liabilities . . . . .	2.5
Deferred acquisition and origination costs . . . . .	2.5
Liability adequacy testing . . . . .	2.5.1
Impairment of financial instruments classified as available for sale . . . . .	2.6.3
Fair value of financial instruments not traded in active markets . . . . .	2.6.2

Further details of estimation uncertainty in respect of the valuation and impairment of financial instruments are given in Notes 23 and 31 respectively. Further details of the estimation of amounts for insurance and investment contract liabilities and deferred acquisition and origination costs are given in Notes 26, 27, 28 and 20 respectively.

## **2.4 Basis of consolidation**

### *Subsidiaries*

Subsidiaries are those entities (including special purpose entities) over which the AIA Group, directly or indirectly, has power to exercise control over financial and operating policies in order to gain economic benefits. Subsidiaries are consolidated from the date on which control is transferred to the AIA Group and are excluded from consolidation from the date at which the AIA Group no longer has control. Intercompany transactions are eliminated.

From 1 December 2006, the date of transition to IFRS, the AIA Group is required to use the purchase method of accounting to account for the acquisition of subsidiaries, unless the acquisition forms part of the AIA Group reorganisation of entities under common control (see Note 1). Under this method, the cost of an acquisition is measured as the fair value of consideration payable, shares issued or liabilities assumed at the date of acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill (see 2.11 below). Any surplus of the acquirer's interest in the subsidiary's net assets over the cost of acquisition is credited to the consolidated income statement.

The AIA Group Historical Financial Information includes the assets, liabilities and results of AIA and subsidiaries in which AIA has a controlling interest, using accounts drawn up to 30 November.

### *Investment funds*

In several countries, the AIA Group has invested in investment funds, such as mutual funds and unit trusts. These invest mainly in equities, debt securities and cash and cash equivalents. The AIA Group's percentage ownership in these funds can fluctuate from day to day according to the AIA Group's and third party participation in them. Where the AIA Group is deemed to control such funds, with control determined based on an analysis of the guidance in IAS 27 and SIC 12, they are consolidated, with the interests of parties other than the AIA Group being classified as liabilities because there is a contractual obligation for the issuer to repurchase or redeem units in such funds for cash. These are presented as 'Third party interests in consolidated investment funds' within other liabilities in the consolidated statement of financial position. In instances where the AIA Group's ownership of investment funds declines marginally below 50% and, based on historical analysis and future expectations, the decline in ownership is expected to be temporary, the funds continue to be consolidated as subsidiaries under IAS 27. Likewise, marginal increases in ownership of investment funds above 50% which are expected to be temporary are not consolidated. Where the AIA Group does not control such funds, they are not accounted for as associates and are, instead, carried at fair value through profit or loss within financial investments in the consolidated statement of financial position.

### *Non-controlling interests*

Non-controlling interests are presented within equity except when they arise through the minority's interest in puttable liabilities such as the unit holders' interest in consolidated investment funds, when they are recognised as a liability, reflecting the net assets of the consolidated entity.

Acquisitions and disposals of non-controlling interests, except when they arise through the minority's interest in puttable liabilities, are treated as transactions between equity holders. As a result, any difference between the acquisition cost or sale price of the non-controlling interest and the carrying value of the non-controlling interest is recognised as an increase or decrease in equity.

#### *Group reorganisations and business combinations*

Group reorganisations and business combinations arising from transfers of interests in entities that are under common control throughout all periods presented are accounted for as if they had occurred at the beginning of the earliest period presented in the AIA Group Historical Financial Information. The components of equity of the acquired entities are added to the same components within equity, except that any share capital of the acquired entities is recognised as part of other reserves.

#### *Associates and joint ventures*

Associates are entities over which the AIA Group has significant influence, but which it does not control. Generally, it is presumed that the AIA Group has significant influence if it has between 20% and 50% of voting rights. Joint ventures are entities whereby the AIA Group and other parties undertake an economic activity which is subject to joint control arising from a contractual agreement.

Gains on transactions between the AIA Group and its associates and joint ventures are eliminated to the extent of the AIA Group's interest in the associates and joint ventures. Losses are also eliminated, unless the transaction provides evidence of an impairment of an asset transferred between entities.

Investments in associates and joint ventures are accounted for using the equity method of accounting. Under this method, the cost of the investment in an associate or joint venture, together with the AIA Group's share of that entity's post acquisition changes to equity, is included as an asset in the consolidated statement of financial position. Cost includes goodwill arising on acquisition. The AIA Group's share of post acquisition profits or losses is recognised in the consolidated income statement and its share of post acquisition movement in equity is recognised in equity. Equity accounting is discontinued when the AIA Group no longer has significant influence over the investment. If the AIA Group's share of losses in an associate or joint venture equals or exceeds its interest in the undertaking, additional losses are provided for, and a liability recognised, only to the extent that the AIA Group has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

#### *AIA's investments*

In AIA's statement of financial position, subsidiaries, associates and joint ventures are stated at cost, unless impaired. No such impairment has arisen during the reporting period. AIA's interests in investment funds such as mutual funds and unit trusts are designated at fair value through profit or loss.

### **2.5 Insurance and investment contracts**

Consistent accounting policies for the measurement and recognition of insurance and investment contracts have been adopted throughout the AIA Group to substantially all of its business for each financial year presented. As permitted by IFRS 4, the AIA Group has revised its previous accounting policies prior to the adoption of IFRS for certain insurance and investment contracts in order to make the AIA Group Historical Financial Information more relevant and no less reliable to the economic decision making needs of users than the accounting policies previously adopted, primarily through the adoption of a consistent accounting basis for the AIA Group.

In a limited number of cases, the AIA Group measures insurance contract liabilities with reference to statutory requirements in the applicable jurisdiction, without deferral of acquisition costs.

#### *Product classification*

Insurance contracts are those contracts that transfer significant insurance risk. These contracts may also transfer financial risk. Significant insurance risk is defined as the possibility of paying significantly more in a scenario where the insured event occurs than in a scenario in which it does not. Scenarios considered are those with commercial substance.

Investment contracts are those contracts without significant insurance risk.

Once a contract has been classified as an insurance or investment contract no reclassification is subsequently performed, unless the terms of the agreement are later amended.

Certain contracts with DPF supplement the amount of guaranteed benefits due to policyholders. These contracts are distinct from other insurance and investment contracts as the AIA Group has discretion in the amount and/or timing of the benefits declared, and how such benefits are allocated between groups of policyholders. Customers may be entitled to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that are likely to be a significant portion of the total contractual benefits;
- whose amount or timing is contractually at the discretion of the AIA Group; and
- that are contractually based on:
  - the performance of a specified pool of contracts or a specified type of contract;
  - realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
  - the profit or loss of the company, fund or other entity that issues the contract.

The AIA Group applies the same accounting policies for the recognition and measurement of obligations and the deferral of acquisition costs arising from investment contracts with DPF as it does to insurance contracts. The AIA Group refers to such contracts as participating business.

In some jurisdictions participating business is written in a participating fund which is distinct from the other assets of the company or branch. The allocation of benefits from the assets held in such participating funds is subject to minimum policyholder participation mechanisms which are established by regulation. The extent of such policy participation may change over time. The current policyholder participation in declared dividends for locations with participating funds is set out below:

<u>Country</u>	<u>Current policyholder participation</u>
Singapore . . . . .	90%
Malaysia . . . . .	90%
China . . . . .	70%
Australia . . . . .	80%
Brunei . . . . .	80%

In some jurisdictions participating business is not written in a distinct fund and the AIA Group refers to this as other participating business.

The AIA Group's products may be divided into the following main categories:

<u>Policy type</u>	<u>Description of benefits payable</u>	<u>Insurance contract liabilities</u>	<u>Basis of accounting for Investment contract liabilities</u>
Traditional participating life assurance with DPF	<p>Participating funds</p> <p>Participating products combine protection with a savings element. The basic sum assured, payable on death or maturity, may be enhanced by dividends or bonuses, the aggregate amount of which is determined by the performance of a distinct fund of assets and liabilities</p> <p>The timing of dividend declarations is at the discretion of the insurer. Local regulations generally prescribe a minimum proportion of policyholder participation in declared dividends</p>	<p>Insurance contract liabilities make provision for the present value of guaranteed benefits less estimated future net premiums to be collected from policyholders. In addition, an insurance liability is recorded for the net assets of participating funds. As such, income is recognised only when dividend or bonus declarations are made, to the extent that a portion of such declarations is attributable to the Group</p>	<p>Not applicable, as IFRS 4 permits contracts with DPF to be accounted for as insurance contracts</p>

Policy type		Description of benefits payable	Basis of accounting for	
			Insurance contract liabilities	Investment contract liabilities
	Other participating business	Participating products combine protection with a savings element. The basic sum assured, payable on death or maturity, may be enhanced by dividends or bonuses, the timing or amount of which are at the discretion of the insurer taking into account factors such as investment experience	Insurance contract liabilities make provision for the present value of guaranteed benefits and non-guaranteed participation less estimated future net premiums to be collected from policyholders	Not applicable, as IFRS 4 permits contracts with DPF to be accounted for as insurance contracts
Non-participating life assurance, annuities and other protection products	Benefits payable are not at the discretion of the insurer	Insurance contract liabilities reflect the present value of future policy benefits to be paid less the present value of estimated future net premiums to be collected from policyholders. In addition, deferred profit liabilities for limited payment contracts are recognised	Investment contract liabilities are measured at amortised cost	
Universal life		Benefits are based on an account balance, credited with interest at a rate set by the insurer, and a death benefit, which may be varied by the customer	Insurance contract liabilities reflect the accumulation value, representing premiums received and investment return credited, less deductions for front end loads, mortality and morbidity costs and expense charges. In addition, liabilities for unearned revenue and additional insurance benefits are recorded	Not applicable as such contracts generally contain significant insurance risk
Investment-linked		These may be primarily savings products or may combine savings with an element of protection	Insurance contract liabilities reflect the accumulation value, representing premiums received and investment return credited, less deductions for front end loads, mortality and morbidity costs and expense charges. In addition, liabilities for unearned revenue and additional insurance benefits are recorded	Investment contract liabilities are either measured at fair value (determined with reference to the accumulation value)

The basis of accounting for insurance and investment contracts is discussed in Notes 2.5.1 and 2.5.2 below.

### 2.5.1 Insurance contracts and investment contracts with DPF

#### Premiums

Premiums from life insurance contracts, including participating policies and annuity policies with life contingencies, are recognised as revenue when due from the policyholder. Benefits and expenses are provided in respect of such revenue so as to recognise profits over the estimated life of the policies. For limited pay contracts,

premiums are recognised in profit or loss when due, with any excess profit deferred and recognised in income in a constant relationship to the insurance in-force or, for annuities, the amount of expected benefit payments.

Amounts collected as premiums from insurance contracts with investment features but with sufficient insurance risk to be considered insurance contracts, such as universal life, and certain investment-linked contracts, are accumulated as deposits. Revenue from these contracts consists of policy fees for the cost of insurance, administration, and surrenders during the period.

Upfront fees are recognised over the estimated life of the contracts to which they relate. Policy benefits and claims that are charged to expenses include benefit claims incurred in the period in excess of related policyholder contract deposits and interest credited to policyholder deposits.

#### *Unearned revenue liability*

Unearned revenue liability arising from insurance contracts representing upfront fees and other non-level charges is deferred and released to the consolidated income statement over the estimated life of the business.

#### *Deferred acquisition costs*

The costs of acquiring new business, including commissions, underwriting and other policy issue expenses, which vary with and are primarily related to the production of new business, are deferred. Deferred acquisition costs are subject to the testing of recoverability when issued and at least annually thereafter. Future investment income is taken into account in assessing recoverability.

Deferred acquisition costs for life insurance and annuity policies are amortised over the expected life of the contracts as a constant percentage of expected premiums. Expected premiums are estimated at the date of policy issue and are consistently applied throughout the life of the contract unless a deficiency occurs when performing liability adequacy testing (see below).

Deferred acquisition costs for universal life and investment-linked contracts are amortised over the expected life of the contracts based on a constant percentage of the present value of estimated gross profits expected to be realised over the life of the contract or on a straight line basis. Estimated gross profits include expected amounts to be assessed for mortality, administration, investment and surrenders, less benefit claims in excess of policyholder balances, administrative expenses and interest credited. Estimated gross profits are revised regularly. The interest rate used to compute the present value of revised estimates of expected gross profits is the latest revised rate applied to the remaining benefit period. Deviations of actual results from estimated experience are reflected in earnings.

Unamortised acquisition costs associated with internally replaced contracts that are, in substance, contract modifications, continue to be deferred and amortised. Any remaining unamortised balance of deferred acquisition costs associated with internally replaced contracts that are, in substance, new contracts, are expensed.

#### *Deferred sales inducements*

Deferred sales inducements, consisting of day one bonuses, persistency bonuses and enhanced crediting rates are deferred and amortised using the same methodology and assumptions used to amortise acquisition costs when:

- the sales inducements are recognised as part of insurance contract liabilities;
- they are explicitly identified in the contract on inception;
- they are incremental to amounts credited on similar contracts without sales inducements; and
- they are higher than the expected ongoing crediting rates for periods after the inducement.

#### *Unbundling*

The deposit component of an insurance contract is unbundled when both of the following conditions are met:

- the deposit component (including any embedded surrender option) can be measured separately (i.e. without taking into account the insurance component); and
- the AIA Group's accounting policies do not otherwise require the recognition of all obligations and rights arising from the deposit component.

### *Bifurcation*

To the extent that certain of the AIA Group's insurance contracts include embedded derivatives that are not clearly and closely related to the host contract, these are bifurcated from the insurance contracts and accounted for as derivatives.

### *Benefits and claims*

Insurance contract benefits reflect the cost of all maturities, surrenders, withdrawals and claims arising during the year, as well as policyholder dividends accrued in anticipation of dividend declarations.

Accident and health claims incurred include all losses occurring during the year, whether reported or not, related handling costs, a reduction for recoveries, and any adjustments to claims outstanding from previous years.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims, and are included in operating expenses.

### *Insurance contract liabilities (including liabilities in respect of investment contracts with DPF)*

These represent the estimated future policyholder benefit liability for life insurance policies.

Future policy benefits for life insurance policies are calculated using a net level premium valuation method which represents the present value of estimated future policy benefits to be paid, less the present value of estimated future net premiums to be collected from policyholders. The method uses best estimate assumptions set at the policy inception date, adjusted for a provision for the risk of adverse deviation for mortality, morbidity, expected investment yields, dividends (for other participating business), surrenders and expenses, which remain locked in thereafter, unless a deficiency arises on liability adequacy testing (see below).

Interest rate assumptions can vary by country, year of issuance and product. Mortality assumptions are based on actual experience by geographic area and are modified to allow for variations in policy form. Surrender assumptions are based on actual experience by geographic area and are modified to allow for variations in policy form.

For contracts with an explicit account balance, such as universal life and investment-linked contracts, insurance contract liabilities are equal to the accumulation value, which represents premiums received and investment returns credited to the policy less deductions for mortality and morbidity costs and expense charges.

Settlement options are accounted for as an integral component of the underlying insurance or investment contract unless they provide annuitisation benefits, in which case an additional liability is established to the extent that the present value of expected annuitisation payments at the expected annuitisation date exceeds the expected account balance at that date. Where settlement options have been issued with guaranteed rates less than market interest rates, the insurance or investment contract liability does not reflect any provision for subsequent declines in market interest rates unless a deficiency is identified through liability adequacy testing.

The AIA Group accounts for participating policies within participating funds by establishing a liability for the present value of guaranteed benefits less estimated future net premiums to be collected from policyholders. In addition, an insurance liability is recorded for the net assets of participating funds. As such, income is recognised only when dividend or bonus declarations are made, to the extent that a portion of such declarations is attributable to the AIA Group. The AIA Group accounts for other participating business by establishing a liability for the present value of guaranteed benefits and non-guaranteed participation, less estimated future net premiums to be collected from policyholders.

### *Liability adequacy testing*

The adequacy of liabilities is assessed by portfolio of contracts, in accordance with the AIA Group's manner of acquiring, servicing and measuring the profitability of its insurance contracts. Liability adequacy testing is performed for each geographical market.

For traditional life insurance contracts, insurance contract liabilities, reduced by deferred acquisition costs and value of business acquired on acquired insurance contracts are compared to the gross premium valuation calculated on a best estimate basis, as of the valuation date. If there is a deficiency, the unamortised balance of deferred acquisition costs and value of business acquired on acquired insurance contracts are written down to the extent of the deficiency. If, after writing down the unamortised balance for the specific portfolio of contracts to nil, a deficiency still exists, the net liability is increased by the amount of the remaining deficiency.

For universal life and investment contracts, deferred acquisition costs, net of unearned revenue liabilities, are compared to estimated gross profits. If a deficiency exists, deferred acquisition costs are written down.

#### *Financial guarantees*

Financial guarantees are regarded as insurance contracts. Liabilities in respect of such contracts are recognised as incurred.

#### *2.5.2 Investment contracts*

Investment contracts do not contain sufficient insurance risk to be considered insurance contracts and are accounted for as a financial liability, other than investment contracts with DPF which are excluded from the scope of IAS 39 and are accounted for as insurance contracts.

Revenue from these contracts consists of various charges (policy fees, handling fees, management fees and surrender charges) made against the contract for the cost of insurance, expenses and early surrender. First year charges are amortised over the life of the contract as the services are provided.

#### *Investment contract fee revenue*

Customers are charged fees for policy administration, investment management, surrenders or other contract services. The fees may be fixed amounts or vary with the amounts being managed, and will generally be charged as an adjustment to the policyholder's account balance. The fees are recognised as revenue in the period in which they are received unless they relate to services to be provided in future periods, in which case they are deferred and recognised as the service is provided.

Origination and other "upfront" fees (fees that are assessed against the account balance as consideration for origination of the contract) are charged on some non-participating investment and pension contracts. Where the investment contract is recorded at amortised cost, these fees are amortised and recognised over the expected term of the policy as an adjustment to the effective yield. Where the investment contract is measured at fair value, the front end fees that relate to the provision of investment management services are amortised and recognised as the services are provided.

#### *Deferred origination costs*

The costs of acquiring investment contracts with investment management services, including commissions and other incremental expenses directly related to the issue of each new contract, are deferred and amortised over the period that services are provided. Deferred origination costs are tested for recoverability at each reporting date.

The costs of acquiring new investment contracts without investment management services are included as part of the effective interest rate used to calculate the amortised cost of the related investment contract liabilities.

#### *Investment contract liabilities*

Deposits received in respect of investment contracts are not accounted for through the consolidated income statement, except for the investment income and fees attributable to those contracts, but are accounted for directly through the consolidated statement of financial position as an adjustment to the investment contract liability, which reflects the account balance.

The majority of the AIA Group's contracts classified as investment contracts are investment-linked contracts. These represent investment portfolios maintained to meet specific investment objectives of policyholders who generally bear the credit and market risks on those investments. The liabilities are carried at fair value determined with reference to the accumulation value (current unit value) with changes recognised in income. The costs of policy administration, investment management, surrender charges and certain policyholder taxes assessed against customers' account balances are included in revenue, and accounted for as described under Investment contract fee revenue above.

Non investment-linked investment contract liabilities are carried at amortised cost, being the fair value of consideration received at the date of initial recognition, less the net effect of principal payments such as transaction costs and front end fees, plus or minus the cumulative amortisation using the effective interest rate method of any difference between that initial amount and the maturity value, and less any write down for surrender payments. The effective interest rate equates the discounted cash payments to the initial amount. At each reporting date, the unearned revenue liability is determined as the value of the future best estimate cash flows discounted at the

effective interest rate. Any adjustment is immediately recognised as income or expense in the consolidated income statement.

The amortised cost of the financial liability is never recorded at less than the amount payable on surrender, discounted for the time value of money where applicable, if the investment contract is subject to a surrender option.

### *2.5.3 Insurance and investment contracts*

#### *Reinsurance*

The AIA Group cedes reinsurance in the normal course of business, with retentions varying by line of business. The cost of reinsurance is accounted for over the life of the underlying reinsured policies, using assumptions consistent with those used to account for such policies.

Premiums ceded and claims reimbursed are presented on a gross basis in the consolidated income statement and statement of financial position.

Reinsurance assets consist of amounts receivable in respect of ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured insurance or investment contract liabilities or benefits paid and in accordance with the relevant reinsurance contract.

To the extent that reinsurance contracts principally transfer financial risk (as opposed to insurance risk) they are accounted for directly through the consolidated statement of financial position and are not included in reinsurance assets or liabilities. A deposit asset or liability is recognised, based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the reinsured.

If a reinsurance asset is impaired, the AIA Group reduces the carrying amount accordingly and recognises that impairment loss in the consolidated income statement. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the AIA Group may not receive all amounts due to it under the terms of the contract, and the impact on the amounts that the AIA Group will receive from the reinsurer can be reliably measured.

#### *Value of business acquired ('VOBA')*

The value of business acquired ('VOBA') in respect of a portfolio of long term insurance and investment contracts, either directly or through the purchase of a subsidiary, is recognised as an asset. If this results from the acquisition of an investment in a joint venture or an associate, the VOBA is held within the carrying amount of that investment. In all cases, the VOBA is amortised over the estimated life of the contracts in the acquired portfolio on a systematic basis. The rate of amortisation reflects the profile of the value of in-force business acquired. The carrying value of VOBA is reviewed annually for impairment and any reduction is charged to the consolidated income statement.

#### *Shadow accounting*

Shadow accounting is applied to insurance and certain investment contracts where financial assets backing insurance and investment contracts liabilities are classified as available for sale. Shadow accounting is applied to deferred acquisition costs, VOBA, deferred origination costs and the contract liabilities for investment contracts with DPF to take into account the effect of unrealised gains or losses on insurance liabilities or assets that are recognised in equity in the same way as for a realised gain or loss recognised in the consolidated income statement. Such assets or liabilities are adjusted with corresponding charges or credits recognised directly in shareholders' equity as a component of the related unrealised gains and losses.

#### *Other assessments and levies*

The AIA Group is potentially subject to various periodic insurance related assessments or guarantee fund levies. Related provisions are established where there is a present obligation (legal or constructive) as a result of a past event. Such amounts are not included in insurance or investment contract liabilities but are included under 'Provisions' in the consolidated statement of financial position.

## **2.6 Financial instruments**

### *2.6.1 Classification of and designation of financial instruments*

#### *Financial instruments at fair value through profit or loss*

Financial instruments at fair value through profit or loss comprise two categories:

- financial assets designated at fair value through profit or loss; and
- derivative assets and liabilities.

Management designates financial assets at fair value through profit or loss if this eliminates a measurement inconsistency or if the related assets and liabilities are actively managed on a fair value basis, including:

- financial assets held to back investment-linked contracts and participating funds;
- other financial assets managed on a fair value basis; consisting of the AIA Group's equity portfolio (other than its holding of shares of AIG which are now managed on a fair value basis) and investments held by the AIA Group's fully consolidated investment funds; and
- compound instruments containing an embedded derivative, where the embedded derivative would otherwise require bifurcation.

Dividend income from equity instruments designated at fair value through profit or loss is recognised in investment income in the consolidated income statement, generally when the security becomes ex-dividend. Interest income is recognised on an accrued basis. For all financial assets designated at fair value through profit or loss, changes in fair value are recognised in investment experience.

Transaction costs in respect of financial instruments at fair value through profit or loss are expensed as they are incurred.

#### *Available for sale financial assets*

Financial assets, other than those at fair value through profit or loss, and loans and receivables, are classified as available for sale.

The available for sale category is used where the relevant investments backing insurance and investment contract liabilities and shareholders' equity are not managed on a fair value basis. These principally consist of the AIA Group's debt securities (other than those backing participating funds and investment-linked contracts) and the AIA Group's holding of shares in AIG. Available for sale financial assets are initially recognised at fair value plus attributable transaction costs. For available for sale debt securities, the difference between their cost and par value is amortised. Available for sale financial assets are subsequently measured at fair value. Interest income from debt securities classified as available for sale is recognised in investment income in the consolidated income statement using the effective interest method.

Unrealised gains and losses on securities classified as available for sale are analysed between differences resulting from foreign currency translation, and other fair value changes. Foreign currency translation differences on monetary available for sale investments, such as debt securities, are recognised in the consolidated income statement as investment experience. For impairments of available for sale financial assets reference is made to the section "Impairment of other financial assets".

Changes in the fair value of securities classified as available for sale, except for impairment losses and relevant foreign exchange gains and losses, are recorded in a separate fair value reserve within equity.

#### *Realised gains and losses on financial assets*

Realised gains and losses on available for sale financial assets are determined as the difference between the sale proceeds and amortised cost. Cost is determined by specific identification.

#### *Recognition of financial instruments*

Purchases and sales of financial instruments are recognised on the trade date, which is the date at which the AIA Group commits to purchase or sell the assets.

### *Derecognition and offset of financial assets*

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the AIA Group has transferred substantially all risks and rewards of ownership. If the AIA Group neither transfers nor retains substantially all the risks and rewards of ownership of a financial asset, it derecognises the financial asset if it no longer has control over the asset. In transfers where control over the asset is retained, the AIA Group continues to recognise the asset to the extent of its continuing involvement. The extent of continuing involvement is determined by the extent to which the AIA Group is exposed to changes in the fair value of the asset.

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are initially recognised at fair value plus transaction costs. Subsequently, they are carried at amortised cost using the effective interest rate method less any impairment losses. Interest income from loans and receivables is recognised in investment income in the consolidated income statement using the effective interest rate method.

### *Term deposits*

Deposits include time deposits with financial institutions which do not meet the definition of cash and cash equivalents as their maturity at acquisition exceeds three months. Certain of these balances are subject to regulatory or other restriction as disclosed in Note 21 Loans and Receivables. Deposits are stated at face value.

### *Cash and cash equivalents*

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short term highly liquid investments with maturities at acquisition of three months or less, which are held for cash management purposes. Cash and cash equivalents also include cash received as collateral for securities lending as well as cash and cash equivalents held for the benefit of policyholders in connection with investment-linked products. Cash and cash equivalents are stated at face value.

### *2.6.2. Fair values of non-derivative financial assets*

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, having regard to the specific characteristics of the asset or liability concerned, assuming that the transfer takes place in the most advantageous market to which the AIA Group has access. The fair values of financial instruments traded in active markets (such as financial instruments at fair value through profit or loss and available for sale securities) are based on quoted market prices at the date of the consolidated statement of financial position. The quoted market price used for financial assets held by the AIA Group is the current bid price. The fair values of financial instruments that are not traded in active markets are determined using valuation techniques. The AIA Group uses a variety of methods and makes assumptions that are based on market conditions at the date of each consolidated statement of financial position. The objective of using a valuation technique is to estimate the price at which an orderly transaction would take place between market participants at the date of the consolidated statement of financial position.

Financial instruments carried at fair value are measured using a fair value hierarchy described in Note 23.

The degree of judgment used in measuring the fair value of financial instruments generally correlates with the level of pricing observability. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and general market conditions.

### *2.6.3. Impairment of financial assets*

#### **General**

Financial assets are assessed for impairment on a regular basis. A financial asset is impaired if its carrying value exceeds the estimated recoverable amount and there is objective evidence of impairment to the financial asset.

The AIA Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the AIA Group about the following events:

- significant financial difficulty of the issuer or debtor;
- a breach of contract, such as a default or delinquency in payments;
- it becomes probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data, including market prices, indicating that there is a potential decrease in the estimated future cash flows since the initial recognition of those assets, including:
  - adverse changes in the payment status of issuers
  - national or local economic conditions that correlate with increased default risk.

The AIA Group first assesses whether objective evidence of impairment exists for financial assets that are individually significant. If the AIA Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

#### *Available for sale financial instruments*

When a decline in the fair value of an available for sale asset has been recognised in shareholders’ equity and there is objective evidence that the asset is impaired, the cumulative loss already recognised directly in shareholders’ equity is recognised in current period profit or loss. The AIA Group generally considers an available for sale equity instrument for evidence of impairment if the fair value is significantly below cost or has been below cost for a prolonged period. If such assets are considered to be impaired, the amount of the cumulative loss that is removed from shareholders’ equity and recognised in current period profit or loss is the difference between acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised.

If the fair value of a debt instrument classified as available for sale increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in income, the impairment loss is reversed through profit or loss. Impairment losses recognised in profit or loss on equity instruments classified as available for sale are not reversed.

Where, following the recognition of an impairment loss in respect of an available for sale debt security, the asset suffers further falls in value, such further falls are recognised as an impairment only in the case when objective evidence exists of a further impairment event to which the losses can be attributed.

#### *Loans and receivables*

For loans and receivables impairment is considered to have taken place if it is probable that the AIA Group will not be able to collect principal and/or interest due according to the contractual terms of the instrument. When impairment is determined to have occurred, the carrying amount is decreased through a charge to profit or loss. The carrying amount of mortgage loans or receivables is reduced through the use of an allowance account, and the amount of any allowance is recognised as an impairment loss in profit or loss. The allowance is determined using an analytical method based on knowledge of each loan group or receivable. The method is usually based on historical statistics, adjusted for trends in the group of financial assets or individual accounts.

#### *2.6.4. Derivative financial instruments*

Derivative financial instruments include foreign exchange contracts and interest rate swaps that derive their value mainly from underlying foreign exchange rates and interest rates. All derivatives are initially recognised in the consolidated statement of financial position at their fair value, which represents their cost excluding transaction

costs, which are expensed, giving rise to a day one loss. They are subsequently remeasured at their fair value, with movements in this value recognised in profit or loss. Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative.

#### *Derivative instruments for economic hedging*

Whilst the AIA Group enters into derivative transactions to provide economic hedges under the AIA Group's risk management framework, it does not currently apply hedge accounting to these transactions. This is either because the transactions would not meet the specific IFRS rules to be eligible for hedge accounting or the documentation requirements to meet hedge accounting criteria would be unduly onerous. These transactions are therefore treated as held for trading and fair value movements are recognised immediately in investment experience.

#### *Embedded derivatives*

Embedded derivatives are derivatives embedded within other non-derivative host financial instruments to create hybrid instruments. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value with changes in fair value recognised in profit or loss, the embedded derivative is bifurcated and carried at fair value as a derivative in accordance with IAS 39.

### **2.7 Segment reporting**

An operating segment is a component of the AIA Group that engages in business activity from which it earns revenues and incurs expenses and, for which, discrete financial information is available, and whose operating results are regularly reviewed by the AIA Group's chief operating decision maker, considered to be the Executive Committee of the AIA Group ("Exco").

### **2.8 Foreign currency translation**

Income statements and cash flows of foreign entities are translated into the AIA Group's presentation currency at average exchange rates for the year as this approximates to the exchange rates prevailing at the transaction date. Their statements of financial position are translated at year or period end exchange rates. Exchange differences arising from the translation of the net investment in foreign operations, are taken to the currency translation reserve within equity. On disposal of a foreign operation such exchange differences are transferred out of this reserve and are recognised in the consolidated income statement as part of the gain or loss on sale. As permitted by IFRS 1, the cumulative translation differences were deemed to be nil at the transition date to IFRS.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies into functional currency, are recognised in the consolidated income statement.

Translation differences on financial assets designated at fair value through profit or loss are included in investment experience. For monetary financial assets classified as available for sale, translation differences are calculated as if they were carried at amortised cost and so are recognised in the consolidated income statement. Foreign exchange movements on non-monetary equities that are accounted for as available for sale, are included in the fair value reserve.

### **2.9 Property, plant and equipment**

Property, plant and equipment is stated at historical cost less accumulated depreciation and any accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Depreciation is calculated using the straight line method to allocate cost less any residual value over the estimated useful life.

Subsequent costs are included in the carrying amount or recognised as a separate asset, as appropriate, when it is probable that future economic benefits will flow to the AIA Group. Repairs and maintenance are charged to the consolidated income statement during the financial period in which they are incurred.

Residual values and useful lives are reviewed and adjusted, if applicable, at each reporting date. An asset is written down to its recoverable amount if the carrying value is greater than the estimated recoverable amount.

Any gain and loss arising on disposal of property, plant and equipment is measured as the difference between the net sale proceeds and the carrying amount of the relevant asset, and is recognised in the consolidated income statement.

The Government of the Hong Kong Special Administrative Region owns all the land in Hong Kong and permits its use under leasehold agreements. Where the cost of such leasehold is known, or can be reliably determined at the inception of the lease, the AIA Group records its interest in leasehold land and land use rights separately as operating leases. These leases are recorded at original cost and amortised over the term of the lease (see 2.19).

### **2.10 Investment properties**

Property held for long term rental that is not occupied by the AIA Group is classified as investment property. Investment property comprises freehold and leasehold land and buildings and is carried at fair value, with changes in fair value included in the income statement. Properties are valued annually by independent qualified valuers.

If an investment property becomes held for use, it is reclassified as property, plant and equipment and, where applicable operating lease prepayment, using the fair value at the date of the transfer. Where a property is partly used as an investment property and partly for the use of the AIA Group, these elements are recorded separately within property, plant and equipment and investment property respectively, where the component used as investment property would be capable of separate sale or finance lease.

### **2.11 Goodwill and other intangible assets**

#### *Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the AIA Group's share of the net identifiable assets of the acquired subsidiary, associate or joint venture at the date of acquisition. Goodwill on acquisitions prior to 1 December 2006 (the date of transition to IFRS) is carried at book value (original cost less cumulative amortisation) on that date, less any impairment subsequently incurred. Goodwill arising on the AIA Group's investment in subsidiaries since that date is shown as a separate asset, whilst that on associates and joint ventures is included within the carrying value of those investments.

#### *Other intangible assets*

Other intangible assets consist primarily of acquired computer software and contractual relationships, such as access to distribution networks, and are amortised over their estimated useful lives.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs directly associated with the internal production of identifiable and unique software by the AIA Group that will generate economic benefits exceeding those costs over a period greater than a year, are recognised as intangible assets. All other costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs of acquiring computer software licences and incurred in the internal production of computer software are amortised using the straight line method over the estimated useful life of the software, which does not generally exceed a period of 3-15 years.

The amortisation charge for the year is included in the consolidated income statement under 'Other operating expenses'.

### **2.12 Impairment of non-financial assets**

Property, plant and equipment, goodwill and other non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised to the extent that the carrying amount of the asset exceeds its recoverable amount, which is the higher of the asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped into cash generating units at the level of the AIA Group's operating segments, the lowest level for which separately identifiable cash flows are reported. The carrying value of goodwill and intangible assets with indefinite useful lives is reviewed at least annually or when circumstances or events indicate that there may be uncertainty over this value.

### **2.13 Securities lending including repurchase agreements**

The AIA Group is party to various securities lending agreements under which securities are loaned to third parties on a short term basis. The loaned securities are not derecognised and so they continue to be recognised within the appropriate investment classification.

### *Assets sold under repurchase agreements (repos)*

Assets sold under repurchase agreements continue to be recognised and a liability is established for the consideration received. The AIA Group may be required to provide additional collateral based on the fair value of the underlying assets, and such collateral assets remain on the consolidated statement of financial position.

### *Assets purchased under agreements to resell (reverse repos)*

The AIA Group enters into purchases of assets under agreements to resell (reverse repos). Reverse repos are initially recorded at the cost of the loan or collateral advanced within the caption 'Loans and Receivables' in the consolidated statement of financial position. In the event of failure by the counterparty to repay the loan the AIA Group has the right to the underlying assets.

### *Collateral*

The AIA Group receives and pledges collateral in the form of cash or non-cash assets in respect of securities lending transactions, and repo and reverse repo transactions, in order to reduce the credit risk of these transactions. The amount and type of collateral depends on an assessment of the credit risk of the counterparty. Collateral received in the form of cash, which is not legally segregated from the AIA Group, is recognised as an asset in the consolidated statement of financial position with a corresponding liability for the repayment. Non-cash collateral received is not recognised on the consolidated statement of financial position unless the AIA Group either sells or repledges these assets in the absence of default, at which point the obligation to return this collateral is recognised as a liability. To further minimise credit risk, the financial condition of counterparties is monitored on a regular basis.

Collateral pledged in the form of cash which is legally segregated from the group is derecognised from the consolidated statement of financial position and a corresponding receivable established for its return. Non-cash collateral pledged is not derecognised (except in the event of default) and therefore continues to be recognised in the consolidated statement of financial position within the appropriate financial instrument classification.

## **2.14 Borrowings**

Borrowings are recognised initially at their issue proceeds less transaction costs incurred. Subsequently, borrowings are stated at amortised cost, and any difference between net proceeds and redemption value is recognised in the consolidated income statement over the period of the borrowings using the effective interest rate method. All borrowing costs are expensed as they are incurred, except for borrowing costs directly attributable to the development of investment properties and other qualifying assets, which are capitalised as part of the cost of the asset.

## **2.15 Income taxes**

The current tax expense is based on the taxable profits for the year, including any adjustments in respect of prior years. Tax is allocated to profit or loss before taxation and amounts charged or credited to equity as appropriate.

Deferred tax is recognised in respect of temporary differences between the tax bases of assets and liabilities and their carrying amounts in the AIA Group Historical Financial Information, except as described below.

The principal temporary differences arise from the basis of recognition of insurance and investment contract liabilities, revaluation of certain financial assets and liabilities including derivative contracts, deferred acquisition costs and the future taxes arising on the surplus in life funds where the relevant local tax regime is distributions based. The rates enacted or substantively enacted at the date of the consolidated statement of financial position are used to determine deferred tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. In countries where there is a history of tax losses, deferred tax assets are only recognised in excess of deferred tax liabilities if there is evidence that future profits will be available.

Deferred taxes are not provided in respect of temporary differences arising from the initial recognition of goodwill or from goodwill for which amortisation is not deductible for tax purposes, or from the initial recognition of an asset or liability in a transaction which is not a business combination and which affects neither accounting nor taxable profit or loss at the time of the transaction.

Deferred tax related to fair value re-measurement of available for sale investments and other amounts taken directly to equity, is recognised initially within the applicable component of equity. It is subsequently recognised in the consolidated income statement, together with the gain or loss arising on the underlying item.

In addition to paying tax on shareholders' profits, certain of the AIA Group's life insurance businesses pay tax on policyholders' investment returns "policyholder tax" at policyholder tax rates. Policyholder tax is accounted for as an income tax and is included in the total tax expense and disclosed separately.

## **2.16 Revenue**

### *Investment return*

Investment income consists of dividends, interest and rents receivable for the reporting period. Investment experience comprises realised gains and losses, impairments, unrealised gains and losses on investments held at fair value through profit or loss and changes in the fair value of investment properties. Interest income is recognised as it accrues, taking into account the effective yield on the investment. Rental income on investment property is recognised on an accruals basis. Investment return consists of investment income and investment experience.

The realised gain or loss on disposal of an investment is the difference between the proceeds received, net of transaction costs, and its original cost or amortised cost as appropriate. Unrealised gains and losses represent the difference between the carrying value at the year end and the carrying value at the previous year end or purchase price if purchased during the year, less the reversal of previously recognised unrealised gains and losses in respect of disposals made during the year.

### *Other fee and commission income*

Other fee and commission income consists primarily of fund management fees, income from any incidental non-insurance activities, distribution fees from mutual funds, commissions on reinsurance ceded and commission revenue from the sale of mutual fund shares. Reinsurance commissions receivable are deferred in the same way as acquisition costs. All other fee and commission income is recognised as the services are provided.

## **2.17 Employee benefits**

### *Annual leave and long service leave*

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the reporting date.

### *Post retirement benefit obligations*

The AIA Group operates a number of funded and unfunded post retirement employee benefit schemes, whose members receive benefits on either a defined benefit basis (generally related to salary and length of service) or a defined contribution basis (generally related to the amount invested, investment return and annuity rates), the assets of which are generally held in separate trustee administered funds. The defined benefit plans provide life and medical benefits for employees after retirement and a lump sum benefit on cessation of employment, and the defined contribution plans provide post retirement pension benefits.

For defined benefit plans, the costs are assessed using the projected unit credit method. Under this method, the cost of providing benefits is charged to the consolidated income statement so as to spread the regular cost over the service lives of employees, in accordance with the advice of qualified actuaries. The obligation is measured as the present value of the estimated future cash outflows, using a discount rate based on market yields for high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related liability. The resulting scheme surplus or deficit appears as an asset or liability in the consolidated statement of financial position.

For each plan, AIA Group recognises actuarial gains and losses directly in the income statement.

For defined contribution plans, the AIA Group pays contributions to publicly or privately administered pension plans. Once the contributions have been paid, the AIA Group, as employer, has no further payment obligations. The AIA Group's contributions are charged to the consolidated income statement in the reporting period to which they relate and are included in staff costs.

### *Share based compensation and cash incentive plans*

The AIA Group has various share based compensation and cash incentive plans sponsored by AIG.

The AIA Group accounts for options and awards under equity settled share based compensation plans, which were granted after 7 November 2002, until such time as they are fully vested, using the fair value based method of accounting (the “fair value method”).

Under AIG’s equity settled share based compensation plans, the fair value of the employee services received in exchange for the grant of shares and/or options is recognised as an expense in profit or loss over the vesting period, with a corresponding amount recorded in equity. Any amounts recharged from AIG clearly related to equity settled share based payment arrangements are offset against the amount recorded in equity.

The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares and/or options granted. Non-market vesting conditions (for example, profitability and premium income growth targets) are included in assumptions about the number of shares and/or options that are expected to be issued or become exercisable. At each period end, the AIA Group revises its estimates of the number of shares and/or options that are expected to be issued or become exercisable. It recognises the impact of the revision to original estimates, if any, in profit or loss with a corresponding adjustment to equity. However, no subsequent adjustment to total equity is made after the vesting date. Where awards of share based payment arrangements vest in stages, each vesting tranche is recognised as a separate award, and therefore the fair value of each tranche is recognised over the applicable vesting period.

As the fair value of the options which AIG uses for its employee schemes cannot be compared to options available in the market, the AIA Group estimates the fair value using a binomial lattice model. This model requires inputs such as share price, exercise price, implied volatility, risk free interest rate, expected dividend rate and the expected life of the option.

Where modification or cancellation of an equity settled share based compensation plan occurs, the grant date fair value continues to be recognised, together with any incremental value arising on the date of modification if non-market conditions are met.

#### **2.18 Provisions and contingencies**

Provisions are recognised when the AIA Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of economic resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Where the AIA Group expects a provision to be reimbursed, for example under an insurance contract held, the reimbursement is recognised as a separate asset only when the reimbursement is virtually certain.

The AIA Group recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

Contingencies are disclosed if material and if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event, but either a payment is not probable or the amount cannot be reliably estimated.

#### **2.19 Leases**

Leases, where a significant portion of the risks and rewards of ownership is retained by the AIA Group as a lessor, are classified as operating leases. Assets subject to such leases are included in property, plant and equipment, and are depreciated to their residual values over their estimated useful lives. Rentals from such leases are credited to the consolidated income statement on a straight line basis over the period of the relevant lease. Payments made by the AIA Group as lessee under operating leases (net of any incentives received from the lessor) are charged to the consolidated income statement on a straight line basis over the period of the relevant lease. The AIA Group classifies amounts paid to acquire leasehold land as an operating lease prepayment.

There are no freehold land interests in Hong Kong. Accordingly, all land in Hong Kong is considered to be held under operating leases. The AIA Group classifies the amounts paid to acquire leasehold land as operating lease prepayments. Such amounts are included within ‘Other Assets’. Amortisation is calculated to write off the cost of the land on a straight line basis over the terms of the lease, which are generally between 19 and 886 years.

#### **2.20 Share capital**

Issued capital represents the nominal value of shares issued plus any share premium received from the issue of share capital.

### *Share issue costs*

Incremental external costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds of the issue.

### *Dividends*

Dividends on ordinary shares are recognised when they have been approved by shareholders.

### **2.21 *Disposal groups classified as held for sale***

Disposal groups are classified as held for sale if their carrying amounts will be principally recovered through a sale transaction rather than through continuing use. This requires that the disposal group must be available for immediate sale in its present condition and its sale must be highly probable. The appropriate level of management must be committed to a plan to sell the disposal group and the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Any subsequent increase in the fair value less costs to sell is recognised as a gain but not in excess of the cumulative impairment loss that has been previously recognised.

### **2.22 *Presentation of the consolidated statement of financial position***

The AIA Group's insurance and investment contract liabilities and related assets are realised and settled over periods of several years, reflecting the long term nature of the AIA Group's products. Accordingly, the AIA Group presents the assets and liabilities in its consolidated statement of financial position in approximate order of liquidity, rather than distinguishing current and non-current assets and liabilities. The AIA Group regards its intangible assets, investments in associates and joint ventures, property plant and equipment, investment property and deferred acquisition and origination costs as non-current assets as these are held for the longer term use of the AIA Group.

### **2.23 *Earnings per share***

Basic earnings per share is calculated by dividing net income available to ordinary shareholders by the weighted average number of ordinary shares in issue during the year.

Earnings per share has also been calculated on the operating profit before adjusting items, after tax, attributable to ordinary shareholders, as the Directors believe this figure provides a better indication of operating performance.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, such as share options granted to employees.

Potential or contingent share issuances are treated as dilutive when their conversion to shares would decrease net earnings per share.

### **2.24 *Fiduciary activities***

Assets and income arising from fiduciary activities, together with related undertakings to return such assets to customers, are excluded from the AIA Group Historical Financial Information where the AIA Group has no contractual rights to the assets and acts in a fiduciary capacity such as nominee, trustee or agent.

### **2.25 *Consolidated cash flow statement***

The consolidated cash flow statement presents movements in cash and cash equivalents as shown in the consolidated statement of financial position.

Purchases and sales of financial investments are included in operating cash flows as the purchases are funded from cash flows associated with the origination of insurance and investment contracts, net of payments of related benefits and claims. Purchases and sales of investment property are included within investing cash flows.

### **2.26 *Related party transactions***

Transactions with related parties are recorded at amounts mutually agreed and transacted between the parties to the arrangement.

## 2.27 IFRS 1 — Adoption of IFRS

The AIA Group is required to determine its IFRS accounting policies and apply them retrospectively to establish its opening consolidated statement of financial position under IFRS. However, IFRS 1 (revised), *First-Time Adoption of International Financial Reporting Standards* allows a number of exceptions and exemptions on adoption of IFRS for the first time. The date of adoption to IFRS for the Group is 1 December 2006. The AIA Group has not previously published consolidated financial information because the parent company of the AIA Group was only established on 29 August 2009 and the group it heads has not previously published consolidated financial information and therefore there are no previously published consolidated financial information on which the effect of the impact of transition to IFRS can be disclosed.

The AIA Group has taken advantage of the following exceptions and exemptions as permitted by IFRS 1:

### *Cumulative translation differences*

Cumulative translation differences of foreign operations have not been restated on an IFRS basis and are deemed to be nil at the date of adoption.

### *Share based payment plans*

The provisions of IFRS 2, *Share Based Payments*, have not been applied to options and awards granted on or before 7 November 2002 which had not vested by 1 December 2006.

### *Designation of previously recognised financial instruments*

The AIA Group has designated the following previously recognised financial instruments at fair value through profit or loss on the date of adoption of IFRS:

- investments held to back investment-linked contracts and participating funds;
- assets that are actively managed on a fair value basis, such as the majority of the Group's equity portfolio and financial instruments held by consolidated investment funds; and
- compound instruments containing an embedded derivative that would otherwise require to be bifurcated.

## 3. Exchange rates

The AIA Group's principal overseas operations during the reporting period were located within the Asia Pacific region. The results and cash flows of these operations have been translated into US Dollars at the following average rates:

	US dollar exchange rates		
	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
Hong Kong . . . . .	7.80	7.79	7.75
Thailand . . . . .	34.69	33.21	34.47
Singapore . . . . .	1.52	1.42	1.46
Malaysia . . . . .	3.46	3.31	3.53
China . . . . .	7.65	6.99	6.83
Korea . . . . .	929.37	1,047.12	1,287.00

Assets and liabilities have been translated at the following year end rates:

	US dollar exchange rates		
	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
Hong Kong . . . . .	7.79	7.75	7.75
Thailand . . . . .	33.85	35.52	33.24
Singapore . . . . .	1.45	1.51	1.38
Malaysia . . . . .	3.36	3.62	3.39
China . . . . .	7.39	6.83	6.83
Korea . . . . .	920.81	1,468.43	1,162.79

Exchange rates are expressed in units of local currency per US\$1.

#### 4. Changes in group composition

This note provides details of the acquisitions and disposals of subsidiaries that the AIA Group has made during the reporting period, together with details of businesses held for sale. Principal subsidiary companies are listed in Note 43.

##### Acquisitions

On 27 November 2009, the AIA Group acquired 51% of the share capital of Ayala Life Assurance Incorporated (subsequently renamed BPI-Philam Life Assurance Corporation (“BPLAC”)), a company carrying on life insurance business in the Philippines, and entered a distribution agreement with Bank of the Philippine Islands (“BPI”) to distribute BPLAC’s products, for consideration of US\$39m of which US\$10m is deferred and expected to be settled in 2010. This amount is subject to a purchase price adjustment based on the final adjusted net worth as at the date of acquisition. The AIA Group has initially estimated this purchase price adjustment to be US\$7m which is expected to be settled during 2010.

The profit after tax contributed by BPLAC for the year ended 30 November 2009 is insignificant as a consequence of the transaction completing at the end of the AIA Group’s financial year. Revenue and profit as though the acquisition had occurred on 1 December 2008 are not material to the AIA Group.

Details of the fair value of the assets and liabilities acquired and the goodwill arising, which have been provisionally determined in view of the time available, are as follows:

	<u>Fair value</u>	<u>Carrying amount</u> US\$m
<b>BPLAC</b>		
Intangible assets . . . . .	15	—
Deferred acquisition costs (value of business acquired) . . . . .	31	—
Property, plant and equipment . . . . .	8	9
Investment property . . . . .	13	13
Loans and receivables . . . . .	67	65
Investment securities . . . . .	246	246
Other assets . . . . .	5	5
Cash and cash equivalents . . . . .	2	2
Insurance and investment contract liabilities . . . . .	(281)	(281)
Deferred tax assets/(liabilities) . . . . .	(17)	3
Other liabilities . . . . .	<u>(6)</u>	<u>(6)</u>
<b>Total net assets acquired . . . . .</b>	<b><u>83</u></b>	<b><u>56</u></b>
Less: non-controlling interests acquired . . . . .	(44)	
<b>Net assets acquired . . . . .</b>	<b>39</b>	
Fair value of purchase consideration . . . . .	46	
Acquisition costs . . . . .	<u>1</u>	
<b>Total purchase consideration . . . . .</b>	<b><u>47</u></b>	
<b>Goodwill arising on acquisition . . . . .</b>	<b><u>8</u></b>	
Fair value of purchase consideration . . . . .	47	
Less: deferred consideration and purchase price adjustment . . . . .	(17)	
Less: cash and cash equivalents in acquired subsidiary . . . . .	<u>(2)</u>	
<b>Net cash outflow . . . . .</b>	<b><u>28</u></b>	

On 30 November 2007, the AIA Group acquired a further 50% of the share capital of Grand Design Development Limited (“Grand Design”) for cash consideration of US\$233m. Grand Design is a holding company with a 90% interest in the share capital of Bayshore Development Group Limited (“Bayshore”), which owns a property in Hong Kong. Prior to the acquisition of this interest, the AIA Group held a 50% interest in Grand Design. After such acquisition, the AIA Group held a 100% interest in Grand Design. Prior to 30 November 2007, the AIA Group had accounted for its interest in the share capital and shareholder loans of Grand Design as an associate. As a consequence of the acquisition of the further 50% interest in Grand Design, the AIA Group consolidated Grand Design and Bayshore.

Also on 30 November 2007, Bayshore obtained banking refinancing of US\$539m, which enabled Bayshore to repay certain shareholder loans, including accrued interest. The AIA Group received US\$204m for its share of these shareholder loans, which exceeded the AIA Group’s carrying value of Grand Design of US\$191m. As this

refinancing occurred concurrent with the AIA Group's acquisition of the further 50% of the share capital of Grand Design, the AIA Group did not recognise a gain on this repayment, considering it to be a reduction in the purchase consideration payable for the further 50% interest in Grand Design. During 2008, a final purchase price adjustment of US\$1m was received by the AIA Group.

Details of the fair value of the assets and liabilities acquired and the goodwill arising are as follows:

	<u>Fair value</u>	<u>Carrying amount</u>
US\$m		
<b>Grand Design</b>		
Property, plant and equipment . . . . .	19	17
Investment property . . . . .	613	613
Loans and receivables . . . . .	3	7
Other assets . . . . .	115	69
Cash and cash equivalents . . . . .	26	26
Borrowings . . . . .	(544)	(544)
Deferred tax liabilities . . . . .	(2)	—
Other liabilities . . . . .	(11)	(11)
<b>Net assets acquired</b> . . . . .	<u><b>219</b></u>	<u><b>177</b></u>
Repayment of shareholders' loans . . . . .	14	
<b>Fair value of purchase consideration</b> . . . . .	<b>233</b>	
Less: cash and cash equivalents in acquired subsidiaries . . . . .	<u>(26)</u>	
<b>Net cash outflow</b> . . . . .	<u><b>207</b></u>	

During 2008, the AIA Group acquired a further 50% of the share capital of AIG Consulting Services Company Limited. The fair value of the net assets acquired and purchase consideration are considered immaterial. Prior to the acquisition of this interest, the AIA Group held a 50% interest in AIG Consulting Services Company Limited. After such acquisition, the AIA Group held a 100% interest in AIG Consulting Services Company Limited.

**Disposal**

In October 2009, the AIA Group sold its 60% interest in PT Asuransi AIA Indonesia for US\$65m. The loss on sale was US\$29m before tax. The AIA Group continues to operate in Indonesia through its wholly owned subsidiary PT AIA Financial.

## 5. Operating profit

Operating profit may be reconciled to net profit as follows:

	Note	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
				US\$m
<b>Operating profit</b> . . . . .	7	<b>1,742</b>	<b>1,943</b>	<b>1,835</b>
Non-operating investment return:				
Investment experience . . . . .		3,640	(10,222)	5,716
Investment income related to investment-linked contracts . . . . .		63	80	68
Investment management expenses related to investment-linked contracts . . . . .		(9)	(10)	(16)
Corresponding changes in insurance and investment contract liabilities for investment-linked contracts . . . . .		(2,469)	5,919	(4,166)
Corresponding changes in insurance contract liabilities for participating funds . . . . .		(308)	1,502	(773)
Corresponding changes in third party interests in consolidated investment funds . . . . .		(80)	319	(164)
<b>Non-operating investment return</b> . . . . .		<b>837</b>	<b>(2,412)</b>	<b>665</b>
Other non-operating items:				
Gain on recapture of reinsurance from former parent company . . . . .		—	447	—
Restructuring and separation costs . . . . .		—	(10)	(89)
Other . . . . .		219	74	169
<b>Non-operating items</b> . . . . .		<b>1,056</b>	<b>(1,901)</b>	<b>745</b>
<b>Profit before tax</b> . . . . .		<b>2,798</b>	<b>42</b>	<b>2,580</b>
Tax on operating profit . . . . .		(461)	(348)	(392)
Tax on non-operating investment return . . . . .		(190)	518	(262)
Other non-operating tax items:				
Release of withholding tax provision . . . . .		—	275	—
Other . . . . .		2	(8)	11
Tax (expense)/credit . . . . .		(649)	437	(643)
<b>Net profit</b> . . . . .		<b>2,149</b>	<b>479</b>	<b>1,937</b>
<b>Operating profit</b> . . . . .		<b>1,742</b>	<b>1,943</b>	<b>1,835</b>
Tax on operating profit . . . . .		(461)	(348)	(392)
<b>Operating profit after tax</b> . . . . .		<b>1,281</b>	<b>1,595</b>	<b>1,443</b>
<i>Operating profit after tax attributable to:</i>				
<b>Shareholders of AIA</b> . . . . .		<b>1,270</b>	<b>1,588</b>	<b>1,438</b>
Non-controlling interests . . . . .		11	7	5

Other non-operating items include restructuring and separation costs, the gain on recapture of reinsurance from the former parent company in 2008 and other adjustments. Other adjustments relate to the differences in accounting policies between those applied by management, for decision making and internal performance management purposes and the accounting policies described in note 2 to the AIA Group Historical Financial Information. Further details are provided below:

### *Gain on recapture of reinsurance from former parent company*

During 2008, the AIA Group paid US\$190m to its then immediate parent, AIRCO, in full and final settlement of the recapture of a portfolio of reinsured risks and the transfer of a related portfolio of financial assets. The fair value of financial assets received exceeded the insurance and investment contract liabilities, deferred acquisition and origination costs, and this fee, resulting in a gain on recapture of US\$447m. Other items in 2008 considered to be non-operating in nature consist of restructuring and separation costs of US\$10m and the release of a provision for withholding tax, as a tax treaty was clarified during 2008 which resulted in the release of tax liabilities for withholding tax on profits to be remitted to Hong Kong in the amount of US\$275m.

### ***Restructuring and separation costs***

Restructuring costs represent costs related to restructuring programmes and are primarily comprised of redundancy and contract termination costs. Separation costs are those significant and identifiable costs related to the AIA Group's separation from AIG.

### ***Other adjustments***

These include accounting for investment properties, net assets of participating funds and actuarial gains and losses arising from defined benefit schemes. Further details are provided below.

#### **(i) Investment properties**

For operating profit purposes all real estate is measured at depreciated cost. The IFRS accounting policies described in note 2 and applied in the preparation of the consolidated income statement, consolidated statement of financial position and notes thereto measure investment properties at fair value.

#### **(ii) Participating funds**

For operating profit purposes the Group records a liability for the proportion of the net assets of participating funds that would be allocated to policyholders assuming all performance were to be declared as a dividend based upon local regulations. The change in this liability, which corresponds to investment experience of participating funds, is excluded from operating profit, as shown in the table above. The IFRS accounting policies described in note 2 and applied in the preparation of the consolidated income statement, consolidated statement of financial position and notes thereto record a liability for the net assets of participating funds such that income is recognised only when a dividend or bonus declarations are made, to the extent that a portion of such declarations is attributable to the AIA Group.

#### **(iii) Actuarial gains and losses arising from defined benefit schemes**

For operating profit purposes the AIA Group recognises a portion of actuarial gains and losses if the unrecognised actuarial net gain or loss at the end of the previous reporting period exceeds the greater of 10% of the projected benefit obligations at that date or 10% of the fair value of any plan assets at that date. Any actuarial net gain or loss exceeding the greater of these two values is recognised in operating profit over the expected average remaining service periods of the employees participating in the plans. The IFRS accounting policies described in note 2 and applied in the preparation of the consolidated income statement consolidated statement of financial position and notes thereto recognise actuarial gains and losses in the period in which they arise.

### **6. Total weighted premium income**

For management decision making and internal performance management purposes, the AIA Group measures business volumes using a performance measure referred to as total weighted premium income (TWPI). Total weighted premium income consists of 100% of renewal premiums, 100% of first year premiums and 10% of single premiums and includes deposits and contributions for contracts that are accounted for as deposits in accordance with the AIA Group's accounting policies.

Management considers that total weighted premium income provides 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 intended to be indicative of premium and fee income recorded in the consolidated income statement.

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
	US\$m		
<b>Total weighted premium income by geography</b>			
Hong Kong . . . . .	2,845	2,916	2,861
Thailand . . . . .	2,164	2,351	2,373
Singapore . . . . .	1,514	1,641	1,524
Malaysia . . . . .	667	727	707
China . . . . .	806	934	1,018
Korea . . . . .	2,178	2,268	1,759
Other Markets . . . . .	1,184	1,366	1,390
<b>Total</b> . . . . .	<b><u>11,358</u></b>	<b><u>12,203</u></b>	<b><u>11,632</u></b>
<b>First year premiums by geography</b>			
Hong Kong . . . . .	482	414	357
Thailand . . . . .	301	326	337
Singapore . . . . .	115	139	111
Malaysia . . . . .	78	91	93
China . . . . .	161	160	166
Korea . . . . .	683	664	322
Other Markets . . . . .	296	325	358
<b>Total</b> . . . . .	<b><u>2,116</u></b>	<b><u>2,119</u></b>	<b><u>1,744</u></b>
<b>Single premiums by geography</b>			
Hong Kong . . . . .	893	475	175
Thailand . . . . .	99	158	121
Singapore . . . . .	1,187	952	400
Malaysia . . . . .	107	93	32
China . . . . .	380	193	166
Korea . . . . .	740	457	77
Other Markets . . . . .	273	247	119
<b>Total</b> . . . . .	<b><u>3,679</u></b>	<b><u>2,575</u></b>	<b><u>1,090</u></b>
<b>Renewal premiums by geography</b>			
Hong Kong . . . . .	2,274	2,455	2,487
Thailand . . . . .	1,853	2,009	2,024
Singapore . . . . .	1,280	1,407	1,373
Malaysia . . . . .	578	627	611
China . . . . .	607	755	835
Korea . . . . .	1,421	1,559	1,429
Other Markets . . . . .	861	1,015	1,020
<b>Total</b> . . . . .	<b><u>8,874</u></b>	<b><u>9,827</u></b>	<b><u>9,779</u></b>

## 7. Segment information

The AIA Group's operating segments, based on the reporting received by the AIA Group's Exco are each of the geographical markets in which the AIA Group operates. Each of the reportable segments, other than the 'Corporate and Other' segment, writes life insurance business, providing life, pensions, and accident and health products to customers in its local market, and distributes related investment and other financial services products. The reportable segments, as required to be disclosed separately under IFRS 8, are Hong Kong, Thailand, Singapore, Korea, Malaysia, China, Other Markets and Corporate and Other. The AIA Group's Hong Kong reportable segment includes Macau. The AIA Group's Singapore reportable segment includes Brunei. Other Markets primarily includes the AIA Group's operations in the Philippines, Indonesia, Vietnam, India, Australia, New Zealand and Taiwan. The activities of the Corporate and Other segment consist of the AIA Group's corporate functions, shared services and eliminations of intragroup transactions.

Because each reportable segment other than the Corporate and Other segment focuses on serving the life insurance needs of its local market there are limited transactions between reportable segments. The key performance indicators reported in respect of each segment are:

- total weighted premium income;
- investment income (excluding investment income in respect of investment-linked contracts);
- operating expenses;
- operating profit; (see Note 5);
- expense ratio; measured as operating expenses divided by total weight premium income;
- operating margin; measured as operating profit (see above) expressed as a percentage of total weighted premium income; and
- operating return on allocated segment equity, measured as operating profit after tax attributable to shareholders of AIA expressed as a simple average of opening and closing allocated segment equity (being the segment assets less segment liabilities in respect of each reportable segment less non-controlling interests, fair value and foreign currency translation reserves, and adjusted for subordinated intercompany debt).

In presenting net capital in/(out) flows to reportable segments, capital outflows consist of dividends and profit distributions to the Corporate and Other segment and capital inflows consist of capital injections into reportable segments by the Corporate and Other segment. For the AIA Group, net capital in/(out) flows reflect the net amount received from shareholders by way of capital contributions less amounts distributed by way of dividends.

Business volumes in respect of the AIA Group's five largest customers are less than 30% of premiums and fee income.

	Key markets						Other Markets	Corporate and Other	Total US\$m
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>Year ended 30 November 2007</b>									
<b>Total weighted premium income</b> . . . . .	<b>2,845</b>	<b>2,164</b>	<b>1,514</b>	<b>667</b>	<b>806</b>	<b>2,178</b>	<b>1,184</b>	<b>—</b>	<b>11,358</b>
Net premiums, fee income and other operating revenue (net of reinsurance ceded) . . . . .	1,401	2,206	1,464	610	723	1,506	912	(5)	8,817
Investment income <sup>(1)</sup> . . . . .	607	557	538	200	147	233	352	72	2,706
<b>Total revenue</b> . . . . .	<b>2,008</b>	<b>2,763</b>	<b>2,002</b>	<b>810</b>	<b>870</b>	<b>1,739</b>	<b>1,264</b>	<b>67</b>	<b>11,523</b>
Net insurance and investment contract benefits <sup>(2)</sup> . . . . .	1,124	1,928	1,434	554	551	1,165	829	1	7,586
Commission and other acquisition expenses . . . . .	198	293	76	75	68	165	70	2	947
Operating expenses . . . . .	133	114	95	52	127	136	157	148	962
Investment management expenses and finance costs <sup>(3)</sup> . . . . .	153	26	49	6	2	4	30	16	286
<b>Total expenses</b> . . . . .	<b>1,608</b>	<b>2,361</b>	<b>1,654</b>	<b>687</b>	<b>748</b>	<b>1,470</b>	<b>1,086</b>	<b>167</b>	<b>9,781</b>
Share of profit/(loss) from associates and joint ventures . . . . .	8	(1)	—	—	—	—	(8)	1	—
<b>Operating profit/(loss)</b> . . . . .	<b>408</b>	<b>401</b>	<b>348</b>	<b>123</b>	<b>122</b>	<b>269</b>	<b>170</b>	<b>(99)</b>	<b>1,742</b>
Tax on operating profit . . . . .	(40)	(126)	(68)	(38)	(11)	(77)	(54)	(47)	(461)
<b>Operating profit/(loss) after tax</b> . . . . .	<b>368</b>	<b>275</b>	<b>280</b>	<b>85</b>	<b>111</b>	<b>192</b>	<b>116</b>	<b>(146)</b>	<b>1,281</b>
<i>Operating profit/(loss) after tax attributable to:</i>									
<b>Shareholders of AIA</b> . . . . .	<b>368</b>	<b>275</b>	<b>280</b>	<b>85</b>	<b>111</b>	<b>192</b>	<b>105</b>	<b>(146)</b>	<b>1,270</b>
Non-controlling interests . . . . .	—	—	—	—	—	—	11	—	11
<b>Key operating ratios:</b>									
Expense ratio . . . . .	4.7%	5.3%	6.3%	7.8%	15.8%	6.2%	13.3%	—	8.5%
Operating margin . . . . .	14.3%	18.5%	23.0%	18.4%	15.1%	12.4%	14.4%	—	15.3%
Operating return on allocated equity . . . . .	14.1%	11.0%	33.4%	34.8%	30.2%	23.7%	10.0%	—	13.6%
Operating profit includes:									
Finance costs . . . . .	141	—	42	2	1	—	—	17	203
Depreciation and amortisation . . . . .	6	8	8	4	7	8	6	5	52
Strategic initiative expenses . . . . .	—	—	—	—	—	—	—	—	—

Note: (1) Excludes investment income related to investment-linked contracts

Note: (2) Excludes corresponding changes in insurance and investment contract liabilities from investment experience for investment-linked contracts and participating funds and investment income related to investment-linked contracts

Note: (3) Excludes investment management expenses related to investment-linked contracts

Operating profit may be reconciled to net profit/(loss) as follows:

	Key markets						Other Markets	Corporate and Other	Total
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>30 November 2007</b>									US\$m
<b>Operating profit/(loss)</b> . . . . .	<b>408</b>	<b>401</b>	<b>348</b>	<b>123</b>	<b>122</b>	<b>269</b>	<b>170</b>	<b>(99)</b>	<b>1,742</b>
Non-operating items . . . . .	<u>303</u>	<u>343</u>	<u>139</u>	<u>46</u>	<u>66</u>	<u>40</u>	<u>79</u>	<u>40</u>	<u>1,056</u>
<b>Profit/(loss) before tax</b> . . . . .	<b>711</b>	<b>744</b>	<b>487</b>	<b>169</b>	<b>188</b>	<b>309</b>	<b>249</b>	<b>(59)</b>	<b>2,798</b>
Tax on operating profit . . . . .	(40)	(126)	(68)	(38)	(11)	(77)	(54)	(47)	(461)
Tax on non-operating items . . . . .	—	(103)	(36)	(28)	(12)	(11)	(1)	1	(190)
Other non-operating tax items . . . . .	—	(1)	7	4	—	(1)	(3)	(4)	2
Tax (expense)/credit . . . . .	(40)	(230)	(97)	(62)	(23)	(89)	(58)	(50)	(649)
<b>Net profit/(loss)</b> . . . . .	<b><u>671</u></b>	<b><u>514</u></b>	<b><u>390</u></b>	<b><u>107</u></b>	<b><u>165</u></b>	<b><u>220</u></b>	<b><u>191</u></b>	<b><u>(109)</u></b>	<b><u>2,149</u></b>
<i>Net profit/(loss) attributable to:</i>									
<b>Shareholders of AIA</b> . . . . .	<b>671</b>	<b>514</b>	<b>390</b>	<b>107</b>	<b>165</b>	<b>220</b>	<b>175</b>	<b>(109)</b>	<b>2,133</b>
Non-controlling interests . . . . .	—	—	—	—	—	—	16	—	16

Allocated equity may be analysed as follows:

	Key markets						Other Markets	Corporate and Other	Total
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>30 November 2007</b>									US\$m
Assets before investments in associates and joint ventures . . . . .	23,907	13,730	20,642	5,796	4,544	7,763	6,963	5,507	<b>88,852</b>
Investments in associates and joint ventures . . . . .	—	4	17	—	—	—	23	19	<b>63</b>
<b>Total assets</b> . . . . .	<b>23,907</b>	<b>13,734</b>	<b>20,659</b>	<b>5,796</b>	<b>4,544</b>	<b>7,763</b>	<b>6,986</b>	<b>5,526</b>	<b>88,915</b>
<b>Total liabilities</b> . . . . .	<b>20,875</b>	<b>10,714</b>	<b>19,666</b>	<b>5,489</b>	<b>4,186</b>	<b>6,890</b>	<b>5,147</b>	<b>2,271</b>	<b>75,238</b>
<b>Total equity</b> . . . . .	<b>3,032</b>	<b>3,020</b>	<b>993</b>	<b>307</b>	<b>358</b>	<b>873</b>	<b>1,839</b>	<b>3,255</b>	<b>13,677</b>
Non-controlling interests . . . . .	—	—	—	—	—	—	61	—	61
Amounts reflected in other comprehensive income:									
Fair value reserve . . . . .	104	141	58	17	(108)	(85)	557	2,272	<b>2,956</b>
Foreign currency translation reserve . . . . .	—	142	61	18	16	8	86	(2)	<b>329</b>
<b>Allocated equity</b> . . . . .	<b><u>2,928</u></b>	<b><u>2,737</u></b>	<b><u>874</u></b>	<b><u>272</u></b>	<b><u>450</u></b>	<b><u>950</u></b>	<b><u>1,135</u></b>	<b><u>985</u></b>	<b><u>10,331</u></b>
Net capital in/(out) flows . . . . .	(7)	(61)	(319)	(51)	—	60	(1)	285	(94)

Segment information may be reconciled to the consolidated income statement as shown below.

	Segment information	Investment experience	Investment income related to investment-linked contracts	Investment management expenses related to investment-linked contracts	Related changes in insurance and investment contract benefits	Third party interests in consolidated investment funds	Other non-operating items	Consolidated income statement	US\$m
<b>30 November 2007</b>									
<b>Total revenue</b> . . . . .	<b>11,523</b>	<b>3,640</b>	<b>63</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>139</b>	<b>15,365</b>	<b>Total revenue</b>
Of which:									
Net premiums, fee income and other operating revenue . . . . .	8,817	—	—	—	—	—	—	8,817	Net premiums and fee income and other operating revenue
Investment return . . . . .	2,706	3,640	63	—	—	—	139	6,548	Investment return
<b>Total expenses</b> . . . . .	<b>9,781</b>	<b>—</b>	<b>—</b>	<b>9</b>	<b>2,469</b>	<b>308</b>	<b>19</b>	<b>12,666</b>	<b>Total expenses</b>
Of which:									
Net insurance and investment contract benefits . . . . .	7,586	—	—	—	2,469	308	34	10,397	Net insurance and investment contract benefits
Operating expenses . . . . .	962	—	—	—	—	—	(11)	951	Operating expenses
Investment management expenses and finance costs . . . . .	286	—	—	9	—	—	(4)	291	Investment management expenses and finance costs
Change in third party interests in consolidated investment funds . . . . .	—	—	—	—	—	80	—	80	Change in third party interests in consolidated investment funds
Share of loss of associates and joint ventures . . . . .	—	—	—	—	—	—	99	99	Share of loss of associates and joint ventures
<b>Operating profit</b> . . . . .	<b>1,742</b>	<b>3,640</b>	<b>63</b>	<b>(9)</b>	<b>(2,469)</b>	<b>(80)</b>	<b>219</b>	<b>2,798</b>	<b>Profit/(loss) before tax</b>

	Key markets						Other Markets	Corporate and Other	Total
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>Year ended 30 November 2008</b>									
<b>Total weighted premium income</b>	<b>2,916</b>	<b>2,351</b>	<b>1,641</b>	<b>727</b>	<b>934</b>	<b>2,268</b>	<b>1,366</b>	<b>—</b>	<b>12,203</b>
Net premiums, fee income and other operating revenue (net of reinsurance ceded)	2,023	2,403	1,658	706	847	1,698	1,032	(6)	10,361
Investment income <sup>(1)</sup>	767	657	616	230	184	248	397	45	3,144
<b>Total revenue</b>	<b>2,790</b>	<b>3,060</b>	<b>2,274</b>	<b>936</b>	<b>1,031</b>	<b>1,946</b>	<b>1,429</b>	<b>39</b>	<b>13,505</b>
Net insurance and investment contract benefits <sup>(2)</sup>	1,540	2,101	1,551	663	692	1,222	860	1	8,630
Commission and other acquisition expenses	336	381	238	80	76	307	148	(3)	1,563
Operating expenses	183	132	129	64	172	132	173	104	1,089
Investment management expenses and finance costs	141	23	24	5	6	4	31	18	252
<b>Total expenses</b>	<b>2,200</b>	<b>2,637</b>	<b>1,942</b>	<b>812</b>	<b>946</b>	<b>1,665</b>	<b>1,212</b>	<b>120</b>	<b>11,534</b>
Share of profit/(loss) from associates and joint ventures	—	1	1	(1)	—	—	(29)	—	(28)
<b>Operating profit/(loss)</b>	<b>590</b>	<b>424</b>	<b>333</b>	<b>123</b>	<b>85</b>	<b>281</b>	<b>188</b>	<b>(81)</b>	<b>1,943</b>
Tax on operating profit/(loss)	(21)	(121)	(100)	(11)	3	(63)	(29)	(6)	(348)
<b>Operating profit/(loss) after tax</b>	<b>569</b>	<b>303</b>	<b>233</b>	<b>112</b>	<b>88</b>	<b>218</b>	<b>159</b>	<b>(87)</b>	<b>1,595</b>
<i>Operating profit/(loss) after tax attributable to:</i>									
<b>Shareholders of AIA</b>	<b>568</b>	<b>303</b>	<b>233</b>	<b>112</b>	<b>88</b>	<b>218</b>	<b>153</b>	<b>(87)</b>	<b>1,588</b>
Non-controlling interests	1	—	—	—	—	—	6	—	7
<b>Key operating ratios:</b>									
Expense ratio	6.3%	5.6%	7.9%	8.8%	18.4%	5.8%	12.7%	—	8.9%
Operating margin	20.2%	18.0%	20.3%	16.9%	9.1%	12.4%	13.8%	—	15.9%
Operating return on allocated equity	16.8%	11.7%	26.7%	37.5%	18.7%	20.1%	12.5%	—	14.8%
Operating profit includes:									
Finance costs	122	2	21	1	1	—	2	10	159
Depreciation and amortisation	1	13	9	7	14	9	6	5	64
Strategic initiative expenses	4	2	9	1	—	—	1	8	25

Note: (1) Excludes investment income related to investment-linked contracts

Note: (2) Excludes corresponding changes in insurance and investment contract liabilities from investment experience for investment-linked contracts and participating funds and investment income related to investment-linked contracts

Note: (3) Excludes investment management expenses related to investment-linked contracts

Operating profit may be reconciled to net profit/(loss) as follows:

	Key markets						Other Markets	Corporate and Other	Total
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>30 November 2008</b>									
Operating profit/(loss)	<b>590</b>	<b>424</b>	<b>333</b>	<b>123</b>	<b>85</b>	<b>281</b>	<b>188</b>	<b>(81)</b>	<b>1,943</b>
Non-operating items	(341)	(745)	(388)	(58)	(76)	(77)	(106)	(110)	(1,901)
<b>Profit/(loss) before tax</b>	<b>249</b>	<b>(321)</b>	<b>(55)</b>	<b>65</b>	<b>9</b>	<b>204</b>	<b>82</b>	<b>(191)</b>	<b>42</b>
Tax on operating profit	(21)	(121)	(100)	(11)	3	(63)	(29)	(6)	(348)
Tax on non-operating items	—	221	193	48	15	29	9	3	518
Other non-operating tax items	—	1	4	(21)	5	(1)	3	276	267
Tax (expense)/credit	(21)	101	97	16	23	(35)	(17)	273	437
<b>Net profit/(loss)</b>	<b>228</b>	<b>(220)</b>	<b>42</b>	<b>81</b>	<b>32</b>	<b>169</b>	<b>65</b>	<b>82</b>	<b>479</b>
<i>Net profit/(loss) attributable to:</i>									
<b>Shareholders of AIA</b>	<b>227</b>	<b>(220)</b>	<b>42</b>	<b>81</b>	<b>32</b>	<b>169</b>	<b>61</b>	<b>81</b>	<b>473</b>
Non-controlling interests	1	—	—	—	—	—	4	1	6

Allocated equity may be analysed as follows:

	Key markets						Other Markets	Corporate and Other	Total US\$m
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>30 November 2008</b>									
Assets before investments in associates and joint ventures . . . . .	19,526	13,933	15,948	5,541	5,636	5,055	5,785	1,207	<b>72,631</b>
Investments in associates and joint ventures . . . . .	—	2	7	2	—	—	36	—	<b>47</b>
<b>Total assets</b> . . . . .	<b>19,526</b>	<b>13,935</b>	<b>15,955</b>	<b>5,543</b>	<b>5,636</b>	<b>5,055</b>	<b>5,821</b>	<b>1,207</b>	<b>72,678</b>
<b>Total liabilities</b> <sup>(4)</sup> . . . . .	<b>17,423</b>	<b>11,030</b>	<b>15,186</b>	<b>5,193</b>	<b>5,014</b>	<b>4,418</b>	<b>4,716</b>	<b>502</b>	<b>63,482</b>
<b>Total equity</b> . . . . .	<b>2,103</b>	<b>2,905</b>	<b>769</b>	<b>350</b>	<b>622</b>	<b>637</b>	<b>1,105</b>	<b>705</b>	<b>9,196</b>
Non-controlling interests . . . . .	1	—	—	—	—	—	19	—	<b>20</b>
Amounts reflected in other comprehensive income:									
Fair value reserve . . . . .	(1,737)	457	(117)	27	80	(175)	(116)	17	<b>(1,564)</b>
Foreign currency translation reserve . . . . .	—	5	15	(2)	53	(412)	(112)	(1)	<b>(454)</b>
<b>Allocated equity</b> . . . . .	<b>3,839</b>	<b>2,443</b>	<b>871</b>	<b>325</b>	<b>489</b>	<b>1,224</b>	<b>1,314</b>	<b>689</b>	<b>11,194</b>
Net capital in/(out) flows . . . . .	684	(74)	(45)	(28)	7	105	118	(377)	<b>390</b>

Note: (4) Corporate and Other and Other Markets *adjusted for subordinated intercompany debt provided to Other Markets of US\$68m*

Segment information may be reconciled to the consolidated income statement as shown below.

	Segment information	Investment experience	Investment-related to linked contracts	Investment management income related to linked contracts	Investment management expenses related to linked contracts	Related changes in investment contract benefits	Third party interests in consolidated investment funds	Other non-operating items	Consolidated income statement	US\$m
<b>30 November 2008</b>										
<b>Total revenue</b> . . . . .	<b>13,505</b>	<b>(10,222)</b>	<b>80</b>					<b>424</b>	<b>3,787</b>	<b>Total revenue</b>
Of which:										Of which:
Net premiums, fee income and other operating revenue . . . . .	10,361	—	—	—	—	—	—	447	10,808	Net premiums, fee income and other operating revenue
Investment return . . . . .	3,144	(10,222)	80	—	—	—	—	(23)	(7,021)	Investment return
<b>Total expenses</b> . . . . .	<b>11,534</b>			<b>10</b>	<b>(5,919)</b>	<b>(1,502)</b>	<b>(319)</b>	<b>(87)</b>	<b>3,717</b>	<b>Total expenses</b>
Of which:										Of which:
Net insurance and investment contract benefits . . . . .	8,630	—	—	—	(5,919)	(1,502)	—	(100)	1,109	Net insurance and investment contract benefits
Restructuring and separation costs . . . . .	—	—	—	—	—	—	—	10	10	Restructuring and separation costs
Operating expenses . . . . .	1,089	—	—	—	—	—	—	5	1,094	Operating expenses
Investment management expenses and finance costs . . . . .	252	—	—	10	—	—	—	(2)	260	Investment management expenses and finance costs
Change in third party interests in consolidated investment funds . . . . .	—	—	—	—	—	—	(319)	—	(319)	Change in third party interests in consolidated investment funds
Share of loss of associates and joint ventures . . . . .	(28)	—	—	—	—	—	—	—	(28)	Share of loss of associates and joint ventures
<b>Operating profit</b> . . . . .	<b>1,943</b>	<b>(10,222)</b>	<b>80</b>	<b>(10)</b>	<b>5,919</b>	<b>1,502</b>	<b>319</b>	<b>511</b>	<b>42</b>	<b>Profit/(loss) before tax</b>

Other non-operating items in 2008 consist of a gain of US\$447m arising on the recapture of a reinsurance treaty and restructuring costs of US\$10m (see Note 5).

	Key markets						Other Markets	Corporate and Other	Total US\$m
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>Year ended 30 November 2009</b>									
<b>Total weighted premium income</b> . . . . .	<b>2,861</b>	<b>2,373</b>	<b>1,524</b>	<b>707</b>	<b>1,018</b>	<b>1,759</b>	<b>1,390</b>	<b>—</b>	<b>11,632</b>
Net premiums, fee income and other operating revenue (net of reinsurance ceded) . . . . .	2,232	2,374	1,506	656	999	1,367	1,055	(16)	10,173
Investment income <sup>1</sup> . . . . .	779	640	609	223	201	217	400	(10)	3,059
<b>Total revenue</b> . . . . .	<b>3,011</b>	<b>3,014</b>	<b>2,115</b>	<b>879</b>	<b>1,200</b>	<b>1,584</b>	<b>1,455</b>	<b>(26)</b>	<b>13,232</b>
Net insurance and investment contract benefits <sup>2</sup> . . . . .	1,700	2,107	1,495	597	872	1,027	843	(17)	8,624
Commission and other acquisition expenses . . . . .	398	391	160	70	55	371	204	(1)	1,648
Operating expenses . . . . .	163	135	91	58	181	101	170	82	981
Investment management expenses and finance costs <sup>3</sup> . . . . .	52	23	13	5	3	4	25	(2)	123
<b>Total expenses</b> . . . . .	<b>2,313</b>	<b>2,656</b>	<b>1,759</b>	<b>730</b>	<b>1,111</b>	<b>1,503</b>	<b>1,242</b>	<b>62</b>	<b>11,376</b>
Share of profit/(loss) from associates and joint ventures . . . . .	—	—	—	1	—	—	(22)	—	(21)
<b>Operating profit/(loss)</b> . . . . .	<b>698</b>	<b>358</b>	<b>356</b>	<b>150</b>	<b>89</b>	<b>81</b>	<b>191</b>	<b>(88)</b>	<b>1,835</b>
Tax on operating profit . . . . .	(43)	(111)	(92)	(44)	(21)	(16)	(47)	(18)	(392)
<b>Operating profit/(loss) after tax</b> . . . . .	<b>655</b>	<b>247</b>	<b>264</b>	<b>106</b>	<b>68</b>	<b>65</b>	<b>144</b>	<b>(106)</b>	<b>1,443</b>
<b>Operating profit/(loss) after tax attributable to:</b>									
<b>Shareholders of AIA</b> . . . . .	<b>653</b>	<b>251</b>	<b>264</b>	<b>106</b>	<b>68</b>	<b>65</b>	<b>137</b>	<b>(106)</b>	<b>1,438</b>
Non-controlling interests . . . . .	2	(4)	—	—	—	—	7	—	5
<b>Key operating ratios:</b>									
Expense ratio . . . . .	5.7%	5.7%	6.0%	8.2%	17.8%	5.7%	12.2%	—	8.4%
Operating margin . . . . .	24.4%	15.1%	23.4%	21.2%	8.7%	4.6%	13.7%	—	15.8%
Operating return on allocated equity . . . . .	15.4%	9.4%	23.7%	29.8%	12.5%	5.3%	9.9%	—	11.6%
Operating profit includes:									
Finance costs . . . . .	43	2	6	2	—	—	3	(6)	50
Depreciation and amortisation . . . . .	4	8	8	8	13	10	9	6	66
Strategic initiative expenses . . . . .	10	6	14	2	3	—	9	18	62

Note: (1) Excludes investment income related to investment-linked contracts

Note: (2) Excludes corresponding changes in insurance and investment contract liabilities from investment experience for investment-linked contracts and participating funds and investment income related to investment-linked contracts

Note: (3) Excludes investment management expenses related to investment-linked contracts

Operating profit may be reconciled to net profit/(loss) as follows:

	Key markets						Other Markets	Corporate and Other	Total US\$m
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>30 November 2009</b>									
<b>Operating profit/(loss)</b> . . . . .	<b>698</b>	<b>358</b>	<b>356</b>	<b>150</b>	<b>89</b>	<b>81</b>	<b>191</b>	<b>(88)</b>	<b>1,835</b>
Non-operating items . . . . .	211	570	68	24	36	(90)	(21)	(53)	745
<b>Profit/(loss) before tax</b> . . . . .	<b>909</b>	<b>928</b>	<b>424</b>	<b>174</b>	<b>125</b>	<b>(9)</b>	<b>170</b>	<b>(141)</b>	<b>2,580</b>
Tax on operating profit . . . . .	(43)	(111)	(92)	(44)	(21)	(16)	(47)	(18)	(392)
Tax on non-operating items . . . . .	—	(168)	(75)	(20)	(8)	15	(3)	(3)	(262)
Other non-operating tax items . . . . .	—	(2)	7	5	—	2	2	(3)	11
Tax (expense)/credit . . . . .	(43)	(281)	(160)	(59)	(29)	1	(48)	(24)	(643)
<b>Net profit/(loss)</b> . . . . .	<b>866</b>	<b>647</b>	<b>264</b>	<b>115</b>	<b>96</b>	<b>(8)</b>	<b>122</b>	<b>(165)</b>	<b>1,937</b>
<i>Net profit/(loss) attributable to:</i>									
<b>Shareholders of AIA</b> . . . . .	<b>848</b>	<b>651</b>	<b>264</b>	<b>115</b>	<b>96</b>	<b>(8)</b>	<b>113</b>	<b>(163)</b>	<b>1,916</b>
Non-controlling interests . . . . .	18	(4)	—	—	—	—	9	(2)	21

Allocated equity may be analysed as follows:

	Key markets						Other Markets	Corporate and Other	Total US\$m
	Hong Kong	Thailand	Singapore	Malaysia	China	Korea			
<b>30 November 2009</b>									
Assets before investments in associates and joint ventures . . . . .	24,269	16,531	20,730	6,346	6,510	7,498	7,982	1,626	91,492
Investments in associates and joint ventures . . . . .	—	2	7	4	—	—	40	—	53
<b>Total assets</b> . . . . .	<b>24,269</b>	<b>16,533</b>	<b>20,737</b>	<b>6,350</b>	<b>6,510</b>	<b>7,498</b>	<b>8,022</b>	<b>1,626</b>	<b>91,545</b>
<b>Total liabilities</b> <sup>(4)</sup> . . . . .	<b>19,020</b>	<b>12,956</b>	<b>19,184</b>	<b>5,928</b>	<b>5,887</b>	<b>6,380</b>	<b>6,111</b>	<b>747</b>	<b>76,213</b>
<b>Total equity</b> . . . . .	<b>5,249</b>	<b>3,577</b>	<b>1,553</b>	<b>422</b>	<b>623</b>	<b>1,118</b>	<b>1,911</b>	<b>879</b>	<b>15,332</b>
Non-controlling interests . . . . .	20	—	—	—	—	—	59	1	80
Amounts reflected in other comprehensive income:									
Fair value reserve . . . . .	572	463	101	24	(30)	49	363	(31)	1,511
Foreign currency translation reserve . . . . .	—	195	97	12	52	(158)	44	—	242
<b>Allocated equity</b> . . . . .	<b>4,657</b>	<b>2,919</b>	<b>1,355</b>	<b>386</b>	<b>601</b>	<b>1,227</b>	<b>1,445</b>	<b>909</b>	<b>13,499</b>
Net capital in/(out) flows . . . . .	(30)	(175)	220	(54)	16	11	18	383	389

Note: (4) Corporate and Other and Other Markets adjusted for subordinated intercompany debt provided to Other Markets of US\$63m.

Segment information may be reconciled to the consolidated income statement as shown below.

	Segment information	Investment experience	Investment-related to linked contracts	Investment management expenses related to investment-linked contracts	Related changes in insurance and investment contract benefits	Third party interests in consolidated investment funds	Other non-operating items	Consolidated income statement	US\$m
<b>30 November 2009</b>									
<b>Total revenue</b> . . . . .	<u>13,232</u>	<u>5,716</u>	<u>68</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>227</u>	<u>19,243</u>	<b>Total revenue</b>
Of which:									
Net premiums, fee income and other operating revenue . . . . .	10,173	—	—	—	—	—	—	10,173	Net premiums and fee income and other operating revenue
Investment return . . . . .	3,059	5,716	68	—	—	—	227	9,070	Investment return
<b>Total expenses</b> . . . . .	<u>11,376</u>	<u>—</u>	<u>16</u>	<u>4,166</u>	<u>773</u>	<u>164</u>	<u>147</u>	<u>16,642</u>	<b>Total segment expenses</b>
Of which:									
Net insurance and investment contract benefits . . . . .	8,624	—	—	4,166	773	—	66	13,629	Net insurance and investment contract benefits
Restructuring and separation costs . . . . .	—	—	—	—	—	—	89	89	Restructuring and separation costs
Operating expenses . . . . .	981	—	—	—	—	—	(6)	975	Operating expenses
Investment management expenses and finance costs . . . . .	123	—	16	—	—	—	(2)	137	Investment management expenses and finance costs
Change in third party interests in consolidated investment funds . . . . .	—	—	—	—	—	164	—	164	Change in third party interests in consolidated investment funds
Share of loss of associates and joint ventures . . . . .	(21)	—	—	—	—	—	—	(21)	Share of loss of associates and joint ventures
<b>Operating profit</b> . . . . .	<u>1,835</u>	<u>5,716</u>	<u>68</u>	<u>(4,166)</u>	<u>(773)</u>	<u>(164)</u>	<u>80</u>	<u>2,580</u>	<b>Profit/(loss) before tax</b>

Other non-operating items in 2009 consist of restructuring and separation costs of US\$89m (see Note 5).

## 8. Revenue

### Investment return

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
			US\$m
Interest income . . . . .	2,560	2,958	2,913
Dividend income . . . . .	184	203	147
Rental income . . . . .	25	63	67
<b>Investment income</b> . . . . .	<b>2,769</b>	<b>3,224</b>	<b>3,127</b>
<b>Available for sale</b>			
Net realised gains/(losses) from debt securities . . . . .	1	(90)	(162)
Impairment of debt securities . . . . .	—	(142)	(67)
<b>Net gains/(losses) of available for sale financial assets reflected in the consolidated income statement</b> . . . . .	<b>1</b>	<b>(232)</b>	<b>(229)</b>
<b>At fair value through profit or loss</b>			
Net (losses)/gains of debt securities . . . . .	(227)	(1,117)	635
Net gains/(losses) of equity securities . . . . .	4,030	(8,968)	5,506
Net fair value movement on derivatives . . . . .	100	(247)	273
Net fair value adjustments on investment properties . . . . .	139	(23)	228
<b>Net gains/(losses) in respect of financial assets at fair value through profit or loss</b> . . . . .	<b>4,042</b>	<b>(10,355)</b>	<b>6,642</b>
Net foreign exchange (losses)/gains . . . . .	(262)	300	(426)
Other realised (losses)/gains . . . . .	(2)	42	(44)
<b>Investment experience</b> . . . . .	<b>3,778</b>	<b>(10,013)</b>	<b>6,172</b>
<b>Investment return</b> . . . . .	<b>6,548</b>	<b>(7,021)</b>	<b>9,070</b>

Other realised (losses)/gains for the year ended 30 November 2009 includes US\$9m of impairment loss relating to the disposal group held for sale (see Note 11 for further information) and US\$29m loss before tax relating to the disposal of PT Asuransi AIA Indonesia.

Foreign currency movements resulted in the following (losses)/gains recognised in the income statement (other than gains and losses arising on items measured at fair value through profit or loss):

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
			US\$m
Foreign exchange (loss)/gain . . . . .	(225)	227	(140)

### Other operating revenue

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
			US\$m
Gain on recapture of reinsurance from former parent company (see Note 5) . . . . .	—	447	—
Other revenue . . . . .	77	79	71
<b>Total</b> . . . . .	<b>77</b>	<b>526</b>	<b>71</b>

The balance of other operating revenue largely consists of asset management fees.

## 9. Expenses

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
	US\$m		
Insurance contract benefits . . . . .	4,555	5,402	5,375
Change in insurance contract liabilities . . . . .	5,267	(1,998)	6,341
Investment contract benefits . . . . .	<u>1,228</u>	<u>(2,047)</u>	<u>2,164</u>
<b>Insurance and investment contract benefits . . . . .</b>	<b>11,050</b>	<b>1,357</b>	<b>13,880</b>
Insurance and investment contract benefits ceded . . . . .	<u>(653)</u>	<u>(248)</u>	<u>(251)</u>
<b>Insurance and investment contract benefits, net of ceded reinsurance . . . . .</b>	<b>10,397</b>	<b>1,109</b>	<b>13,629</b>
Commissions and other acquisition expenses incurred . . . . .	2,282	2,269	1,855
Deferral and amortisation of acquisition costs . . . . .	<u>(1,335)</u>	<u>(706)</u>	<u>(207)</u>
<b>Commission and other acquisition expenses . . . . .</b>	<b>947</b>	<b>1,563</b>	<b>1,648</b>
Employee benefit expenses . . . . .	574	644	602
Depreciation . . . . .	45	61	59
Amortisation . . . . .	7	3	9
Operating lease rentals . . . . .	81	94	90
Other operating expenses . . . . .	<u>244</u>	<u>292</u>	<u>215</u>
<b>Operating expenses . . . . .</b>	<b>951</b>	<b>1,094</b>	<b>975</b>
Restructuring costs . . . . .	—	8	11
Separation costs . . . . .	<u>—</u>	<u>2</u>	<u>78</u>
<b>Restructuring and separation costs . . . . .</b>	<b>—</b>	<b>10</b>	<b>89</b>
Investment management expenses . . . . .	88	101	87
Finance costs . . . . .	203	159	50
Change in third party interests in consolidated investment funds . . . . .	<u>80</u>	<u>(319)</u>	<u>164</u>
<b>Total . . . . .</b>	<b><u>12,666</u></b>	<b><u>3,717</u></b>	<b><u>16,642</u></b>

Other operating expenses include auditors' remuneration of US\$8m (2007: US\$8m; 2008: US\$8m). Operating expenses include strategic initiative expenses of US\$62m (2007: US\$nil, 2008: US\$25m). Strategic initiative expenses consist of expenses for enhancing distribution capability and operational efficiency and are approved by the AIA Group's Strategic Initiative Officer.

Finance costs may be analysed as:

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
	US\$m		
Securities lending and repurchase agreements (see Note 30 for details) . . . . .	193	134	44
Bank and other loans . . . . .	1	18	5
Related party borrowings (see Note 41) . . . . .	<u>9</u>	<u>7</u>	<u>1</u>
<b>Total . . . . .</b>	<b><u>203</u></b>	<b><u>159</u></b>	<b><u>50</u></b>

Interest expense includes US\$5m (2007: US\$10m; 2008: US\$25m) on bank loans, overdrafts and related party loans wholly repayable within five years.

Employee benefit expenses consist of:

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
			US\$m
Wages and salaries . . . . .	464	497	477
Share based compensation . . . . .	11	19	8
Pension costs — defined contribution plans . . . . .	20	27	30
Pension costs — defined benefit plans . . . . .	1	17	6
Other employee benefit expenses . . . . .	<u>78</u>	<u>84</u>	<u>81</u>
<b>Total</b> . . . . .	<b><u>574</u></b>	<b><u>644</u></b>	<b><u>602</u></b>

## 10. Income tax

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
			US\$m
<b>Tax (credited)/charged in the consolidated income statement</b>			
Current income tax — Hong Kong Profits Tax . . . . .	39	37	34
Current income tax — overseas . . . . .	425	364	287
Deferred income tax on temporary differences . . . . .	<u>185</u>	<u>(838)</u>	<u>322</u>
<b>Total</b> . . . . .	<b><u>649</u></b>	<b><u>(437)</u></b>	<b><u>643</u></b>

The provision for Hong Kong Profits Tax is calculated at 16.5%, starting from the year of assessment 2008/09. In previous periods, the Profits Tax rate in Hong Kong was 17.5%. Taxation for overseas subsidiaries and branches is charged at the appropriate current rates of taxation ruling in the relevant jurisdictions of which the most significant jurisdictions are outlined below. The tax benefit or expense attributable to Singapore, Malaysia, Australia and New Zealand life insurance policyholder returns is included in the tax charge or credit and is analysed separately in the consolidated income statement in order to permit comparison of the underlying effective rate of tax attributable to shareholders from year to year. The tax attributable to policyholders' returns included above is US\$137m expense (2007: US\$70m expense; 2008: US\$90m credit).

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
Thailand . . . . .	30%	30%	30%
Singapore . . . . .	18%	18%	17%
Korea . . . . .	27.50%	24.20%	24.2%
Malaysia . . . . .	27%	26%	25%
China . . . . .	25%/33%	25%	25%
Hong Kong . . . . .	17.50%	16.50%	16.50%
Other . . . . .	20% - 35%	20% - 35%	20% - 30%

The table above reflects the principal rate of corporate income taxes, as at the end of each year. The rate changes reflect changes to the enacted or substantively enacted corporate tax rates throughout the period in each jurisdiction.

The most significant matters affecting the tax charge for the year ended 30 November 2008 are the release of a provision for withholding tax of US\$275m following clarification of a tax treaty with Hong Kong (see Note 5 and below), a tax credit of US\$41m relating to a change of tax law in Malaysia and a reduction in Korea's corporate tax rate which will fall to 22% from 2012.

Hong Kong, where the AIA Group is headquartered, currently has a number of tax treaties providing double tax relief in respect of countries in which the AIA Group operates. The overall benefit of these treaties reduces the tax balances recorded in the consolidated statement of financial position as at 30 November 2009 by US\$358m (2008: US\$290m).

In the analysis that follows, the terms 'life insurance tax' and 'life surplus' have the following meaning:

- life insurance tax refers to the permanent differences which arise where the tax regime specific to the life insurance business does not adopt net income as the basis for calculating taxable profit, for example Hong Kong, where life business taxable profit is derived from life premiums; and
- life surplus relates to the temporary difference which arises where the taxable profits are based on actual distributions from the long term fund. This primarily relates to Singapore and Malaysia.

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
	US\$m		
<b>Income tax reconciliation</b>			
<b>Profit before income tax</b> . . . . .	<b>2,798</b>	<b>42</b>	<b>2,580</b>
Tax calculated at domestic tax rates applicable to profits in the respective countries . . . . .	615	3	548
Reduction in tax payable from:			
Release of provision for withholding tax . . . . .	—	(277)	—
Life insurance tax . . . . .	—	(96)	—
Exempt investment income . . . . .	(17)	(33)	(38)
Changes in tax rate and law . . . . .	(24)	(44)	—
Release of provisions for uncertain tax positions . . . . .	—	(10)	—
Amounts over provided in prior years . . . . .	(10)	(3)	(4)
Unrecognised deferred tax assets . . . . .	—	—	—
Other . . . . .	—	(4)	—
	<b>(51)</b>	<b>(467)</b>	<b>(42)</b>
Increase in tax payable from:			
Life insurance tax . . . . .	8	—	57
Withholding taxes . . . . .	41	—	15
Disallowed expenses . . . . .	3	20	43
Unrecognised deferred tax assets . . . . .	13	7	4
Provisions for uncertain tax positions . . . . .	3	—	3
Other . . . . .	17	—	15
	<b>85</b>	<b>27</b>	<b>137</b>
<b>Total income tax expense/(credit)</b> . . . . .	<b><u>649</u></b>	<b><u>(437)</u></b>	<b><u>643</u></b>
<b>Deferred tax</b>			
Temporary differences not recognised in the consolidated statement of financial position are:			
Tax losses . . . . .	144	148	148
Insurance contract liabilities . . . . .	<u>117</u>	<u>89</u>	<u>52</u>
<b>Total</b> . . . . .	<b><u>261</u></b>	<b><u>237</u></b>	<b><u>200</u></b>

There are no current tax assets recoverable in more than one year. All jurisdictions are either in a net deferred tax liability position or there is no recognition of deferred tax assets.

The AIA Group has unused income tax losses carried forward in China, Indonesia and the Philippines. The losses in China, Vietnam and Indonesia expire if they remain unused five years after being incurred. Losses in the Philippines expire three years after being incurred. All of the tax losses currently carried forward are due to expire by the end of 2014.

The movement in deferred tax in the period may be analysed as set out below:

	Net deferred tax asset/(liability) at 1 December	(Charged)/ credited to the income statement	(Charged)/credited to other comprehensive income		Net deferred tax asset/(liability) at 30 November US\$m
			Fair value reserve	Foreign exchange	
<b>30 November 2007</b>					
Revaluation of financial instruments . .	(434)	(55)	181	(26)	(334)
Deferred acquisition costs . . . . .	(1,484)	(98)	—	(38)	(1,620)
Insurance and investment contract liabilities . . . . .	742	342	—	132	1,216
Withholding taxes . . . . .	(269)	(39)	—	(17)	(325)
Provision for expenses . . . . .	150	(44)	—	(16)	90
Losses available for offset against future taxable income . . . . .	68	(45)	—	(17)	6
Life surplus . . . . .	342	(595)	—	(110)	(363)
Other . . . . .	(99)	28	—	9	(62)
<b>Total</b> . . . . .	<b>(984)</b>	<b>(506)</b>	<b>181<sup>(1)</sup></b>	<b>(83)</b>	<b>(1,392)</b>
<b>30 November 2008</b>					
Revaluation of financial instruments . .	(334)	389	(12)	34	77
Deferred acquisition costs . . . . .	(1,620)	346	—	30	(1,244)
Insurance and investment contract liabilities . . . . .	1,216	(352)	—	(31)	833
Withholding taxes . . . . .	(325)	262	—	(3)	(66)
Provision for expenses . . . . .	90	(22)	—	(2)	66
Losses available for offset against future taxable income . . . . .	6	(2)	—	—	4
Life surplus . . . . .	(363)	149	—	14	(200)
Other . . . . .	(62)	68	—	7	13
<b>Total</b> . . . . .	<b>(1,392)</b>	<b>838</b>	<b>(12)<sup>(1)</sup></b>	<b>49</b>	<b>(517)</b>
<b>30 November 2009</b>					
Revaluation of financial instruments . .	77	(185)	(133)	(41)	(282)
Deferred acquisition costs . . . . .	(1,244)	(187)	—	(41)	(1,472)
Insurance and investment contract liabilities . . . . .	833	170	—	38	1,041
Withholding taxes . . . . .	(66)	(16)	—	(4)	(86)
Provision for expenses . . . . .	66	(4)	—	(2)	60
Losses available for offset against future taxable income . . . . .	4	—	—	—	4
Life surplus . . . . .	(200)	(105)	—	(26)	(331)
Other . . . . .	13	5	—	1	19
<b>Total</b> . . . . .	<b>(517)</b>	<b>(322)</b>	<b>(133)<sup>(1)</sup></b>	<b>(75)</b>	<b>(1,047)</b>

Note: (1) Of the fair value reserve deferred tax charge of US\$133m for 2009, US\$139m (2008: US\$(22)m, 2007: US\$181m) relates to fair value gains and losses on available for sale financial assets and US\$6m (2008: US\$10m, 2007: US\$nil) relates to fair value gains and losses on available for sale financial assets transferred to the income statement on disposal or impairment

## 11. Disposal groups held for sale

On 28 August 2009, AIA-B agreed to sell AIA (Bermuda) Services Inc. and transfer a block of life insurance policies through a business transfer to ALICO for an aggregate consideration of US\$1.

As a result, the assets and liabilities have been presented as held for sale at 30 November 2009. Refer to Note 8 for additional information.

The following table shows the assets and liabilities of the disposal group classified as held for sale.

	<b>30 November 2009</b>
	<u>US\$m</u>
Available for sale — debt securities . . . . .	50
Other assets . . . . .	5
Cash and cash equivalents . . . . .	<u>3</u>
<b>Total assets</b> . . . . .	<b><u>58</u></b>
Insurance contract liabilities . . . . .	57
Other liabilities . . . . .	<u>1</u>
<b>Total liabilities</b> . . . . .	<b><u>58</u></b>

## 12. Earnings per share

### *Basic*

Basic earnings per share is calculated by dividing the profit attributable to the owners of AIA by the weighted average number of ordinary shares in issue during the year.

	<b>Year ended 30 November 2007</b>	<b>Year ended 30 November 2008</b>	<b>Year ended 30 November 2009</b>
Net profit attributable to shareholders of AIA (US\$m) . . . . .	2,133	473	1,916
Weighted average number of ordinary shares in issue (million) . . . . .	12,000	12,000	12,000
<b>Basic earnings per share (cents per share)</b> . . . . .	<b><u>18</u></b>	<b><u>4</u></b>	<b><u>16</u></b>

### *Diluted*

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The AIA Group's only potentially dilutive instruments during the years presented are the share yet to be issued at 30 November 2009 as described in note 34.

	<b>Year ended 30 November 2007</b>	<b>Year ended 30 November 2008</b>	<b>Year ended 30 November 2009</b>
Net profit attributable to shareholders of AIA (US\$m) . . . . .	2,133	473	1,916
Weighted average number of ordinary shares for diluted earnings per share (million) . . . . .	12,000	12,000	12,000
<b>Diluted earnings per share (cents per share)</b> . . . . .	<b><u>18</u></b>	<b><u>4</u></b>	<b><u>16</u></b>

### *Operating profit per share*

Operating profit (see Note 5) per share is calculated by dividing the operating profit after tax attributable to the owners of AIA by the weighted average number of ordinary shares in issue during the year. The AIA Group's only potentially dilutive instruments during the years presented are the shares yet to be issued at 30 November 2009 as described in note 34.

	<b>Year ended 30 November 2007</b>	<b>Year ended 30 November 2008</b>	<b>Year ended 30 November 2009</b>
Basic and fully diluted (cents per share) . . . . .	<u>11</u>	<u>13</u>	<u>12</u>

## 13. Dividends

	<b>Year ended 30 November 2007</b>	<b>Year ended 30 November 2008</b>	<b>Year ended 30 November 2009</b>
	<u>US\$m</u>		
<b>Ordinary dividends declared and charged to equity in the period</b> . . . . .	<b><u>261</u></b>	<b><u>346</u></b>	<b><u>25</u></b>

Dividends declared and charged to equity reflect dividends declared by the subsidiaries of the AIA Group to their former parent companies.

#### 14. Intangible assets

	<u>Goodwill</u>	<u>Computer software</u>	<u>Distribution and other rights</u>	<u>Total</u> US\$m
<b>Cost</b>				
At 1 December 2006	144	81	5	230
Additions	—	22	—	22
Foreign exchange movements	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>
At 30 November 2007	145	103	5	253
Additions	—	20	18	38
Disposals	—	(8)	—	(8)
Foreign exchange movements	<u>(1)</u>	<u>(5)</u>	<u>—</u>	<u>(6)</u>
At 30 November 2008	144	110	23	277
Additions	8	23	5	36
Acquisitions of a subsidiary	—	—	15	15
Disposals	—	(4)	(18)	(22)
Disposal of a subsidiary	(23)	(1)	—	(24)
Foreign exchange movements	<u>—</u>	<u>8</u>	<u>(1)</u>	<u>7</u>
<b>At 30 November 2009</b>	<b><u>129</u></b>	<b><u>136</u></b>	<b><u>24</u></b>	<b><u>289</u></b>
<b>Accumulated amortisation</b>				
At 1 December 2006	(6)	(39)	—	(45)
Amortisation charge for the year	—	(7)	—	(7)
Foreign exchange movements	—	(1)	—	(1)
At 30 November 2007	<u>(6)</u>	<u>(47)</u>	<u>—</u>	<u>(53)</u>
Amortisation charge for the year	—	(3)	—	(3)
Disposals	—	8	—	8
Foreign exchange rate movements	—	3	—	3
At 30 November 2008	(6)	(39)	—	(45)
Amortisation charge for the year	—	(8)	(1)	(9)
Disposal of a subsidiary	—	1	—	1
Foreign exchange rate movements	<u>—</u>	<u>(3)</u>	<u>—</u>	<u>(3)</u>
<b>At 30 November 2009</b>	<b><u>(6)</u></b>	<b><u>(49)</u></b>	<b><u>(1)</u></b>	<b><u>(56)</u></b>
<b>Net book value</b>				
At 30 November 2007	139	56	5	<b>200</b>
At 30 November 2008	138	71	23	<b>232</b>
At 30 November 2009	123	87	23	<b>233</b>

Of the above, US\$224m (2007: US\$191m; 2008: US\$210m) is expected to be recovered more than 12 months after the end of the reporting period.

#### *Goodwill*

Goodwill arises primarily in respect of the AIA Group's insurance businesses. Impairment testing is performed by comparing the carrying value of goodwill with the present value of expected future cash flows plus a multiple of the present value of the new business generated.

## 15. Investments in associates and joint ventures

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
	US\$m		
<b>AIA Group</b>			
At 1 December . . . . .	438	63	47
Cash distributions (see Note 4 for details) . . . . .	(190)	—	—
Additions . . . . .	8	48	24
Disposals . . . . .	(297)	(17)	(1)
Share of net (loss)/profit . . . . .	99	(28)	(21)
Foreign exchange movements . . . . .	5	(19)	4
<b>At 30 November</b> . . . . .	<b><u>63</u></b>	<b><u>47</u></b>	<b><u>53</u></b>

The AIA Group's interest in its principal associates and joint ventures is as follows:

	Country of incorporation	Type of Shares held	Principal activity	Percentage interest held		
				As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
AIG Card (Thailand) Company Limited . . . . .	Thailand	Ordinary	Credit card business	39%	39%	—
AIG Consulting Services Company Limited . . . . .	China	Ordinary	Consultancy service	50%	—	—
AIG Credit Card Co. (HK) Limited . . . . .	Hong Kong	Ordinary	Credit card business	50%	—	—
Beacon Property Ventures, Inc. . . . .	Philippines	Ordinary	Property management	40%	40%	40%
Chelshire Investments Private Limited . . . . .	Singapore	Ordinary	Property management	50%	50%	50%
Chelville Investments Private Limited . . . . .	Singapore	Ordinary	Property management	50%	50%	50%
Deeptro Private Limited . . . . .	Singapore	Ordinary	Property management	50%	50%	50%
Grange Development Private Limited . . . . .	Singapore	Ordinary	Property development	23.25%	—	—
ICCP Holdings Inc. . . . .	Philippines	Ordinary	Investment holding	20%	20%	20%
Manila Exposition Complex, Inc. . . . .	Philippines	Ordinary	Hotel	10%	10%	10%
NaiLert Park Hotel Co. Limited . . . . .	Thailand	Ordinary	Property management	20%	20%	20%
Panareno Sendrian Berhad . . . . .	Malaysia	Ordinary and preference	Property management	35%	35%	35%
Philam Realty . . . . .	Philippines	Ordinary	Property management	40%	40%	40%
Science Park of the Philippines . . . . .	Philippines	Ordinary	Property management	17%	17%	17%
Tata AIG Life Insurance Company Limited . . . . .	India	Ordinary	Insurance	26%	26%	26%
Winfame Investments Private Limited . . . . .	Singapore	Ordinary	Property management	50%	50%	50%
Winwave Investments Private Limited . . . . .	Singapore	Ordinary	Property management	50%	50%	50%

In 2008, AIG Consulting Services Company Limited in China became a subsidiary. All associates and joint ventures are unlisted.

*Aggregated financial information of associates and joint ventures*

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
			US\$m
Share of income . . . . .	241	65	146
Share of expenses . . . . .	<u>(142)</u>	<u>(93)</u>	<u>(167)</u>
<b>Share of profit/(loss) . . . . .</b>	<b><u>99</u></b>	<b><u>(28)</u></b>	<b><u>(21)</u></b>
Share of current assets . . . . .	265	221	425
Share of long term assets . . . . .	161	195	186
Share of current liabilities . . . . .	(239)	(73)	(30)
Share of long term liabilities . . . . .	<u>(124)</u>	<u>(296)</u>	<u>(528)</u>
<b>Share of net assets . . . . .</b>	<b><u>63</u></b>	<b><u>47</u></b>	<b><u>53</u></b>

Investments in associates and joint ventures are held for their long term contribution to the AIA Group's performance and so all amounts are expected to be realised more than 12 months after the end of the reporting period.

**16. Property, plant and equipment**

	Property held for use	Fixtures and fittings	Computer hardware	Total US\$m
<b>Cost</b>				
At 1 December 2006 . . . . .	339	194	133	666
Additions . . . . .	22	27	28	77
Disposals . . . . .	—	(7)	(7)	(14)
Foreign exchange movements . . . . .	<u>24</u>	<u>—</u>	<u>(1)</u>	<u>23</u>
At 30 November 2007 . . . . .	385	214	153	752
Additions . . . . .	4	45	18	67
Disposals . . . . .	(10)	(8)	(6)	(24)
Transfers from investment property . . . . .	5	—	—	5
Foreign exchange movements . . . . .	<u>(18)</u>	<u>(19)</u>	<u>(12)</u>	<u>(49)</u>
At 30 November 2008 . . . . .	366	232	153	751
Additions . . . . .	2	15	20	37
Disposals . . . . .	—	(19)	(16)	(35)
Transfers from investment property . . . . .	62	—	—	62
Acquisition of a subsidiary . . . . .	7	—	1	8
Disposal of a subsidiary . . . . .	(1)	(3)	(1)	(5)
Foreign exchange movements . . . . .	<u>20</u>	<u>15</u>	<u>9</u>	<u>44</u>
<b>At 30 November 2009 . . . . .</b>	<b><u>456</u></b>	<b><u>240</u></b>	<b><u>166</u></b>	<b><u>862</u></b>
<b>Accumulated depreciation</b>				
At 1 December 2006 . . . . .	(118)	(135)	(104)	(357)
Depreciation charge . . . . .	(11)	(18)	(16)	(45)
Disposals . . . . .	—	4	4	8
Foreign exchange movements . . . . .	<u>(7)</u>	<u>—</u>	<u>1</u>	<u>(6)</u>
At 30 November 2007 . . . . .	(136)	(149)	(115)	(400)
Depreciation charge . . . . .	(13)	(26)	(22)	(61)
Disposals . . . . .	5	4	5	14
Foreign exchange movements . . . . .	<u>8</u>	<u>12</u>	<u>11</u>	<u>31</u>
At 30 November 2008 . . . . .	(136)	(159)	(121)	(416)
Depreciation charge . . . . .	(13)	(23)	(23)	(59)
Disposals . . . . .	—	14	15	29
Disposal of a subsidiary . . . . .	—	3	1	4
Foreign exchange movements . . . . .	<u>(9)</u>	<u>(9)</u>	<u>(7)</u>	<u>(25)</u>
<b>At 30 November 2009 . . . . .</b>	<b><u>(158)</u></b>	<b><u>(174)</u></b>	<b><u>(135)</u></b>	<b><u>(467)</u></b>
<b>Net book value</b>				
At 30 November 2007 . . . . .	249	65	38	<b>352</b>
At 30 November 2008 . . . . .	230	73	32	<b>335</b>
At 30 November 2009 . . . . .	298	66	31	<b>395</b>

The AIA Group holds property, plant and equipment for its long term use and, accordingly, the annual depreciation charge approximates to the amount expected to be recovered through consumption within 12 months after the end of the reporting period.

## 17. Investment property

	<b>Investment Property</b>
	<b>US\$m</b>
<b>Valuation</b>	
At 1 December 2006 . . . . .	405
Additions resulting from acquisitions . . . . .	884
Additions resulting from subsequent expenditure . . . . .	2
Net gain/(loss) from fair value adjustments . . . . .	139
Foreign exchange and other movements . . . . .	<u>28</u>
At 30 November 2007 . . . . .	1,458
Additions resulting from acquisitions . . . . .	40
Additions resulting from subsequent expenditures . . . . .	7
Disposals . . . . .	(13)
Net gain/(loss) from fair value adjustments . . . . .	(23)
Transfers to property, plant and equipment . . . . .	(5)
Foreign exchange and other movements . . . . .	<u>(54)</u>
At 30 November 2008 . . . . .	1,410
Additions resulting subsequent expenditure . . . . .	2
Additions resulting from acquisitions through business combination . . . . .	13
Net transfers to property, plant and equipment . . . . .	(62)
Net gain/(loss) from fair value adjustments . . . . .	228
Foreign exchange and other movements . . . . .	<u>1</u>
<b>At 30 November 2009</b>	<b><u>1,592</u></b>

The AIA Group leases out its investment property under operating leases. The leases typically run for an initial period of two to twelve years, with an option to renew the lease based on future negotiations. Lease payments are usually negotiated every two years to reflect market rentals. None of the leases include contingent rentals. Rental income generated from investment properties amounted to US\$68m (2007: US\$25m; 2008: US\$63m). Direct operating expenses (including repair and maintenance) on investment property that generates rental income amounted to US\$12m (2007: US\$22m; 2008: US\$25m).

The future minimum operating lease rental income under non-cancellable operating leases that the AIA Group expects to receive in future periods may be analysed as follows:

	<b>As at 30 November 2007</b>	<b>As at 30 November 2008</b>	<b>As at 30 November 2009</b>
	<b>US\$m</b>		
<b>Leases of investment property</b>			
Expiring no later than one year . . . . .	42	47	56
Expiring later than one year and no less than five years . . . . .	100	95	104
Expiring after five years or more . . . . .	<u>23</u>	<u>21</u>	<u>12</u>
<b>Total</b> . . . . .	<b><u>165</u></b>	<b><u>163</u></b>	<b><u>172</u></b>

## 18. Fair value of property held for use

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009 US\$m
<b>Carrying value<sup>(1)</sup></b>			
Property held for use (classified as property, plant and equipment) . . . . .	249	230	298
Leasehold land (classified as prepayments in other assets) . . . . .	<u>139</u>	<u>143</u>	<u>145</u>
<b>Total</b> . . . . .	<u>388</u>	<u>373</u>	<u>443</u>
<b>Fair value<sup>(1)</sup></b>			
Properties held for use (including land) . . . . .	827	748	870

Note: (1) Carrying and fair values are presented before non-controlling interests and, for assets held in participating funds, before allocation to policyholders.

## 19. Reinsurance assets

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009 US\$m
Amounts recoverable from reinsurers . . . . .	87	19	29
Ceded insurance and investment contract liabilities . . . . .	<u>2,581</u>	<u>128</u>	<u>255</u>
<b>Total</b> . . . . .	<u>2,668</u>	<u>147</u>	<u>284</u>

## 20. Deferred acquisition and origination costs

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009 US\$m
<b>Carrying amount</b>			
Deferred acquisition costs on insurance contracts . . . . .	9,188	9,082	10,123
Deferred origination costs on investment contracts . . . . .	<u>856</u>	<u>965</u>	<u>853</u>
<b>Total</b> . . . . .	<u>10,044</u>	<u>10,047</u>	<u>10,976</u>

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>Movements in the period</b>			
<b>At 1 December</b> . . . . .	<b>8,135</b>	<b>10,044</b>	<b>10,047</b>
Deferral and amortisation of acquisition costs . . . . .	1,249	695	308
Foreign exchange movements . . . . .	336	(1,150)	827
Recapture of reinsurance treaty (see Note 5) . . . . .	—	505	—
Impact of assumption changes . . . . .	86	11	(101)
Acquisition of a subsidiary . . . . .	—	—	31
Disposal of a subsidiary . . . . .	—	—	(70)
Other movements . . . . .	<u>238</u>	<u>(58)</u>	<u>(66)</u>
<b>At 30 November</b> . . . . .	<u><b>10,044</b></u>	<u><b>10,047</b></u>	<u><b>10,976</b></u>

Deferred acquisition and origination costs are expected to be recoverable over the mean term of the AIA Group's insurance and investment contracts, and liability adequacy testing is performed at least annually to confirm their recoverability. Accordingly, the annual amortisation charge, which varies with investment performance for certain universal life and investment-linked products, approximates to the amount which is expected to be realised within 12 months of the end of the reporting period.

## 21. Financial investments

The following tables analyse the AIA Group's financial investments by type and nature. The AIA Group manages its financial investments in two distinct categories: Investment-linked Investments and Policyholder and Shareholder Investments. The investment risk in respect of Investment-linked Investments is generally wholly borne by our customers, and does not directly affect the profit for the year before tax. Furthermore, investment-linked contract holders are responsible for allocation of their policy values amongst investment options offered by the AIA Group. Although profit for the year before tax is not affected by Investment-linked Investments, the investment return from such financial investments is included in the AIA Group's profit for the year before tax, as the AIA Group has elected the fair value option for all Investment-linked Investments with corresponding change in insurance and investment contract liabilities for investment-linked contracts. Policyholder and Shareholder Investments include all financial investments other than Investment-linked Investments. The investment risk in respect of Policyholder and Shareholder Investments is partially or wholly borne by the AIA Group.

Policyholder and Shareholder Investments are further categorised as Participating Funds and Other Policyholder and Shareholder. The AIA Group has elected to separately analyse financial investments held by Participating Funds within Policyholder and Shareholder Investments as they are subject to local regulations that generally prescribe a minimum proportion of policyholder participation in declared dividends. The AIA Group has elected the fair value option for debt and equity securities of Participating Funds. The accounting policy is to record an insurance liability of the net assets of participating funds. As a result the AIA Group's net profit for the year before tax is not directly impacted by the fair value of Participating Fund assets.

Other Policyholder and Shareholder Investments are distinct from Investment-linked Investments and Participating Funds as there is no direct contractual or regulatory requirement governing the amount, if any, for allocation to policyholders. The AIA Group has elected to apply the fair value option for equity securities in this category and the available for sale classification in respect of the majority of debt securities in this category. The investment risk from investments in this category directly impacts the AIA Group's financial information. Although a proportion of investment return may be allocated to policyholders through policyholder dividends, the AIA Group's accounting policy for insurance and investment contract liabilities utilises a net level premium methodology that includes best estimates as at the date of issue for non-guaranteed participation. To the extent investment return from these investments either is not allocated to participating contracts or varies from the best estimates, it will impact the AIA Group's profit before tax.

In the following tables, "FVTPL" indicates financial investments designated at fair value through profit or loss and "AFS" indicates financial investments classified as available for sale.

### *Debt securities*

In compiling these tables, external ratings have been used where available. Where external ratings are not readily available an internal rating methodology has been adopted. The following conventions have been adopted to conform the various ratings.

<u>Standard and Poor's</u>	<u>External ratings</u> <u>Moody's</u>	<u>Internal ratings</u>	<u>Reported as</u>
AAA	Aaa	+1/-1	AAA
AA+ to AA-	Aa1 to Aa3	+2/-2	AA
A+ to A-	A1 to A3	+3/-3	A
BBB+ to BBB-	Baa1 to Baa3	+4/-4	BBB
BB+ and below	Ba1 and below	+5 and below	Below investment grade

Debt securities by type comprise the following:

	Rating	Policyholder and shareholder			Sub-total	Investment-linked FVTPL	Total US\$m
		Participating funds	Other policyholder and shareholder				
		FVTPL	FVTPL	AFS			
<b>30 November 2007</b>							
<b>Government bonds — issued in local currency</b>							
Singapore . . . . .	AAA	1,374	—	472	1,846	51	1,897
Thailand . . . . .	A	—	—	5,826	5,826	—	5,826
Philippines . . . . .	BB	—	—	1,200	1,200	30	1,230
Malaysia . . . . .	A	1,154	—	220	1,374	1	1,375
China . . . . .	A	220	—	675	895	30	925
Indonesia . . . . .	BB	—	—	514	514	86	600
Korea . . . . .	A	—	—	1,399	1,399	16	1,415
Other <sup>(1)</sup> . . . . .		36	33	244	313	—	313
<b>Sub-total . . . . .</b>		<b>2,784</b>	<b>33</b>	<b>10,550</b>	<b>13,367</b>	<b>214</b>	<b>13,581</b>
<b>Government bonds — foreign currency</b>							
Mexico . . . . .	BBB	1	15	152	168	—	168
South Africa . . . . .	BBB	—	2	101	103	1	104
Philippines . . . . .	BB	4	22	606	632	39	671
Malaysia . . . . .	A	115	—	192	307	1	308
Indonesia . . . . .	BB	63	9	288	360	17	377
Korea . . . . .	A	101	—	264	365	1	366
China . . . . .	A	9	—	44	53	1	54
Other <sup>(1)</sup> . . . . .		86	173	197	456	12	468
<b>Sub-total . . . . .</b>		<b>379</b>	<b>221</b>	<b>1,844</b>	<b>2,444</b>	<b>72</b>	<b>2,516</b>
<b>Government agency bonds<sup>(2)</sup></b>							
. . . . .	AAA	898	—	438	1,336	31	1,367
. . . . .	AA	45	—	245	290	35	325
. . . . .	A	437	—	2,728	3,165	63	3,228
. . . . .	BBB	533	—	1,351	1,884	16	1,900
. . . . .	Below investment grade	7	2	76	85	3	88
. . . . .	Not rated	—	—	102	102	16	118
<b>Sub-total . . . . .</b>		<b>1,920</b>	<b>2</b>	<b>4,940</b>	<b>6,862</b>	<b>164</b>	<b>7,026</b>
<b>Corporate bonds</b>							
. . . . .	AAA	72	—	229	301	59	360
. . . . .	AA	1,773	66	1,657	3,496	281	3,777
. . . . .	A	2,034	175	5,887	8,096	292	8,388
. . . . .	BBB	1,091	108	3,865	5,064	200	5,264
. . . . .	Below investment grade	319	227	625	1,171	151	1,322
. . . . .	Not rated	—	53	29	82	37	119
<b>Sub-total . . . . .</b>		<b>5,289</b>	<b>629</b>	<b>12,292</b>	<b>18,210</b>	<b>1,020</b>	<b>19,230</b>

Note: (1) Of the total government bonds listed as 'Other' at 30 November 2007, 70% is rated as investment grade and a further 21% is rated BB- and above. The balance is rated below BB- or unrated

Note: (2) Government agency bonds comprise bonds issued by government sponsored institutions such as state owned enterprises, provincial and municipal authorities and supranational financial institutions, such as the Asian Development Bank

Rating	Policyholder and shareholder			Sub-total	Investment-linked FVTPL	Total US\$m
	Participating funds	Other policyholder and shareholder				
	FVTPL	FVTPL	AFS			
<b>30 November 2007</b>						
<b>Structured securities<sup>(3)</sup></b>						
AAA	32	79	887	998	—	998
AA	115	120	33	268	—	268
A	122	41	277	440	—	440
BBB	133	—	87	220	3	223
Below investment grade	22	14	35	71	15	86
Not rated	17	9	10	36	—	36
<b>Sub-total . . . . .</b>	<b>441</b>	<b>263</b>	<b>1,329</b>	<b>2,033</b>	<b>18</b>	<b>2,051</b>
<b>Total . . . . .</b>	<b>10,813</b>	<b>1,148</b>	<b>30,955</b>	<b>42,916</b>	<b>1,488</b>	<b>44,404</b>

Note: (3) Structured securities include CDOs, mortgage backed securities and other asset backed securities

	Rating	Policyholder and shareholder					Investment-linked FVTPL	Total US\$m
		Participating funds		Other policyholder and shareholder		Sub-total		
		FVTPL	FVTPL	AFS				
<b>30 November 2008</b>								
<b>Government bonds — issued in local currency</b>								
Singapore	AAA	1,166	—	547	1,713	69	1,782	
Thailand	A	—	—	6,377	6,377	—	6,377	
Philippines	BB	—	—	862	862	12	874	
Malaysia	A	1,192	—	290	1,482	3	1,485	
China	A	244	—	723	967	70	1,037	
Indonesia	BB	—	—	315	315	59	374	
Korea	A	—	—	857	857	6	863	
Other <sup>(1)</sup>		11	2	231	244	—	244	
<b>Sub-total</b>		<b><u>2,613</u></b>	<b><u>2</u></b>	<b><u>10,202</u></b>	<b><u>12,817</u></b>	<b><u>219</u></b>	<b><u>13,036</u></b>	
<b>Government bonds — foreign currency</b>								
Mexico	BBB	15	11	141	167	3	170	
South Africa	BBB	—	1	115	116	2	118	
Philippines	BB	1	12	452	465	18	483	
Malaysia	A	80	—	186	266	2	268	
Indonesia	BB	39	7	206	252	5	257	
Korea	A	—	—	67	67	2	69	
China	A	10	—	49	59	2	61	
Other <sup>(1)</sup>		49	95	310	454	8	462	
<b>Sub-total</b>		<b><u>194</u></b>	<b><u>126</u></b>	<b><u>1,526</u></b>	<b><u>1,846</u></b>	<b><u>42</u></b>	<b><u>1,888</u></b>	
<b>Government agency bonds<sup>(2)</sup></b>								
	AAA	654	—	536	1,190	15	1,205	
	AA	17	—	378	395	65	460	
	A	610	—	2,459	3,069	100	3,169	
	BBB	509	—	1,868	2,377	6	2,383	
	Below investment grade	1	2	261	264	1	265	
	Not rated	—	—	—	—	33	33	
<b>Sub-total</b>		<b><u>1,791</u></b>	<b><u>2</u></b>	<b><u>5,502</u></b>	<b><u>7,295</u></b>	<b><u>220</u></b>	<b><u>7,515</u></b>	
<b>Corporate bonds</b>								
	AAA	47	—	178	225	78	303	
	AA	1,630	55	1,586	3,271	298	3,569	
	A	2,113	150	5,718	7,981	292	8,273	
	BBB	1,227	132	4,038	5,397	211	5,608	
	Below investment grade	199	250	548	997	45	1,042	
	Not rated	19	65	1	85	47	132	
<b>Sub-total</b>		<b><u>5,235</u></b>	<b><u>652</u></b>	<b><u>12,069</u></b>	<b><u>17,956</u></b>	<b><u>971</u></b>	<b><u>18,927</u></b>	

Note: (1) Of the total government bonds listed as 'Other' at 30 November 2008, 83% is rated as investment grade and a further 16% is rated BB- and above. The balance is rated below BB- or unrated

Note: (2) Government agency bonds comprise bonds issued by government sponsored institutions such as state owned enterprises, provincial and municipal authorities and supranational financial institutions, such as the Asian Development Bank

Rating	Policyholder and shareholder			Sub-total	Investment-linked FVTPL	Total US\$m
	Participating funds	Other policyholder and shareholder				
	FVTPL	FVTPL	AFS			
<b>30 November 2008</b>						
<b>Structured securities<sup>(3)</sup></b>						
AAA	15	30	434	479	—	479
AA	35	37	—	72	—	72
A	22	2	54	78	—	78
BBB	141	—	77	218	1	219
Below investment grade	24	1	70	95	14	109
<b>Sub-total</b>	<b>237</b>	<b>70</b>	<b>635</b>	<b>942</b>	<b>15</b>	<b>957</b>
<b>Total</b>	<b>10,070</b>	<b>852</b>	<b>29,934</b>	<b>40,856</b>	<b>1,467</b>	<b>42,323</b>

Note: (3) Structured securities include CDOs, mortgage backed securities and other asset backed securities

Rating	Policyholder and shareholder			Sub-total	Investment-linked FVTPL	Total US\$m	
	Participating funds	Other policyholder and shareholder					
	FVTPL	FVTPL	AFS				
<b>30 November 2009 Government bonds — issued in local currency</b>							
Singapore	AAA	1,496	—	759	2,255	70	2,325
Thailand	A	—	—	7,374	7,374	—	7,374
Philippines	BB	—	—	1,309	1,309	22	1,331
Malaysia	A	953	—	196	1,149	1	1,150
China	A	271	—	836	1,107	3	1,110
Indonesia	BB	—	—	494	494	115	609
Korea	A	—	—	1,539	1,539	4	1,543
Other <sup>1</sup>		1	4	312	317	—	317
<b>Sub-total</b>		<b>2,721</b>	<b>4</b>	<b>12,819</b>	<b>15,544</b>	<b>215</b>	<b>15,759</b>
<b>Government bonds — foreign currency</b>							
Mexico	BBB	9	15	135	159	2	161
South Africa	BBB	—	2	164	166	2	168
Philippines	BB	2	10	749	761	46	807
Malaysia	A	11	—	77	88	1	89
Indonesia	BB	48	10	210	268	—	268
Korea	A	16	1	205	222	2	224
China	A	—	—	46	46	2	48
Other <sup>1</sup>		53	92	291	436	10	446
<b>Sub-total</b>		<b>139</b>	<b>130</b>	<b>1,877</b>	<b>2,146</b>	<b>65</b>	<b>2,211</b>
<b>Government agency bonds<sup>2</sup></b>							
AAA		542	—	694	1,236	64	1,300
AA		1	—	194	195	64	259
A		611	—	2,797	3,408	116	3,524
BBB		873	—	1,583	2,456	4	2,460
Below investment grade		—	—	346	346	—	346
Not rated		—	—	—	—	8	8
<b>Sub-total</b>		<b>2,027</b>	<b>—</b>	<b>5,614</b>	<b>7,641</b>	<b>256</b>	<b>7,897</b>

Note: (1) Of the total government bonds listed as 'Other' at 30 November 2009, 85% is rated as investment grade and a further 14% is rated BB- and above. The balance is rated below BB- or unrated

Note: (2) Government agency bonds comprise bonds issued by government sponsored institutions such as state owned enterprises, provincial and municipal authorities and supranational financial institutions, such as the Asian Development Bank

Rating	Policyholder and shareholder			Sub-total	Investment-linked FVTPL	Total US\$m
	Participating funds	Other policyholder and shareholder				
	FVTPL	FVTPL	AFS			
<b>30 November 2009 Corporate bonds</b>						
AAA	237	—	296	533	34	567
AA	1,397	79	1,757	3,233	253	3,486
A	2,960	188	8,149	11,297	454	11,751
BBB	1,656	348	5,726	7,730	198	7,928
Below investment grade	198	32	876	1,106	41	1,147
Not rated	127	70	51	248	190	438
<b>Sub-total</b>	<b>6,575</b>	<b>717</b>	<b>16,855</b>	<b>24,147</b>	<b>1,170</b>	<b>25,317</b>
<b>Structured securities<sup>3</sup></b>						
AAA	7	22	—	29	—	29
AA	—	—	—	—	—	—
A	39	—	424	463	—	463
BBB	247	20	90	357	5	362
Below investment grade	51	51	41	143	15	158
Not rated	3	—	2	5	—	5
<b>Sub-total</b>	<b>347</b>	<b>93</b>	<b>557</b>	<b>997</b>	<b>20</b>	<b>1,017</b>
<b>Total</b>	<b>11,809</b>	<b>944</b>	<b>37,722</b>	<b>50,475</b>	<b>1,726</b>	<b>52,201</b>

Note: (3) Structured securities include CDOs, mortgage backed securities and other asset backed securities

### Equity securities

Equity securities by type comprise the following:

	Policyholder and shareholder			Subtotal	Investment-linked FVTPL	Total US\$m
	Participating funds	Other policyholder and shareholder				
	FVTPL	FVTPL	AFS			
<b>30 November 2007</b>						
Ordinary shares	1,629	2,817	—	4,446	2,268	6,714
Securities held by consolidated mutual funds managed by AIG	107	1,047	—	1,154	1,558	2,712
Interests in investment funds						
AIG managed	364	352	—	716	1,380	2,096
Non-AIG managed	221	42	—	263	5,834	6,097
	585	394	—	979	7,214	8,193
Shares in AIG	—	—	2,520	2,520	—	2,520
<b>Total</b>	<b>2,321</b>	<b>4,258</b>	<b>2,520</b>	<b>9,099</b>	<b>11,040</b>	<b>20,139</b>

	Policyholder and shareholder					Total US\$m
	Participating funds	Other policyholder and shareholder		Subtotal	Investment- linked	
		FVTPL	FVTPL			
<b>30 November 2008</b>						
Ordinary shares . . . . .	705	1,000	—	1,705	1,211	2,916
Securities held by consolidated mutual funds managed by AIG . . . . .	109	619	—	728	805	1,533
Interests in investment funds						
AIG managed . . . . .	158	197	—	355	851	1,206
Non-AIG managed . . . . .	151	39	—	190	2,815	3,005
	309	236	—	545	3,666	4,211
Shares in AIG . . . . .	—	—	87	87	—	87
<b>Total</b> . . . . .	<b>1,123</b>	<b>1,855</b>	<b>87</b>	<b>3,065</b>	<b>5,682</b>	<b>8,747</b>

	Policyholder and shareholder					Total US\$m
	Participating funds	Other policyholder and shareholder		Subtotal	Investment- linked	
		FVTPL	FVTPL			
<b>30 November 2009</b>						
Ordinary shares . . . . .	1,685	2,008	—	3,693	2,738	6,431
Securities held by consolidated mutual funds managed by AIG . . . . .	167	494	—	661	1,333	1,994
Interests in investment funds						
AIG managed . . . . .	116	132	—	248	1,232	1,480
Non-AIG managed . . . . .	241	193	—	434	5,777	6,211
	357	325	—	682	7,009	7,691
Shares in AIG . . . . .	—	—	62	62	—	62
<b>Total</b> . . . . .	<b>2,209</b>	<b>2,827</b>	<b>62</b>	<b>5,098</b>	<b>11,080</b>	<b>16,178</b>

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
			US\$m

#### Debt securities

Listed			
Hong Kong . . . . .	377	421	394
Overseas . . . . .	25,344	20,010	30,663
	25,721	20,431	31,057
Unlisted . . . . .	18,683	21,892	21,144
<b>Total</b> . . . . .	<b>44,404</b>	<b>42,323</b>	<b>52,201</b>

#### Equity securities

Listed			
Hong Kong . . . . .	238	47	399
Overseas . . . . .	12,675	3,093	6,606
	12,913	3,140	7,005
Unlisted . . . . .	7,226	5,607	9,173
<b>Total</b> . . . . .	<b>20,139</b>	<b>8,747</b>	<b>16,178</b>

## Loans and receivables

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
			US\$m
Policy loans . . . . .	1,327	1,437	1,644
Mortgage loans on residential real estate . . . . .	609	587	527
Mortgage loans on commercial real estate . . . . .	112	105	48
Intercompany loans to fellow subsidiaries of AIG (see Note 41) . . . . .	1,589	29	87
Other loans . . . . .	182	242	446
Allowance for loan losses . . . . .	<u>(15)</u>	<u>(7)</u>	<u>(12)</u>
<b>Loans</b> . . . . .	<b>3,804</b>	<b>2,393</b>	<b>2,740</b>
Due from insurance and investment contract holders . . . . .	471	536	546
Due from agents, brokers and intermediaries . . . . .	<u>9</u>	<u>13</u>	<u>39</u>
Insurance receivables . . . . .	480	549	585
Related party receivables . . . . .	95	33	1
Receivables from sales of investments . . . . .	329	86	34
Other receivables . . . . .	<u>362</u>	<u>285</u>	<u>396</u>
<b>Receivables</b> . . . . .	<b>1,266</b>	<b>953</b>	<b>1,016</b>
Term deposits . . . . .	<u>595</u>	<u>656</u>	<u>892</u>
<b>Total<sup>(1)</sup></b> . . . . .	<b><u>5,665</u></b>	<b><u>4,002</u></b>	<b><u>4,648</u></b>

Note: (1) Of total loans and receivables, US\$33m of term deposits (2007: US\$38m; 2008: US\$48m), and US\$75m of other loans (2007: US\$62m; 2008: 60m) are held to back investment-linked contracts. The balance of loans and receivables consists of policyholder and shareholder. Of this, US\$942m relates to participating funds (2007: US\$1,136m; 2008: US\$986m).

Certain term deposits with financial institutions are restricted due to local regulatory requirements or other pledge restrictions. The restricted balance held within the term deposits classification is US\$104m (2007: US\$128m; 2008: US\$141m).

All insurance receivables are expected to be recovered within less than one year. Accordingly, no ageing analysis has been provided.

Receivables include receivables from reverse repurchase agreements under which the AIA Group does not take physical possession of securities purchased under the agreements. Sales or transfers of securities are not permitted by the respective clearing house on which they are registered while the loan is outstanding. In the event of default by the counterparty to repay the loan, the AIA Group has the right to the underlying securities held by the clearing house. At 30 November 2009 the carrying value of such receivables is US\$69m (2007: US\$67m; 2008: US\$54m).

## 22. Derivative financial instruments

The AIA Group's non-hedge derivative exposure was as follows:

	<u>Notional Amount</u>	<u>Fair value</u>	
		<u>Assets<sup>(1)(2)</sup></u>	<u>Liabilities<sup>(1)</sup></u>
		US\$m	
<b>30 November 2007</b>			
Foreign exchange contracts:			
Forwards . . . . .	17	—	—
Cross currency swaps . . . . .	<u>6,492</u>	415	<u>(37)</u>
<b>Total foreign exchange contracts . . . . .</b>	<b><u>6,509</u></b>	<b>415</b>	<b><u>(37)</u></b>
<b>Interest rate contracts</b>			
Interest rate swaps . . . . .	978	4	(10)
<b>Other</b>			
Commodity index swaps . . . . .	<u>2</u>	<u>3</u>	—
<b>Total . . . . .</b>	<b><u><u>7,489</u></u></b>	<b><u><u>422</u></u></b>	<b><u><u>(47)</u></u></b>
<b>30 November 2008</b>			
Foreign exchange contracts:			
Forwards . . . . .	333	—	(4)
Cross currency swaps . . . . .	<u>7,423</u>	228	<u>(131)</u>
<b>Total foreign exchange contracts . . . . .</b>	<b><u>7,756</u></b>	<b>228</b>	<b><u>(135)</u></b>
<b>Interest rate contracts</b>			
Interest rate swaps . . . . .	1,086	24	—
<b>Other</b>			
Commodity index swaps . . . . .	<u>20</u>	—	<u>(3)</u>
<b>Total . . . . .</b>	<b><u><u>8,862</u></u></b>	<b><u><u>252</u></u></b>	<b><u><u>(138)</u></u></b>
<b>30 November 2009</b>			
Foreign exchange contracts:			
Forwards . . . . .	222	1	—
Cross currency swaps . . . . .	<u>8,390</u>	439	<u>(69)</u>
<b>Total foreign exchange contracts . . . . .</b>	<b><u>8,612</u></b>	<b>440</b>	<b><u>(69)</u></b>
<b>Interest rate contracts</b>			
Interest rate swaps . . . . .	1,092	13	—
<b>Other</b>			
Commodity index swaps . . . . .	<u>20</u>	—	<u>(2)</u>
<b>Total . . . . .</b>	<b><u><u>9,724</u></u></b>	<b><u><u>453</u></u></b>	<b><u><u>(71)</u></u></b>

Note: (1) Derivative assets and liabilities are classified as at fair value through profit or loss as they are held for trading

(2) Of derivative assets, US\$240m are held to back participating funds (2007: US\$247m; 2008: US\$87m). The balance of derivative assets relate to other policyholder and shareholder amounts.

(3) The notional amount of derivative financial instruments with related parties amounted to US\$58m (2007: US\$43m; 2008: US\$58m)

For swap transactions, both legs of the transaction have been disclosed in the column 'notional amount'.

The AIA Group only holds over the counter ('OTC') derivatives. OTC derivative contracts are individually negotiated between contracting parties and include forwards and swaps. Derivatives are subject to various risks including market, liquidity and credit risk, similar to those related to the underlying financial instruments.

Derivative assets and derivative liabilities are recognised in the consolidated statement of financial position as financial assets at fair value through profit or loss and derivative financial liabilities respectively. The AIA Group's derivative risk management policies are outlined in Note 37. The AIA Group does not employ hedge accounting, although most of its derivative holdings may have the effect of an economic hedge of other exposures. The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities in the consolidated statement of financial position as they do not represent the fair value of these transactions. The notional amounts in the previous table reflect the aggregate of individual derivative positions on a gross basis and to give an indication of the overall scale of derivative transactions.



	Notes	Fair value		Cost/ amortised cost	Total carrying value	Total fair value US\$m
		Fair value through profit or loss	Available for sale			
<b>30 November 2008</b>						
Financial investments . . . . .	21					
Loans and receivables . . . . .		—	—	4,002	4,002	3,990
Debt securities . . . . .		12,389	29,934	—	42,323	42,323
Equity securities . . . . .		8,660	87	—	8,747	8,747
Derivative financial instruments . .	22	252	—	—	252	252
Reinsurance receivables . . . . .	19	—	—	19	19	19
Cash and cash equivalents . . . . .	25	—	—	4,164	4,164	4,164
<b>Financial assets . . . . .</b>		<b>21,301</b>	<b>30,021</b>	<b>8,185</b>	<b>59,507</b>	<b>59,495</b>

	Notes	Fair value through profit or loss	Cost/ amortised cost	Total carrying value	Total fair value US\$m
Financial liabilities					
Investment contract liabilities . . . . .	27	4,226	672	4,898	4,898
Borrowings . . . . .	29	—	661	661	661
Obligations under securities lending and repurchase agreements . . . . .	30	—	2,718	2,718	2,718
Derivative financial instruments . . . . .	22	138	—	138	138
Other liabilities and current tax liabilities <sup>(1)</sup> . .		—	1,407	1,407	1,407
<b>Financial liabilities . . . . .</b>		<b>4,364</b>	<b>5,458</b>	<b>9,822</b>	<b>9,822</b>

Note: (1) Excludes third party interests in consolidated investment funds

	Notes	Fair value		Cost/ amortised cost	Total carrying value	Total fair value US\$m
		Fair value through profit or loss	Available for sale			
<b>30 November 2009</b>						
Financial investments: . . . . .	21					
Loans and receivables . . . . .		—	—	4,648	4,648	4,688
Debt securities . . . . .		14,479	37,722	—	52,201	52,201
Equity securities . . . . .		16,116	62	—	16,178	16,178
Derivative financial instruments . .	22	453	—	—	453	453
Reinsurance receivables . . . . .	19	—	—	29	29	29
Cash and cash equivalents . . . . .	25	—	—	3,405	3,405	3,405
<b>Financial assets . . . . .</b>		<b>31,048</b>	<b>37,784</b>	<b>8,082</b>	<b>76,914</b>	<b>76,954</b>

	Notes	Fair value through profit or loss	Cost/ amortised cost	Total carrying value	Total fair value US\$m
Financial liabilities:					
Investment contract liabilities . . . . .	27	6,669	1,111	7,780	7,780
Borrowings . . . . .	29	—	688	688	688
Obligations under securities lending and repurchase agreements . . . . .	30	—	284	284	284
Derivative financial instruments . . . . .	22	71	—	71	71
Other liabilities and current tax liabilities <sup>(1)</sup> . .		—	1,800	1,800	1,800
<b>Financial liabilities . . . . .</b>		<b>6,740</b>	<b>3,883</b>	<b>10,623</b>	<b>10,623</b>

Note: (1) Excludes third party interests in consolidated investment funds

The carrying amount of assets included in the above tables represents the maximum credit exposure.

Foreign currency exposure, including the net notional amount of foreign currency derivative positions, is shown in Note 37 for the AIA Group's key foreign exchange exposures.

The fair value of investment contract liabilities measured at amortised cost is not considered to be materially different from the amortised cost carrying value.

The carrying value of financial instruments expected to be settled within 12 months (after taking into account valuation allowances, where applicable) is not considered to be materially different from the fair value.

#### ***Fair value measurements on a recurring basis***

The AIA Group measures at fair value financial instruments designated at fair value through profit or loss, available for sale securities portfolios, derivative assets and liabilities, investments held by investment funds which are consolidated, investments in non-consolidated investment funds and certain investment contract liabilities on a recurring basis. The fair value of a financial instrument is the amount that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The degree of judgement used in measuring the fair value of financial instruments generally correlates with the level of pricing observability. Financial instruments with quoted prices in active markets generally have more pricing observability and less judgement is used in measuring fair value. Conversely, financial instruments traded in other than active markets or that do not have quoted prices have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgement. An active market is one in which transactions for the asset or liability being valued occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

An other than active market is one in which there are few transactions, the prices are not current, price quotations vary substantially either over time or among market makers, or in which little information is released publicly for the asset or liability being valued. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, the characteristics specific to the transaction and general market conditions.

The following methods and assumptions were used by the AIA Group to estimate the fair value of financial instruments.

#### ***Financial assets and liabilities***

##### ***Loans and receivables***

For loans and advances that are repriced frequently and have had no significant changes in credit risk, carrying amounts represent a reasonable estimate of fair values. The fair values of other loans are estimated by discounting expected future cash flows using interest rates offered for similar loans to borrowers with similar credit ratings.

The fair values of mortgage loans are estimated by discounting future cash flows using interest rates currently being offered in respect of similar loans to borrowers with similar credit ratings. The fair values of fixed rate policy loans are estimated by discounting cash flows at the interest rates charged on policy loans of similar policies currently being issued. Loans with similar characteristics are aggregated for purposes of the calculations. The carrying values of policy loans with variable rates approximate to their fair value.

##### ***Debt securities and equity securities***

The fair values of equity securities are based on quoted market prices or, if unquoted, on estimated market values generally based on quoted prices for similar securities. Fair values for fixed interest securities are based on quoted market prices, where available. For those securities not actively traded, fair values are estimated using values obtained from private pricing services or by discounting expected future cash flows using a current market rate applicable to the yield, credit quality and maturity of the investment. For holdings in hedge funds and limited partnerships, fair values are determined based on the net asset values provided by the general partner or manager of each investment, the accounts of which are generally audited on an annual basis. The transaction price is used as the best estimate of fair value at inception.

##### ***Derivative financial instruments***

The AIA Group values its derivative financial assets and liabilities using market transactions and other market evidence whenever possible, including market based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency.

When models are used, the selection of a particular model to value a derivative depends on the contract terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. The AIA Group generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For derivatives that trade in liquid markets, such as generic forwards, swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment. Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatilities for commonly traded option products. Examples of inputs that may be unobservable include volatilities for less commonly traded option products and correlations between market factors.

#### *Cash and cash equivalents*

The carrying amount of cash approximates its fair value.

#### *Reinsurance receivables*

The carrying amount of amounts receivable from reinsurers is not considered materially different to their fair value.

#### *Fair value of securities lending invested collateral and securities lending payables*

Securities lending collateral is recorded at fair value. The contract values of securities lending payables approximate fair value as these obligations are short term in nature.

#### *Other assets*

The carrying amount of other assets is not materially different to their fair value. The fair values of deposits with banks are generally based on quoted market prices or, if unquoted, on estimates based on discounting future cash flows using available market interest rates offered for receivables with similar characteristics.

#### *Investment contract liabilities*

For investment contract liabilities the fair values have been estimated using a discounted cash flow approach based on interest rates currently being offered for similar contracts with maturities consistent with those remaining for the contracts being valued. For investment contracts where the investment risk is borne by the policyholder the fair value generally approximates to the fair value of the underlying assets.

Investment contracts with DPF enable the contract holder to receive additional benefits as a supplement to guaranteed benefits. These are referred to as participating business and are measured and classified according to the AIA Group practice for insurance contract liabilities and hence are disclosed within Note 26. These are not measured at fair value as there is currently no agreed definition of fair value for investment and insurance contracts with DPF under IFRS as adopted by the EU. In the absence of any agreed methodology it is not possible to provide a range of estimates within which fair value is likely to fall. The IASB is expecting to address this issue in Phase II of its insurance contracts project.

#### *Borrowings*

The fair values of borrowings with stated maturities have been estimated based on discounting future cash flows using the interest rates currently applicable to deposits of similar maturities.

#### *Other liabilities*

The fair value of other unquoted liabilities is estimated by discounting expected future cash flows using current market rates applicable to their yield, credit quality and maturity, except for those with no stated maturity, where the carrying value approximates to fair value.

#### *Fair value hierarchy*

Beginning on 1 December 2007, assets and liabilities recorded at fair value in the consolidated statement of financial position are measured and classified in a hierarchy for disclosure purposes consisting of three 'levels'

based on the observability of inputs available in the market place used to measure their fair values as discussed below:

- **Level 1:** Fair value measurements that are quoted prices (unadjusted) in active markets for identical assets or liabilities that the AIA Group has the ability to access as of the measurement date. Market price data is generally obtained from exchange or dealer markets. The AIA Group does not adjust the quoted price for such instruments. Assets measured at fair value on a recurring basis and classified as Level 1 are actively traded listed equities. The AIA Group considers that government debt securities issued by G7 countries (United States, Canada, France, Germany, Italy, Japan, the United Kingdom) and traded in a dealer market to be Level 1, until they no longer trade with sufficient frequency and volume to be considered actively traded.
- **Level 2:** Fair value measurements based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted prices that are observable for the asset and liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Assets and liabilities measured at fair value on a recurring basis and classified as Level 2 generally include government securities issued by non-G7 countries, most investment grade corporate bonds, hedge fund investments and derivative contracts.
- **Level 3:** Fair value measurements based on valuation techniques that use significant inputs that are unobservable. Unobservable inputs are only used to measure fair value to the extent that relevant observable inputs are not available, allowing for circumstances in which there is little, if any, market activity for the asset or liability. Assets and liabilities measured at fair value on a recurring basis and classified as Level 3 include certain classes of structured securities, certain derivative contracts, private equity and real estate fund investments, and direct private equity investments.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The AIA Group's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment. In making the assessment, the AIA Group considers factors specific to the asset or liability.

A summary of investments carried at fair value according to fair value hierarchy is given below:

	Fair value hierarchy			Total US\$m
	Level 1	Level 2	Level 3	
<b>30 November 2008</b>				
<b>Financial assets</b>				
Available for sale				
Debt securities . . . . .	—	29,665	269	29,934
Equity securities — shares in ultimate parent . . . . .	87	—	—	87
At fair value through profit or loss				
Debt securities				
Participating funds . . . . .	—	9,835	235	10,070
Investment-linked . . . . .	—	1,467	—	1,467
Other policyholder and shareholder . . . . .	—	682	170	852
Equity securities				
Participating funds . . . . .	895	97	131	1,123
Investment-linked . . . . .	5,158	506	18	5,682
Other policyholder and shareholder . . . . .	1,541	165	149	1,855
Derivative financial assets . . . . .	—	238	14	252
<b>Total</b> . . . . .	<b>7,681</b>	<b>42,655</b>	<b>986</b>	<b>51,322</b>
<i>Total%</i> . . . . .	<i>15.0</i>	<i>83.1</i>	<i>1.9</i>	<i>100.0</i>
<b>Financial liabilities</b>				
Investment contract liabilities . . . . .	—	—	4,226	4,226
Derivative financial instruments . . . . .	—	132	6	138
<b>Total</b> . . . . .	—	<b>132</b>	<b>4,232</b>	<b>4,364</b>
<i>Total%</i> . . . . .	—	<i>3.0</i>	<i>97.0</i>	<i>100.0</i>

	Fair value hierarchy			Total US\$m
	Level 1	Level 2	Level 3	
<b>30 November 2009</b>				
<b>Financial assets</b>				
Available for sale				
Debt securities . . . . .	21	37,533	168	37,722
Equity securities — shares in ultimate parent . . . . .	62	—	—	62
At fair value through profit or loss				
Debt securities				
Participating funds . . . . .	—	11,605	204	11,809
Investment-linked . . . . .	—	1,726	—	1,726
Other policyholder and shareholder . . . . .	1	665	278	944
Equity securities				
Participating funds . . . . .	2,088	15	106	2,209
Investment-linked . . . . .	10,384	696	—	11,080
Other policyholder and shareholder . . . . .	2,607	91	129	2,827
Derivative financial assets . . . . .	—	453	—	453
<b>Total . . . . .</b>	<b>15,163</b>	<b>52,784</b>	<b>885</b>	<b>68,832</b>
<i>Total%</i> . . . . .	22.0	76.7	1.3	100.0
<b>Financial liabilities</b>				
Investment contract liabilities . . . . .	—	—	6,669	6,669
Derivative financial instruments . . . . .	—	69	2	71
<b>Total . . . . .</b>	<b>—</b>	<b>69</b>	<b>6,671</b>	<b>6,740</b>
<i>Total%</i> . . . . .	—	1.0	99.0	100.0

The tables below set out a summary of changes in the AIA Group's Level 3 financial assets and liabilities for the years ended 30 November 2008 and 2009. The tables reflect gains and losses, including gains and losses on financial assets and liabilities categorised as Level 3 as at 30 November 2008 and 2009 respectively. The tables do not present gains or losses for instruments that were sold or transferred out of Level 3 prior to 1 December 2007.

*Level 3 financial assets and liabilities*

	Debt securities	Equity securities	Derivative financial assets	Derivative financial liabilities	Investment contracts
	US\$m				
<b>At 1 December 2007 . . . . .</b>	<b>1,364</b>	<b>131</b>	<b>4</b>	<b>(12)</b>	<b>(5,926)</b>
Realised gains/(losses) . . . . .	(61)	(7)	5	14	—
Net movement on investment contract liabilities . . . . .	—	—	—	—	1,700
Unrealised gains/(losses) relating to instruments held at the reporting date Reported in the consolidated income statement . . . . .	(319)	(21)	—	—	—
Reported in the consolidated statement of comprehensive income . . . . .	(174)	—	—	—	—
Purchases, issues and settlements . . . . .	121	149	(1)	—	—
Transfers in to/(out of) Level 3 . . . . .	(257)	46	6	(8)	—
<b>At 30 November 2008 . . . . .</b>	<b>674</b>	<b>298</b>	<b>14</b>	<b>(6)</b>	<b>(4,226)</b>

Level 3 financial assets and liabilities

	<u>Debt securities</u>	<u>Equity securities</u>	<u>Derivative financial assets</u>	<u>Derivative financial liabilities</u>	<u>Investment contracts</u>
					US\$m
<b>At 1 December 2008</b> .....	<b>674</b>	<b>298</b>	<b>14</b>	<b>(6)</b>	<b>(4,226)</b>
Realised gains/(losses) .....	(134)	(33)	(4)	(2)	—
Net movement on investment contract liabilities .....	—	—	—	—	(2,443)
Unrealised gains/(losses) relating to instruments still held at the reporting date					
Reported in the consolidated income statement .....	73	(23)	—	—	—
Reported in the consolidated statement of comprehensive income .....	245	—	—	—	—
Purchases, issues and settlements .....	(84)	5	—	—	—
Transfers in to/(out of) Level 3 .....	(124)	(12)	(10)	6	—
<b>At 30 November 2009</b> .....	<b><u>650</u></b>	<b><u>235</u></b>	<b><u>—</u></b>	<b><u>(2)</u></b>	<b><u>(6,669)</u></b>

Realised gains and losses arising from the disposal of the AIA Group's Level 3 financial assets and liabilities are presented in the consolidated income statement.

Movements in investment contract liabilities at fair value are offset by movements in the underlying portfolio of matching assets. Details of the movement in investment contract liabilities are provided in Note 27.

There are no differences between the fair values on initial recognition and the amounts determined using valuation techniques since the models adopted are calibrated using initial transaction prices.

Certain private equity investments are measured at cost because there is no quoted market price in an active market. The balance of such investments is US\$nil (2007: US\$1m; 2008: nil).

#### 24. Other assets

	<u>As at 30 November 2007</u>	<u>As at 30 November 2008</u>	<u>As at 30 November 2009</u>
			US\$m
Prepayments			
Operating leases of leasehold land .....	139	143	145
Other .....	45	45	50
Accrued investment income .....	725	766	854
Pension scheme assets			
Defined benefit pension scheme surpluses (Note 38) .....	8	18	20
<b>Total</b> .....	<b><u>917</u></b>	<b><u>972</u></b>	<b><u>1,069</u></b>

Included in 'Other Assets' are the following amounts which relate to the AIA Group's interest in leasehold land and land use rights which are accounted for as prepayments of operating leases.

	<u>As at 30 November 2007</u>	<u>As at 30 November 2008</u>	<u>As at 30 November 2009</u>
			US\$m
<b>Land held in Hong Kong</b>			
Long-term leases (>50 years) .....	115	115	114
Medium-term leases (10 - 50 years) .....	—	—	—
Short-term leases (<10 years) .....	—	—	—
<b>Land held outside Hong Kong</b>			
Freehold .....	—	—	—
Long-term leases (>50 years) .....	22	26	29
Medium-term leases (10 - 50 years) .....	2	2	2
Short-term leases (<10 years) .....	—	—	—
<b>Total</b> .....	<b><u>139</u></b>	<b><u>143</u></b>	<b><u>145</u></b>

All amounts other than prepayments in respect of operating leases of leasehold land are expected to be recovered within 12 months after the end of the reporting period. Prepayments in respect of operating leases of land are expected to be recovered over the period of the leases shown above.

## 25. Cash and cash equivalents

### *Cash and deposits*

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
US\$m			
Cash . . . . .	586	802	1,217
Cash equivalents . . . . .	<u>1,997</u>	<u>3,362</u>	<u>2,188</u>
<b>Total<sup>(1)</sup></b> . . . . .	<b><u>2,583</u></b>	<b><u>4,164</u></b>	<b><u>3,405</u></b>

Note: (1) Of cash and cash equivalents, US\$764m are held to back investment-linked contracts (2007: \$614m; 2008: US\$1,116m). The balance of cash and cash equivalents consists of other policyholder and shareholder.

Cash comprises cash at bank and cash in hand. Cash equivalents comprise bank deposits with maturities at acquisition of three months or less and money market funds. Accordingly, all such amounts are expected to be realised within 12 months after the reporting period.

## 26. Insurance contract liabilities

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
US\$m			
<b>At 1 December</b> . . . . .	<b>47,464</b>	<b>57,735</b>	<b>52,564</b>
Valuation premiums . . . . .	8,758	9,676	8,522
Liabilities released for death or other termination and related expenses . . . . .	(4,161)	(6,180)	(4,639)
Fees deducted from account balances . . . . .	(229)	(320)	(542)
Accretion of interest . . . . .	1,871	1,948	2,080
Foreign exchange movements . . . . .	2,183	(4,178)	4,073
Change in asset values attributable to policyholders . . . . .	1,264	(3,762)	2,082
Transfer to liabilities of the disposal group classified as held for sale . .	—	—	(57)
Acquisition of subsidiary . . . . .	—	—	281
Disposal of subsidiary . . . . .	—	—	(657)
Other movements . . . . .	<u>585</u>	<u>(2,355)</u>	<u>96</u>
<b>At 30 November</b> . . . . .	<b><u>57,735</u></b>	<b><u>52,564</u></b>	<b><u>63,803</u></b>

Insurance contract liabilities include amounts relating to investment-linked contracts of US\$7,031m (2007: US\$7,118m; 2008: US\$3,952m).

## Business description

The table below summarises the key variables on which insurance and investment contract cash flows depend.

Type of contract		Material terms and conditions	Nature of benefits and compensation for claims	Factors affecting contract cash flows	Key reportable segments
Traditional participating life assurance with DPF	Participating funds	Participating products combine protection with a savings element. The basic sum assured, payable on death or maturity, may be enhanced by dividends, the aggregate amount of which is determined by the performance of a distinct fund of assets and liabilities. The timing of dividend declarations is at the discretion of the insurer. Local regulations generally prescribe a minimum proportion of policyholder participation in declared dividends	Minimum guaranteed benefits may be enhanced based on investment experience and other considerations	<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Expenses</li> <li>• Mortality</li> <li>• Surrenders</li> </ul>	Singapore, China, Malaysia
	Other participating business	Participating products combine protection with a savings element. The basic sum assured, payable on death or maturity, may be enhanced by dividends the timing or amount of which is at the discretion of the insurer taking into account factors such as investment experience	Minimum guaranteed benefits may be enhanced based on investment experience and other considerations	<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Expenses</li> <li>• Mortality</li> <li>• Surrenders</li> </ul>	Hong Kong, Thailand, Other Markets
Traditional non-participating life		Benefits paid on death, maturity, sickness or disability that are fixed and guaranteed and not at the discretion of the insurer	Benefits, defined in the insurance contract, are determined by the contract and are not affected by investment performance or the performance of the contract as a whole	<ul style="list-style-type: none"> <li>• Mortality</li> <li>• Morbidity</li> <li>• Lapses</li> <li>• Expenses</li> </ul>	All <sup>(1)</sup>
Accident and health		These products provide morbidity or sickness benefits and include health, disability, critical illness and accident cover	Benefits, defined in the insurance contract are determined by the contract and are not affected investment performance or the performance of the contract as a whole	<ul style="list-style-type: none"> <li>• Mortality</li> <li>• Morbidity</li> <li>• Lapses</li> <li>• Expenses</li> </ul>	All <sup>(1)</sup>
Investment-linked		Investment-linked contracts combine savings with protection, the cash value of the policy depending on the value of unitised funds	Benefits are based on the value of the unitised funds and death benefits	<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Lapses</li> <li>• Expenses</li> <li>• Mortality</li> </ul>	All <sup>(1)</sup>
Universal life		The customer pays flexible premiums subject to specified limits accumulated in an account balance which are credited with interest at a rate set by the insurer, and a death benefit which may be varied by the customer	Benefits are based on the account balance and death benefit	<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Crediting rates</li> <li>• Lapses</li> <li>• Expenses</li> <li>• Mortality</li> </ul>	All <sup>(1)</sup>

### Notes

(1) Other than the AIA Group's corporate and other segment

## Methodology and assumptions

The most significant items to which profit for the period and shareholders' equity are sensitive are market, insurance and lapse risks which are shown in the table below. Indirect exposure indicates that there is a second order impact. For example, whilst the profit for the period attributable to shareholders is not directly affected by investment income earned where the investment risk is borne by policyholders (for example, in respect of investment-linked contracts), there is a second order effect through the investment management fees which the AIA Group earns by managing such investments. The distinction between direct and indirect exposure is not intended to indicate the relative sensitivity to each of these items. Where the direct exposure is shown as being 'net neutral' this is because the exposure to market and credit risk is offset by a corresponding movement in insurance contract liabilities.

Type of contract		Market and credit risk			
		Direct exposure		Indirect exposure	Significant insurance and lapse risks
		Insurance and investment contract liabilities	Risks associated with related investment portfolio		
Traditional participating life assurance with DPF	Participating funds	<ul style="list-style-type: none"> <li>• Net neutral except for the insurer's share of participating investment performance</li> <li>• Guarantees</li> </ul>	<ul style="list-style-type: none"> <li>• Net neutral except for the insurer's share of participating investment performance</li> <li>• Guarantees</li> </ul>	<ul style="list-style-type: none"> <li>• Investment performance subject to smoothing through dividend declarations</li> </ul>	<ul style="list-style-type: none"> <li>• Impact of persistency on future dividends</li> <li>• Mortality</li> </ul>
	Other participating business	<ul style="list-style-type: none"> <li>• Net neutral except for the insurer's share of participating investment performance</li> <li>• Guarantees</li> </ul>	<ul style="list-style-type: none"> <li>• Net neutral except for the insurer's share of participating investment performance</li> <li>• Guarantees</li> </ul>	<ul style="list-style-type: none"> <li>• Investment performance</li> </ul>	<ul style="list-style-type: none"> <li>• Impact of persistency on future dividends</li> <li>• Mortality</li> </ul>
Traditional non-participating life assurance		<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Credit risk</li> <li>• Asset liability mismatch risk</li> </ul>	<ul style="list-style-type: none"> <li>• Guarantees</li> </ul>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>• Mortality</li> <li>• Persistency</li> <li>• Morbidity</li> </ul>
Accident and health		<ul style="list-style-type: none"> <li>• Loss ratio</li> <li>• Asset liability mismatch risk</li> </ul>	<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Credit risk</li> </ul>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>• Claims experience</li> <li>• Morbidity</li> <li>• Persistency</li> </ul>
Pensions		<ul style="list-style-type: none"> <li>• Net neutral</li> <li>• Asset liability mismatch risk</li> </ul>	<ul style="list-style-type: none"> <li>• Net neutral</li> </ul>	<ul style="list-style-type: none"> <li>• Performance related investment management fees</li> </ul>	<ul style="list-style-type: none"> <li>• Persistency</li> </ul>
Investment-linked		<ul style="list-style-type: none"> <li>• Net neutral</li> </ul>	<ul style="list-style-type: none"> <li>• Net neutral</li> </ul>	<ul style="list-style-type: none"> <li>• Performance related investment management fees</li> </ul>	<ul style="list-style-type: none"> <li>• Persistency</li> <li>• Mortality</li> </ul>
Universal life		<ul style="list-style-type: none"> <li>• Guarantees</li> <li>• Asset liability mismatch risk</li> </ul>	<ul style="list-style-type: none"> <li>• Investment performance</li> <li>• Credit risk</li> </ul>	<ul style="list-style-type: none"> <li>• Spread between earned rate and crediting rate to policyholders</li> </ul>	<ul style="list-style-type: none"> <li>• Mortality</li> <li>• Persistency</li> <li>• Withdrawals</li> </ul>

The AIA Group is also exposed to currency risk in respect of its operations, and to interest rate risk, credit risk and equity price risk on assets representing net shareholders' equity, and to expense risk to the extent that actual expenses exceed those that can be charged to insurance and investment contract holders on non-participating business. Expense assumptions applied in the AIA Group's actuarial valuation models assume a continuing level of business volumes.

## 27. Investment contract liabilities

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
US\$m			
<b>At 1 December</b> . . . . .	<b>3,482</b>	<b>6,505</b>	<b>4,898</b>
Effect of foreign exchange translation . . . . .	20	(33)	102
Investment contract benefits . . . . .	1,228	(2,047)	2,164
Fees charged . . . . .	(222)	(174)	(326)
Net deposits/(withdrawals) and other movements . . . . .	1,997	647	942
<b>At 30 November</b> . . . . .	<b><u>6,505</u></b>	<b><u>4,898</u></b>	<b><u>7,780</u></b>

Investment contract liabilities include amounts relating to investment-linked liabilities of US\$6,669m (2007: US\$5,926m; 2008: US\$4,226m).

## 28. Effect of changes in assumptions and estimates

The table below sets out the sensitivities of the assumptions in respect of insurance and investment contracts with DPF to key variables. This disclosure only allows for the impact on liabilities and related assets, such as reinsurance, and deferred acquisition costs and does not allow for offsetting movements in the fair value of financial assets backing those liabilities.

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
US\$m			
<b>(Increase)/decrease in insurance contract liabilities, equity and profit before tax</b>			
Interest rates + 0.5% . . . . .	7	7	4
Interest rates - 0.5% . . . . .	(8)	(7)	(4)
Expenses +10% . . . . .	(1)	(3)	(2)
Mortality +10% . . . . .	(5)	(8)	(10)
Lapse rates +5% . . . . .	(19)	(21)	(12)

Future policy benefits for traditional life insurance policies (including investment contracts with DPF) are calculated using a net level premium valuation method with reference to best estimate assumptions set at policy inception date unless a deficiency arises on liability adequacy testing. There is no impact of the above assumption sensitivities on the carrying amount of traditional life insurance liabilities as the sensitivities presented would not have triggered a liability adequacy adjustment. During the periods presented there was no effect of changes in assumptions and estimates on the AIA Group's traditional life products.

For interest sensitive insurance contracts, such as universal life products and investment-linked contracts, assumptions are made at each reporting date including mortality, persistency, expenses, future investment earnings and future crediting rates.

The impact of changes in assumptions on the valuation of insurance and investment contracts with DPF was US\$86m decrease in profit (2007: US\$17m; 2008: US\$(11)m).

## 29. Borrowings

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
US\$m			
Bank loans . . . . .	546	548	549
Bank overdrafts . . . . .	71	88	85
Loans from fellow subsidiaries of AIG . . . . .	812	20	50
Other loans . . . . .	32	5	4
<b>Total</b> . . . . .	<b><u>1,461</u></b>	<b><u>661</u></b>	<b><u>688</u></b>

Assets with a book value of US\$758m (2007: US\$755m; 2008: US\$751m) and a fair value of US\$1,315m (2007: US\$1,101m; 2008: US\$1,107m) are pledged as security with respect to amounts disclosed as bank loans above. Interest on loans reflects market rates of interest with the exception of certain related party borrowings which are

repayable on demand. Interest expense on borrowings is shown in Note 9. Further information relating to interest rates and the maturity profile of borrowings is presented in Note 37.

### 30. Obligations under securities lending and repurchase agreements

The AIA Group has entered into securities lending agreements whereby securities are loaned to both third parties and a related party. In addition, the AIA Group has entered into repurchase agreements whereby securities are sold to third parties with a concurrent agreement to repurchase the securities at a specified date.

The securities related to these agreements are not derecognised from the AIA Group's consolidated statement of financial position, but are retained within the appropriate financial asset classification. The following table specifies the amounts included within financial investments subject to securities lending or repurchase agreements at each period end:

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
US\$m			
Debt securities:			
Repurchase agreements . . . . .	1,620	831	315
Securities lending			
Related parties . . . . .	1,231	578	—
Others . . . . .	2,446	1,691	—
<b>Total</b> . . . . .	<b><u>5,297</u></b>	<b><u>3,100</u></b>	<b><u>315</u></b>

#### *Collateral*

Generally, the AIA Group received collateral in excess of 100% of the fair value of securities loaned from all borrowers, typically consisting of cash or debt securities. During 2009 and 2008, borrowers were not providing collateral to 100% of the fair value of the securities lent; however, the AIA Group's ultimate parent company provided additional collateral to fully collateralise the arrangements.

Collateral received under securities lending or consideration received for repurchase agreements typically consists of cash or debt securities. Collateral received in the form of cash, which is not legally segregated from the AIA Group, is recognised as an asset in the consolidated statement of financial position, with a corresponding liability for its repayment.

Non-cash collateral received is not recognised in the consolidated statement of financial position unless the AIA Group either sells or repledges these assets in the absence of default, at which point the obligation to return this collateral is recognised as a liability.

The fair value of non-cash collateral received from securities lending agreements and the respective amount which the AIA Group can sell or re-pledge in the absence of default is disclosed in the table below:

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
US\$m			
Debt securities			
Related parties . . . . .	—	390	—
Others . . . . .	—	—	—
<b>Total</b> . . . . .	<b><u>—</u></b>	<b><u>390</u></b>	<b><u>—</u></b>
<b>Collateral available for pledge/sale</b> . . . . .	<b><u>—</u></b>	<b><u>—</u></b>	<b><u>—</u></b>

The value of collateral that was actually sold or re-pledged in the absence of default was nil for all periods.

Obligations under securities lending and repurchase agreements comprise the following:

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
US\$m			
Securities lending			
Related parties . . . . .	1,291	657	—
Others . . . . .	2,523	1,306	—
Repurchase agreements . . . . .	<u>1,581</u>	<u>755</u>	<u>284</u>
<b>Total</b> . . . . .	<b><u>5,395</u></b>	<b><u>2,718</u></b>	<b><u>284</u></b>

On 10 November 2008, the AIA Group entered into an agreement with AIG Funding, Inc. ('AIGF') whereby the AIA Group can borrow from AIGF to return cash collateral to securities borrowers in connection with a portfolio of securities loans of which AIG Securities Lending (Ireland) Ltd ('AIGSL') is the agent.

The AIA Group can only borrow under this facility if the collateral investment account maintained on behalf of the AIA Group does not have sufficient cash at the time to satisfy the AIA Group's obligations to repay the third party borrowers.

Under the terms of this agreement, interest accrues on the outstanding borrowings at three months US\$ LIBOR-BBA plus 1% per annum. Either party may terminate the agreement at any time upon 30 business days prior written notice to the other party.

The AIA Group has not drawn down on this agreement at any time. Effective 30 November 2009, the AIA Group terminated AIGSL's ability to make additional loans on behalf of the AIA Group. As there are no outstanding loans under the programme, the AIA Group no longer has the ability to draw down under this agreement.

### 31. Impairment of financial assets

#### *Impairment of financial assets*

In accordance with the AIA Group's accounting policies, impairment reviews were performed for available for sale securities and loans and receivables.

#### *Available for sale debt securities*

During the period to 30 November 2009, impairment losses of US\$67m (2007: nil; 2008: US\$142m) were recognised in respect of available for sale debt securities.

In 2007 the onset of the credit crisis resulted in a number of impairments being made against debt securities, including CDOs, held by the AIA Group. In 2008 the global outlook worsened significantly as the impact of the credit crisis spread to other parts of the economy. As a result, a number of companies, including certain global financial institutions, amongst them issuers of a number of available for sale debt securities held by the AIA Group, experienced significant financial difficulties. The impairment charge for 2008 includes US\$67m relating to bonds issued by Lehman Brothers and US\$52m relating to CDOs.

#### *Loans and receivables*

The AIA Group's primary potential credit risk exposure in respect of loans and receivables arises in respect of policy loans and a small portfolio of high quality mortgage loans on residential and commercial real estate (see Note 21 Financial investments for further details). The AIA Group's credit exposure on policy loans is mitigated because, if and when the total indebtedness on any policy, including interest due and accrued, exceeds the cash surrender value, the policy terminates and becomes void. The AIA Group has a first lien on all policies which are subject to policy loans.

The AIA Group has a small high quality portfolio of residential and commercial mortgage loans which it originates. To the extent that any such loans are past their due dates specific allowance is made, together with a collective allowance, based on historical delinquency. Insurance receivables are short term in nature and cover is not provided if consideration is not received. An ageing of accounts receivable is not provided as all amounts are due within 1 year and cover is cancelled if consideration is not received.

### 32. Provisions

	<u>Employee benefits</u>	<u>Other</u>	<u>Total</u>
US\$m			
<b>At 1 December 2006</b> . . . . .	<b>52</b>	<b>84</b>	<b>136</b>
Charged to the consolidated income statement . . . . .	8	4	12
Exchange differences . . . . .	—	1	1
Contribution . . . . .	(6)	—	(6)
Utilised during the period . . . . .	(1)	(2)	(3)
<b>At 30 November 2007</b> . . . . .	<b>53</b>	<b>87</b>	<b>140</b>
Charged to the consolidated income statement . . . . .	26	31	57
Exchange differences . . . . .	(7)	(3)	(10)
Contribution . . . . .	(4)	—	(4)
Utilised during the period . . . . .	—	(2)	(2)
<b>At 30 November 2008</b> . . . . .	<b>68</b>	<b>113</b>	<b>181</b>
Charged to the consolidated income statement <sup>1</sup> . . . . .	8	131	139
Incurred in connection with acquisition of a subsidiary . . . . .	—	30	30
Exchange differences . . . . .	2	8	10
Contributions . . . . .	(2)	—	(2)
Utilised during the period . . . . .	<u>—</u>	<u>(73)</u>	<u>(73)</u>
<b>At 30 November 2009</b> . . . . .	<b><u>76</u></b>	<b><u>209</u></b>	<b><u>285</u></b>

Note: (1) Of the provisions charged to the consolidated income statement as “Other” during 2009, US\$89m related to provision for restructuring and separation costs.

Further details of provisions for employee post retirement benefits are provided in Note 38.

#### *Other provisions*

Other provisions comprise provisions in respect of regulatory matters, litigation, reorganisation and restructuring. In view of the diverse nature of the matters provided for and the contingent nature of the matters to which they relate the AIA Group is unable to provide an accurate assessment of the term over which provisions are expected to be utilised.

### 33. Other liabilities

	<u>As at 30 November 2007</u>	<u>As at 30 November 2008</u>	<u>As at 30 November 2009</u>
US\$m			
Trade and other payables . . . . .	1,389	1,082	1,162
Third party interests in consolidated investment funds . . . . .	720	398	397
Payables from purchases of investments . . . . .	84	72	396
Reinsurance payables . . . . .	<u>101</u>	<u>35</u>	<u>57</u>
<b>Total</b> . . . . .	<b><u>2,294</u></b>	<b><u>1,587</u></b>	<b><u>2,012</u></b>

Third party interests in consolidated investment funds consist of third party unit holders’ interests in consolidated investment funds which are reflected as a liability since they can be put back to the AIA Group for cash.

Trade and other payables are all expected to be settled within 12 months after the end of the reporting period. The realisation of third party interests in investment funds cannot be predicted with accuracy since these represent the interests of third party unit holders in consolidated investment funds held to back insurance and investment contract liabilities and are subject to market risk and the actions of third party investors.

### 34. Share capital and reserves

#### Share capital

	As at 30 November 2007		As at 30 November 2008		As at 30 November 2009	
	Million shares	US\$m	Million shares	US\$m	Million shares	US\$m
<b>Authorised</b>						
Ordinary shares of US\$1 each . . . . .	20,000	20,000	20,000	20,000	20,000	20,000
<b>Issued and fully paid</b>						
At start of the reporting period . . . . .	<u>12,000</u>	<u>12,000</u>	<u>12,000</u>	<u>12,000</u>	<u>12,000</u>	<u>12,000</u>
<b>At end of the reporting period . . . . .</b>	<b><u>12,000</u></b>	<b><u>12,000</u></b>	<b><u>12,000</u></b>	<b><u>12,000</u></b>	<b><u>12,000</u></b>	<b><u>12,000</u></b>
Shares yet to be issued . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>44</u>	<u>44</u>
<b>Share premium . . . . .</b>		<b><u>1,914</u></b>		<b><u>1,914</u></b>		<b><u>1,914</u></b>

There were no shares issued under share option schemes in the period. AIA and its subsidiaries have not undertaken any purchase, sale, or redemption of AIA's issued share capital in the reporting period. Share premium of US\$1,914m represents the difference between the net book value of the AIA Group on acquisition by AIA of US\$13,958m and the nominal value of the share capital issued of US\$12,044m.

#### Reserves

##### Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of available for sale securities held at the end of the reporting period.

##### Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign currency exchange differences arising from the translation of the financial statements of foreign operations.

##### Other reserves

Other reserves include the impact of merger accounting for business combinations under common control and share based compensation.

At 30 November 2009 AIA does not have any distributable reserves.

### 35. Non-controlling interests

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
	US\$m		
Equity shares in subsidiaries . . . . .	6	6	51
Share of earnings . . . . .	45	35	29
Share of other reserves . . . . .	<u>10</u>	<u>(21)</u>	<u>—</u>
<b>Total . . . . .</b>	<b><u>61</u></b>	<b><u>20</u></b>	<b><u>80</u></b>

### 36. Group capital structure

#### Objectives, policies and processes for managing capital

The AIA Group's capital management objectives focus on maintaining a strong capital base to support the development of its business, satisfying regulatory capital requirements at all times, and supporting its credit rating targets. The AIA Group recognises the impact on shareholder returns of the level of equity capital employed and seeks to maintain an appropriate balance.

The AIA Group's capital management function oversees all capital related activities of the AIA Group and assists senior management in making capital decisions. The capital management function participates in decisions

concerning asset-liability management exposures, asset-liability proposals and strategic asset allocation. The capital management function also engages in ongoing active capital and solvency management, including maintaining active dialogue and relationships with our regulators and ratings agencies. The AIA Group has also incorporated the capital management framework into its budgeting process to ensure capital and dividend policies and programmes are implemented within the guidelines set forth by the AIA Group.

#### *Externally imposed capital requirements*

The AIA Group is in compliance with the solvency and capital adequacy requirements of its regulators. The AIA Group's primary insurance regulator at the AIA Co and AIA-B levels is the Hong Kong Office of the Commissioner of Insurance ('OCI'), which requires that AIA Co and AIA-B meet the solvency margin requirements of the Hong Kong Insurance Companies Ordinance. The Hong Kong Insurance Companies Ordinance (among other matters) sets minimum solvency margin requirements that an insurer must meet in order to be authorised to carry on insurance business in or from Hong Kong. The OCI requires AIA Co and AIA-B to maintain an excess of assets over liabilities of not less than the required minimum solvency margin. The amount required under the Hong Kong Insurance Companies Ordinance as the minimum solvency margin can be determined and may be treated as 100% of that amount. The excess of assets over liabilities to be maintained by AIA Co and AIA-B required by the OCI is not less than 150% of that amount.

The AIA Group's individual branches and subsidiaries are also subject to the supervision of government regulators in the jurisdictions in which those branches and subsidiaries are domiciled. The various regulators overseeing the AIA Group actively monitor the solvency margin position of the AIA Group. AIA Co and AIA-B submit annual filings to the OCI of their solvency margin position based on their annual audited accounts, and the AIA Group's other operating units perform similar annual filings with their respective local regulators.

The ability of AIA Group to pay dividends and meet other obligations depends on dividends and other payments from its operating subsidiaries and branches, which are subject to contractual, regulatory and other limitations. The various regulators overseeing the individual branches and subsidiaries of the AIA Group have the discretion to impose additional restrictions on the ability of those regulated subsidiaries and branches to make payment of dividends or other distributions and payments to AIA, including increasing the required margin of solvency that an operating unit must maintain.

The payment of dividends and other distributions and payments by the AIA Group's subsidiaries and their branches is regulated by applicable insurance, foreign exchange and tax and other laws, rules and regulations. The amount and timing of certain dividends, distributions and other payments require regulatory approval. In particular, the payment of dividends, distributions and other payments to AIA from AIA Co is subject to the oversight of the Office of the Commissioner of Insurance of Hong Kong. In addition, surplus capital may not be remitted out of Thailand in particular, including by the business and operations of AIA Co's Thailand Branch ('AIA Thailand') to its Head Office in Hong Kong, without the consent of the Office of the Insurance Commission in Thailand. More generally, regulators may prohibit the payment of dividends or other distributions and payments by our regulated subsidiaries and branches if they determine that such payment could be adverse to the interests of relevant policyholders or contract holders.

#### ***Capital and Regulatory Orders Specific to the AIA Group***

Following the AIG events as described in note 44, certain regulators of the AIA Group imposed additional requirements or restrictions on certain of its branches and subsidiaries. These requirements and restrictions may be amended or revoked at the relevant regulator's discretion. As of the date hereof, the requirements and restrictions summarized below remain in effect.

#### *Hong Kong Office of the Commissioner of Insurance*

Letters dated 17 September 2008 were issued from the OCI to each of AIA Co and AIA-B ('Section 35 Orders') requiring each of AIA Co or AIA-B, including all of their branches, as appropriate:

- 1) to ensure that all insurance business and all transactions with any "specified person" (which includes but is not limited to its branches, directors, controllers, shareholders and associates or group companies) is on normal commercial terms;
- 2) to ensure that AIA Co or AIA-B not place any deposit with or transfer assets (except for normal insurance transactions) or provide financial assistance to any specified person without first obtaining written consent from the OCI; and

- 3) to inform the OCI as soon as practicable of any circumstances which may put the interest of policyholders or potential policyholders at risk.

Among other consequences, the Section 35 Orders place restrictions on the ability of AIA Co and AIA-B to engage in capital related transactions with specified persons. Accordingly, the Section 35 Orders restrict the ability of AIA Co and AIA-B to pay dividends to their parent companies, and limit their ability to engage in intercompany transactions with specified persons, such as payment of intercompany service fees without first obtaining written consent from the OCI.

By further letters dated 18 September 2008 to AIA Co and AIA-B, the OCI required that AIA Co or AIA-B as appropriate not acquire a new controller without first obtaining written consent from the OCI.

By letters to AIA Co and AIA-B dated 15 March 2010, the OCI confirmed that the requirements contained in its letters dated 17 and 18 September 2008 remain in force.

#### *Monetary Authority of Singapore*

Since October 2008, the Monetary Authority of Singapore (“MAS”) has issued certain directions to AIA Singapore specifying that it comply with increased capital adequacy requirements. In addition, the directions provide that prior MAS consent be sought in respect of certain transactions including transfers or disposals of certain assets (including land or buildings) and financing and guarantee arrangements. The directions also impose certain additional reporting requirements on AIA Singapore.

#### *Bermuda Monetary Authority*

By a Letter of Undertaking dated 18 December 2008, American International Company Limited (‘AICO’), in its capacity as the licensed Insurance Manager of AIA-B, made certain undertakings to the Bermuda Monetary Authority (‘BMA’).

In the Letter of Undertaking, AICO:

- 1) undertakes to ensure that AIA-B would seek prior approval from the BMA before entering into transactions outside the normal course of business; and
- 2) undertakes to submit a daily basis report to the BMA on: (i) transfers of more than US\$1,000,000 per transaction or an aggregate amount of greater than US\$1,000,000 per day from AIA-B to another jurisdiction other than where the fund originated; (ii) transactions of greater than US\$15,000,000 whether incoming or outgoing; (iii) all material issues having an impact threshold of equal to or greater than 10% of AIA-B’s total statutory capital and surplus.

#### *China Insurance Regulatory Commission*

Notices issued by the China Insurance Regulatory Commission (‘CIRC’) ordered AIA Shanghai Branch, Guangdong Branch, Jiangsu Branch, Beijing Branch, Shenzhen Branch, Suzhou Central Sub-Branch, Dongguan Sub-Branch and Jiangmen Sub-Branch to:

- 1) maintain sufficient funds to cope with possible cancellations and to prevent liquidity risks and monitor the liquidity daily; and
- 2) enhance capital fund safety by: (a) not entering into any mortgage, guarantee, letter of credit or incurring debt other than in the normal course of business; (b) not transferring any assets or funds outside of the PRC; and (c) obtaining approval from the CIRC on any affiliated transaction with AIG including reinsurance transactions (so as to prevent capital and assets from flowing outside of the PRC).

#### *Bank Negara Malaysia*

Under a letter dated 16 September 2008, Bank Negara Malaysia (‘BNM’) requested American International Assurance Bhd. (‘AIA Malaysia’) to obtain prior written approval of BNM in relation to the following:

- 1) payment of dividends (interim and/or final) to its shareholders (being in addition to the general requirement to obtain a no objection from BNM prior to declaring a dividend exceeding a prescribed statutory amount);
- 2) extension of credit facilities to related-parties within the AIG group;
- 3) guarantees or undertakings given to/on behalf of related-parties within the AIG group; and

- 4) any other related-party transactions, excluding any transaction in the ordinary course of AIA Malaysia business relating to insurance policies, reinsurance cessions and claims.

#### *Other Orders*

Correspondence has also been issued to the Group by the Mandatory Provident Fund Schemes Authority in Hong Kong and the regulators in Taiwan, Brunei and Vietnam. Pursuant to this correspondence, regular updates are to be provided to the regulators, and certain regulators must provide their consent before assets are transferred or transactions are entered into with connected parties.

#### *AIA Group capital position*

The AIA Group defines ‘capital’ as the amount of assets in excess of liabilities measured in accordance with the Hong Kong Insurance Companies Ordinance. The AIA Group defines total available capital as the amount of assets in excess of liabilities measured in accordance with the Insurance Companies Ordinance and ‘required capital’ as the minimum required margin of solvency calculated in accordance with the Insurance Companies Ordinance. The solvency margin ratio is the ratio of total available capital to required capital. A number of transactions undertaken in 2008 and 2009 enhanced the solvency position of the AIA Group. With effect from 28 February 2009, AIA-B and AIA Australia, among others, become subsidiaries of AIA Co, and on 3 November 2009, the AIA Group acquired Philam.

In January 2009, the OCI introduced temporary relief measures to all Hong Kong regulated long-term and composite insurers in response to the unprecedented level of volatility in global capital markets and low interest rate environment. These measures apply to financial years running from 2008 to 2010, after which a review will be conducted.

The capital positions of the two principal operating companies within the AIA Group are illustrated in the table:

	30 November 2007			30 November 2008			30 November 2009		
	Total available capital	Required capital	Solvency margin ratio	Total available capital	Required capital	Solvency margin ratio	Total available capital	Required capital	Solvency margin ratio
AIA Co . . . . .	2,551	1,357	188	2,751	1,316	209	4,811	1,547	311
AIA-B . . . . .	2,519	648	389	1,469	684	215	2,742	911	301
									US\$m

### **37. Risk management**

#### *Risk management framework*

The managed acceptance of risk is fundamental to the AIA Group’s insurance business model. The AIA Group’s risk management framework seeks to effectively manage, rather than eliminate, the risks the AIA Group faces.

The AIA Group’s central risk management framework requires all operations to establish processes for identifying, evaluating and managing the key risks faced by the organisation. This risk management framework has evolved in recent years and now encompasses an established risk governance structure with clear oversight and assignment of responsibility for monitoring and management of strategic, operational and financial risks.

#### *Insurance and financial risk exposures*

As an insurance group, the AIA Group is exposed to a range of insurance and financial risks. The AIA Group applies a consistent risk management philosophy that is embedded in management processes and controls such that both existing and emerging risks are considered and addressed.

The following section summarises the AIA Group’s key risk exposures and the primary policies and processes used by the AIA Group to manage its exposures to these risks.

#### *Insurance risk*

The AIA Group considers insurance risk to be a combination of the following component risks:

- inadequate or inappropriate product design;
- inappropriate underwriting or pricing of policies;

- lapse risk; and
- variability in claims experience.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability of the expected outcome. The AIA Group has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

#### *Product design risk*

Product design risk refers to potential defects in product design and pricing. The AIA Group manages product design risk by completing pre-launch reviews and approval of products by local and the AIA Group functional departments such as actuarial and underwriting. These departments have significant experience and have developed proprietary expertise to identify potential flaws in product design.

There is a strong focus within the AIA Group on actively managing each part of the actuarial control cycle to minimise risk in the in-force book as well as for new business acceptances. A significant component of the AIA Group's long-term insurance business is participating in nature where the AIA Group has the ability to adjust dividends to reflect market conditions. This reduces the AIA Group's exposure to changes in circumstances, in particular investment returns, that may arise during the life of long-term insurance policies.

#### *Pricing and underwriting risk*

Pricing and underwriting risk refers to the possibility of product related income being inadequate to support future obligations arising from those contracts.

The AIA Group manages pricing and underwriting risk by adhering to group wide underwriting guidelines. Each operating unit maintains a team of professional underwriters who review and select risks that are consistent with the underwriting strategy of the AIA Group. A second layer of underwriting review is conducted by the AIA Group for complex and large insurance risks. Any exceptions require specific approval and may be subject to separate risk management actions.

The AIA Group makes use, in certain circumstances, of reinsurance to obtain product pricing expertise when entering new lines of business, products or territories. Reinsurance is also used, to a limited extent, to manage concentrations of insurance risk. However, the breadth of the AIA Group's geographical spread and product portfolio creates natural diversification and reduces the extent to which concentrations of insurance risk arise.

#### *Claims risk*

Claims risk refers to the possibility that the frequency or severity of claims arising from insurance contracts exceeds the level anticipated at the time of underwriting. For insurance contracts where death and diagnosis of critical illness are the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics (such as AIDS, SARS or other communicable conditions) or widespread changes in lifestyle resulting in earlier or more claims than expected. Other factors affecting the frequency and severity of claims include the following:

- insurance risk under disability contracts is dependent on economic conditions. Recession and unemployment tend to increase the number of claims for disability benefits as well as reduce the rate of recovery from disability;
- insurance risk under hospitalisation contracts is dependent on medical costs and medical technology; and
- insurance risk under accident contracts is more random and dependent on occupation.

The AIA Group seeks to mitigate claims risk by conducting regular reviews of mortality and morbidity experience and considering the impact of these on reinsurance needs and product design and pricing. These reviews, alongside other experience studies, results and economic outlook data, are incorporated into new product design and in-force policy management which illustrates the benefit of the AIA Group's scale, history and experience in achieving a coherent insurance risk management strategy.

Mortality and morbidity risk in excess of the respective retention limits are ceded to reduce volatility in claims experience for the AIA Group.

### *Lapse risk*

Lapse risk refers to the possibility of financial loss due to early termination of contracts where the acquisition cost incurred may not be recoverable from future revenue.

The AIA Group carries out regular studies of persistency experience. The results are assimilated into new and in-force business management. Target pay back periods that form part of the product pricing controls enable monitoring of the AIA Group's exposure to lapse risk. Certain products include surrender charges that entitle the AIA Group to additional fees on early termination by the policyholder, thereby reducing exposure to lapse risk.

### *Concentrations of insurance risk*

Concentration of insurance risk refers to the possibility of significant financial losses arising from a lack of diversification, either geographical or by product type, of the AIA Group's portfolio. Certain events, such as viral pandemics, may give rise to higher levels of mortality or morbidity experience and exhibit geographical concentrations.

The AIA Group has a broad geographical footprint across Asia and its results are not substantially dependent upon any one of these individual markets. This breadth provides a natural diversification of geographic concentrations of insurance and other risks (such as political risks). However, given the AIA Group's exposure to Asia, it may be relatively more exposed to pandemics localised in Asia than insurance groups with a world-wide presence.

Although long-term insurance and investment business are the AIA Group's primary operations, the AIA Group has a range of product offerings, such as term life, accident and health, participating, annuity and investment-linked, which vary in the extent and nature of risk coverage and thereby reduce exposures to concentrations of mortality or morbidity risk. For example, the insured risk for certain annuity products is survival of the annuitant, whereas the insured risk for a term life product is the death of the policyholder.

As a result of the AIA Group's history and scale, a substantial volume of experience data has been accumulated which assists in evaluation and pricing of insurance risk. The AIA Group's capital position combined with its profitable product portfolio and diversified geographical presence are factors in management's decision to retain (rather than reinsure) a high proportion of its written insurance risks.

Concentrations of risk are managed within each market through the monitoring of product sales and size of the in-force book by product group. Actuarial analyses are also performed to establish the impact of changes in mortality and morbidity experience for use in financial reporting, pricing and the AIA Group's assessment of reinsurance needs.

### ***Credit risk***

Credit risk arises from the possibility of financial loss arising from default by borrowers and transactional counterparties and the loss of value in financial instruments due to deterioration in credit quality. The key areas where the AIA Group is exposed to credit risk include repayment risk in respect of:

- cash and cash equivalents;
- investments in debt securities;
- loans and receivables (including insurance receivables); and
- reinsurance receivables.

The AIA Group has in place a credit analysis process that accounts for diverse factors, including market conditions, industry specific conditions, company cash flows and quality of collateral. The AIA Group also has a monitoring programme in place whereby the AIA Group's credit analysis teams review the status of the obligor on a regular basis to anticipate any credit issues.

Cross-border investment exposures are controlled through the assignment of individual country counterparty risk limits by the CRM.

The AIA Group monitors its credit exposures to any single unrelated external reinsurer or group.

The maximum exposure to credit risk for loans and receivables, debt securities and cash and cash equivalents is the carrying value in the consolidated statement of financial position, net of allowances.

### *Market risk*

Market risk arises from the possibility of financial loss caused by changes in financial instrument fair values or future cash flows due to fluctuations in key variables, including interest rates, equity market prices and foreign exchange rates.

The AIA Group manages the risk of market-based fluctuations in the value of the AIA Group's investments, as well as liabilities with exposure to market risk.

The AIA Group uses various quantitative measures to assess market risk, including sensitivity analysis. The level of movements in market factors on which the sensitivity analysis is based were determined based on economic forecasts and historical experience of variations in these factors.

The AIA Group routinely conducts sensitivity analyses of its fixed income portfolios to estimate its exposure to movements in interest rates. The AIA Group's fixed income sensitivity analysis is primarily a duration-based approach. This approach provides an adequate representation of risk, because very few of the AIA Group's fixed income investments have embedded options which exhibit negative convexity.

### *Interest rate risk*

The AIA Group's exposure to interest rate risk predominantly arises from the AIA Group's investments in long-term fixed income debt securities, which are exposed to fluctuations in interest rates.

Interest rate risk also arises from the AIA Group's insurance and investment contracts with guaranteed and fixed terms, including settlement options available upon maturity, which carry the risk that interest income and capital redemptions from the financial assets backing the liabilities is insufficient to fund the guaranteed benefits payable as interest rates rise and fall. For other products, including those with participation or investment-linked features, interest rate risk is significantly reduced due to the non-guaranteed nature of additional policyholder benefits.

The AIA Group manages its interest rate risk by generally investing in fixed income assets in the same currencies as those of its liabilities, as well as investing in financial instruments with tenors that broadly match the duration of its liabilities.

The AIA Group also considers the effect of interest rate risk in its overall product strategy. Certain products such as investment-linked, universal life and participating business, inherently have lower interest rate risk as their design provides flexibility as to crediting rates and policyholder dividend scales.

*Exposure to interest rate risk*

The table below summarises the nature of the interest rate risk associated with financial assets and liabilities. In preparing this analysis, fixed rate interest bearing instruments that mature or re-price within 12 months of the reporting date have been disclosed as variable rate instruments. The contractual and estimated maturity dates of the liabilities are shown below.

	<u>Variable interest rate</u>	<u>Fixed interest rate</u>	<u>Non-interest bearing</u>	<u>Total</u>
US\$m				
<b>30 November 2007</b>				
Financial assets				
Loans and receivables . . . . .	2,009	1,543	2,113	5,665
Debt securities . . . . .	4,578	39,826	—	44,404
Equity securities . . . . .	—	—	20,139	20,139
Derivative financial instruments . . . . .	—	—	422	422
Reinsurance receivables . . . . .	—	—	87	87
Cash and cash equivalents . . . . .	<u>2,529</u>	<u>—</u>	<u>54</u>	<u>2,583</u>
<b>Total financial assets . . . . .</b>	<b><u>9,116</u></b>	<b><u>41,369</u></b>	<b><u>22,815</u></b>	<b><u>73,300</u></b>
Financial liabilities				
Insurance contract liabilities (net of reinsurance) . . . . .	—	—	55,154	55,154
Investment contract liabilities . . . . .	—	—	6,505	6,505
Borrowings . . . . .	543	846	72	1,461
Obligations under securities lending agreements . . . . .	5,395	—	—	5,395
Derivative financial liabilities . . . . .	—	—	47	47
Other financial liabilities including tax payable . . . . .	<u>—</u>	<u>785</u>	<u>1,058</u>	<u>1,843</u>
<b>Total financial liabilities . . . . .</b>	<b><u>5,938</u></b>	<b><u>1,631</u></b>	<b><u>62,836</u></b>	<b><u>70,405</u></b>
<b>Net financial assets and liabilities . . . . .</b>	<b><u>3,178</u></b>	<b><u>39,738</u></b>	<b><u>(40,021)</u></b>	<b><u>2,895</u></b>
US\$m				
<b>30 November 2008</b>				
Financial assets				
Loans and receivables . . . . .	1,423	1,563	1,016	4,002
Debt securities . . . . .	3,723	38,600	—	42,323
Equity securities . . . . .	—	—	8,747	8,747
Derivative financial instruments . . . . .	—	—	252	252
Reinsurance receivables . . . . .	—	—	19	19
Cash and cash equivalents . . . . .	<u>4,116</u>	<u>—</u>	<u>48</u>	<u>4,164</u>
<b>Total financial assets . . . . .</b>	<b><u>9,262</u></b>	<b><u>40,163</u></b>	<b><u>10,082</u></b>	<b><u>59,507</u></b>
Financial liabilities				
Insurance contract liabilities (net of reinsurance) . . . . .	—	—	52,436	52,436
Investment contract liabilities . . . . .	—	—	4,898	4,898
Borrowings . . . . .	546	26	89	661
Obligations under securities lending agreements . . . . .	2,718	—	—	2,718
Derivative financial liabilities . . . . .	—	—	138	138
Other financial liabilities including tax payable . . . . .	<u>—</u>	<u>—</u>	<u>1,407</u>	<u>1,407</u>
<b>Total financial liabilities . . . . .</b>	<b><u>3,264</u></b>	<b><u>26</u></b>	<b><u>58,968</u></b>	<b><u>62,258</u></b>
<b>Net financial assets and liabilities . . . . .</b>	<b><u>5,998</u></b>	<b><u>40,137</u></b>	<b><u>(48,886)</u></b>	<b><u>(2,751)</u></b>

US\$m	<u>Variable interest rate</u>	<u>Fixed interest rate</u>	<u>Non-interest bearing</u>	<u>Total</u>
<b>30 November 2009</b>				
Financial assets				
Loans and receivables . . . . .	904	2,825	919	4,648
Debt securities . . . . .	4,715	47,486	—	52,201
Equity securities . . . . .	—	—	16,178	16,178
Reinsurance receivables . . . . .	—	—	29	29
Derivative financial instruments . . . . .	—	—	453	453
Cash and cash equivalents . . . . .	<u>3,144</u>	<u>—</u>	<u>261</u>	<u>3,405</u>
<b>Total financial assets . . . . .</b>	<b>8,763</b>	<b>50,311</b>	<b>17,840</b>	<b>76,914</b>
Financial liabilities				
Insurance contract liabilities (net of reinsurance) . . . . .	—	—	63,548	63,548
Investment contract liabilities . . . . .	—	—	7,780	7,780
Borrowings . . . . .	603	—	85	688
Obligations under securities lending and repurchase agreements . . . . .	284	—	—	284
Derivative financial liabilities . . . . .	—	—	71	71
Other financial liabilities including tax payable . . . . .	<u>—</u>	<u>—</u>	<u>1,800</u>	<u>1,800</u>
<b>Total financial liabilities . . . . .</b>	<b>887</b>	<b>—</b>	<b>73,284</b>	<b>74,171</b>
<b>Net financial assets and liabilities . . . . .</b>	<b><u>7,876</u></b>	<b><u>50,311</u></b>	<b><u>(55,444)</u></b>	<b><u>2,743</u></b>

*Foreign exchange rate risk*

Foreign exchange risk arises from the AIA Group's operations in multiple jurisdictions in the Asia Pacific region. Foreign currency risk associated with assets and liabilities denominated in non-functional currencies results in gains and losses being recognised in the consolidated income statement. Foreign currency risk associated with the translation of the net assets of operations with non-US dollar functional currencies results in gains or losses being recorded directly in total equity.

The AIA Group generally invests in assets denominated in currencies that match its liabilities to avoid currency mismatches. However, for yield enhancement and risk diversification purposes, the AIA Group's business units also invest, in some instances, in instruments in currencies that are different from the originating liabilities. These activities expose the AIA Group to gains and losses arising from foreign exchange rate movements. The AIA Group's business units monitor foreign currency exposures and where these are not consistent with the risk appetite of the AIA Group, positions may be closed or hedging instruments may be purchased.

The AIA Group's net foreign currency exposures and the estimated impact of changes in foreign exchange rates are set out in the tables below after taking into account the effect of economic hedges of currency risk. Whilst providing economic hedges that reduce the AIA Group's net exposure to foreign exchange risk, hedge accounting is not applied. Currencies for which net exposure is not significant are excluded from the analysis below. In compiling the table below the impact of a 5% strengthening of original currency is stated relative to the functional currency of the relevant operation of the AIA Group. The impact of a 5% strengthening of the US dollar is also stated relative to functional currency. Currency exposure reflects the net notional amount of currency derivative positions as well as net equity by currency.

*Net exposure*

	<u>United States Dollar</u>	<u>Hong Kong Dollar</u>	<u>Thai Baht</u>	<u>Singapore Dollar</u>	<u>Malaysian Ringgit</u>	<u>China Renminbi</u>	<u>Korean Won</u>
US\$m							
<b>30 November 2007</b>							
Equity analysed by original currency . . . .	11,387	(15)	2,141	(2,370)	318	355	831
Net notional amounts of currency derivative positions . . . . .	<u>(2,818)</u>	<u>—</u>	<u>686</u>	<u>2,728</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Currency exposure . . . . .</b>	<u><b>8,569</b></u>	<u><b>(15)</b></u>	<u><b>2,827</b></u>	<u><b>358</b></u>	<u><b>318</b></u>	<u><b>355</b></u>	<u><b>831</b></u>
5% strengthening of original currency							
<b>Impact on profit before tax . . . . .</b>	<u><b>128</b></u>	<u><b>(41)</b></u>	<u><b>(14)</b></u>	<u><b>8</b></u>	<u><b>2</b></u>	<u><b>8</b></u>	<u><b>8</b></u>
5% strengthening of the US dollar							
<b>Impact on shareholders' equity . . . . .</b>	<u><b>(128)</b></u>	<u><b>(9)</b></u>	<u><b>(141)</b></u>	<u><b>(16)</b></u>	<u><b>(15)</b></u>	<u><b>(14)</b></u>	<u><b>(35)</b></u>
<b>30 November 2008</b>							
Equity analysed by original currency . . . .	7,085	(502)	2,113	(1,887)	482	628	598
Net notional amounts of currency derivative positions . . . . .	<u>(3,316)</u>	<u>—</u>	<u>1,039</u>	<u>2,776</u>	<u>—</u>	<u>—</u>	<u>(96)</u>
<b>Currency exposure . . . . .</b>	<u><b>3,769</b></u>	<u><b>(502)</b></u>	<u><b>3,152</b></u>	<u><b>889</b></u>	<u><b>482</b></u>	<u><b>628</b></u>	<u><b>502</b></u>
5% strengthening of original currency							
<b>Impact on profit before tax . . . . .</b>	<u><b>31</b></u>	<u><b>(66)</b></u>	<u><b>1</b></u>	<u><b>6</b></u>	<u><b>—</b></u>	<u><b>7</b></u>	<u><b>1</b></u>
5% strengthening of the US dollar							
<b>Impact on shareholders' equity . . . . .</b>	<u><b>(31)</b></u>	<u><b>(5)</b></u>	<u><b>(156)</b></u>	<u><b>(42)</b></u>	<u><b>(24)</b></u>	<u><b>(28)</b></u>	<u><b>(25)</b></u>
<b>30 November 2009</b>							
Equity analysed by original currency . . . .	11,824	(410)	2,448	(1,922)	563	704	924
Net notional amounts of currency derivative positions . . . . .	<u>(3,845)</u>	<u>—</u>	<u>1,256</u>	<u>3,031</u>	<u>—</u>	<u>—</u>	<u>100</u>
<b>Currency exposure . . . . .</b>	<u><b>7,979</b></u>	<u><b>(410)</b></u>	<u><b>3,704</b></u>	<u><b>1,109</b></u>	<u><b>563</b></u>	<u><b>704</b></u>	<u><b>1,024</b></u>
5% strengthening of original currency							
<b>Impact on profit before tax . . . . .</b>	<u><b>103</b></u>	<u><b>(63)</b></u>	<u><b>1</b></u>	<u><b>11</b></u>	<u><b>1</b></u>	<u><b>9</b></u>	<u><b>2</b></u>
5% strengthening of the US dollar							
<b>Impact on shareholders' equity . . . . .</b>	<u><b>(103)</b></u>	<u><b>(9)</b></u>	<u><b>(184)</b></u>	<u><b>(54)</b></u>	<u><b>(28)</b></u>	<u><b>(30)</b></u>	<u><b>(50)</b></u>

*Equity market price risk*

Equity market price risk arises from changes in the market value of equity securities and equity funds. With the exception of the AIA Group's holding of shares in AIG, the majority of the AIA Group's equity instruments are held to match investment-linked contracts, the investment risk in respect of which is wholly borne by policyholders, or in respect of participating business, where investment risks are shared between the AIA Group and its policyholders. Equity securities form a relatively low proportion of the AIA Group's overall non-linked investment portfolios (including participating funds).

*Sensitivity analysis*

Sensitivity analysis to the key variables affecting financial assets and liabilities is set out in the table below. Information relating to sensitivity of insurance and investment contracts with DPF is provided in Note 28. The carrying values of other financial assets are not subject to changes in response to movements in interest rates or equity prices. In calculating the sensitivity of debt and equity instruments to changes in interest rates and equity prices the AIA Group has made assumptions about the corresponding impact of asset valuations on liabilities to policyholders. Assets held to support investment-linked contracts have been excluded on the basis that changes in fair value are wholly borne by policyholders. Sensitivity analysis for assets held in participating funds has been calculated after allocation of returns to policyholders using the applicable minimum policyholders' participation

ratios described in Note 2. Information is presented to illustrate the estimated impact on profits and equity arising from a change in a single variable before taking into account the effects of taxation.

For the purpose of illustrating the sensitivity of profit and total equity to changes in interest rates and equity prices, the impact of possible impairments of financial investments classified as available for sale which may arise in times of economic stress has been ignored, since default events reflect the characteristics of individual issuers. Because the AIA Group's accounting policies lock in interest rate assumptions on policy inception and the AIA Group's assumptions incorporate a provision for adverse deviations, the level of movement illustrated in this sensitivity analysis does not result in loss recognition and so there is no corresponding effect on liabilities.

	30 November 2007		30 November 2008		30 November 2009	
	Impact on profit before tax	Impact on net assets (before the effects of taxation)	Impact on profit before tax	Impact on net assets (before the effects of taxation)	Impact on profit before tax	Impact on net assets (before the effects of taxation)
US\$m						
<b>Interest rate risk</b>						
+50 basis points shift in yield curves . . . . .	(45)	(1,130)	(53)	(1,096)	(64)	(1,492)
-50 basis points shift in yield curves . . . . .	45	1,130	53	1,096	64	1,492
<b>Equity risk</b>						
10% increase in equity prices . . . . .	464	716	204	214	308	314
10% decrease in equity prices . . . . .	(464)	(716)	(204)	(214)	(308)	(314)

**Liquidity risk**

Liquidity risk refers to the possibility that the AIA Group is unable to meet its obligations to counterparties when falling due. This can arise when internal funds are insufficient to meet cash outflow obligations and where the AIA Group is unable to obtain funding at market rates or liquidate assets at fair value resulting in the forced liquidation of assets at depressed prices. The AIA Group is exposed to liquidity risk in respect of insurance and investment policies that permit surrender, withdrawal or other forms of early termination for a cash surrender value specified in the contractual terms and conditions.

The AIA Group's liquidity position is monitored in compliance with regulatory and internal requirements in combination with maturity gap analyses. To manage liquidity risk, the AIA Group has implemented a variety of measures, including emphasising flexible insurance product design so that it can retain the greatest flexibility to adjust contract pricing or crediting rates. The AIA Group also seeks to match, to the extent possible and appropriate, the duration of its investment assets with the duration of insurance policies issued.

The maturity analysis presented in the tables below presents the estimated maturity of carrying amounts in the consolidated statement of financial position which, for insurance and investment contracts, is based on projections of estimated undiscounted cash flows arising from insurance and investment contracts in force at that date. The AIA Group has made significant assumptions to determine the estimated undiscounted cash flows of insurance benefits and claims and investment contract benefits, which include assumptions in respect of mortality, morbidity, future lapse rates, expenses, investment returns and interest crediting rates, offset by expected future deposits and premiums on in-force policies. The maturity profile of the AIA Group's borrowings is presented on the presumption that the AIA Group will continue to satisfy loan covenants which, if breached, would cause the borrowings to be repayable on demand. The AIA Group regularly monitors its compliance with these covenants and was in compliance with them at the date of the consolidated statement of financial position and throughout each of the periods presented. Due to the significance of the assumptions used, the maturity profiles presented below could be materially different from actual payments.

A maturity analysis based on the earliest contractual repayment date would present the insurance and investment contract liabilities as falling due in the earliest period in the table because of the ability of policyholders to exercise surrender options. Financial assets and liabilities other than investment contract liabilities are presented based on their respective contractual maturities.

	<u>Total</u>	<u>No fixed maturity</u>	<u>Due in one year or less</u>	<u>Due after one year through five years</u>	<u>Due after five years through 10 years</u>	<u>Due after 10 years</u>
US\$m						
<b>30 November 2007</b>						
Financial assets:						
Loans and receivables . . . . .	5,665	204	4,165	392	427	477
Debt securities . . . . .	44,404	—	1,925	8,983	15,168	18,328
Equity securities . . . . .	20,139	20,139	—	—	—	—
Derivative financial instruments . . . . .	422	—	14	107	301	—
Reinsurance receivables . . . . .	87	—	87	—	—	—
Cash and cash equivalents . . . . .	2,583	—	2,583	—	—	—
<b>Total . . . . .</b>	<b><u>73,300</u></b>	<b><u>20,343</u></b>	<b><u>8,774</u></b>	<b><u>9,482</u></b>	<b><u>15,896</u></b>	<b><u>18,805</u></b>
Financial liabilities and insurance contracts:						
Insurance and investment contracts (net of reinsurance) . . . . .	61,659	43	(1,316)	(929)	4,699	59,162
Borrowings . . . . .	1,461	4	911	546 <sup>(1)</sup>	—	—
Obligations under securities lending and repurchase agreements . . . . .	5,395	—	5,395	—	—	—
Derivative financial instruments . . . . .	47	—	1	12	34	—
Other liabilities including tax payable . . . . .	1,843	—	1,843	—	—	—
<b>Total . . . . .</b>	<b><u>70,405</u></b>	<b><u>47</u></b>	<b><u>6,834</u></b>	<b><u>(371)</u></b>	<b><u>4,733</u></b>	<b><u>59,162</u></b>

Note: (1) Includes amounts of US\$542m (2008: US\$542m; 2007: US\$546m) falling due after 2 years through 5 years

	<u>Total</u>	<u>No fixed maturity</u>	<u>Due in one year or less</u>	<u>Due after one year through five years</u>	<u>Due after five years through 10 years</u>	<u>Due after 10 years</u>
US\$m						
<b>30 November 2008</b>						
Financial assets:						
Loans and receivables . . . . .	4,002	232	2,220	736	637	177
Debt securities . . . . .	42,323	—	1,842	9,568	13,661	17,252
Equity securities . . . . .	8,747	8,747	—	—	—	—
Derivative financial instruments . . . . .	252	—	2	160	90	—
Reinsurance receivables . . . . .	19	—	19	—	—	—
Cash and cash equivalents . . . . .	4,164	—	4,164	—	—	—
<b>Total . . . . .</b>	<b><u>59,507</u></b>	<b><u>8,979</u></b>	<b><u>8,247</u></b>	<b><u>10,464</u></b>	<b><u>14,388</u></b>	<b><u>17,429</u></b>
Financial liabilities and insurance contracts:						
Insurance and investment contracts (net of reinsurance) . . . . .	57,334	46	(1,304)	(1,824)	3,114	57,302
Borrowings . . . . .	661	4	108	549 <sup>(1)</sup>	—	—
Obligations under securities lending and repurchase agreements . . . . .	2,718	—	2,718	—	—	—
Derivative financial instruments . . . . .	138	—	19	53	58	8
Other liabilities including tax payable . . . . .	1,407	—	1,407	—	—	—
<b>Total . . . . .</b>	<b><u>62,258</u></b>	<b><u>50</u></b>	<b><u>2,948</u></b>	<b><u>(1,222)</u></b>	<b><u>3,172</u></b>	<b><u>57,310</u></b>

	<u>Total</u>	<u>No fixed maturity</u>	<u>Due in one year or less</u>	<u>Due after one year through five years</u>	<u>Due after five years through 10 years</u>	<u>Due after 10 years</u>
<b>US\$m</b>						
<b>30 November 2009</b>						
Financial assets:						
Loans and receivables . . . . .	4,648	1,814	1,508	209	626	491
Debt securities . . . . .	52,201	—	1,624	11,825	14,806	23,946
Equity securities . . . . .	16,178	16,178	—	—	—	—
Derivative financial instruments . . . . .	453	—	12	308	133	—
Reinsurance receivables . . . . .	29	—	29	—	—	—
Cash and cash equivalents . . . . .	3,405	—	3,405	—	—	—
<b>Total . . . . .</b>	<b><u>76,914</u></b>	<b><u>17,992</u></b>	<b><u>6,578</u></b>	<b><u>12,342</u></b>	<b><u>15,565</u></b>	<b><u>24,437</u></b>
Financial liabilities and insurance contracts:						
Insurance and investment contracts (net of reinsurance) . . . . .	71,328	—	(687)	922	6,628	64,465
Borrowings . . . . .	688	139	7	542 <sup>(1)</sup>	—	—
Obligations under securities lending and repurchase agreements . . . . .	284	—	284	—	—	—
Derivative financial instruments . . . . .	71	—	10	46	14	1
Other liabilities including tax payable . . . . .	1,800	—	1,800	—	—	—
<b>Total . . . . .</b>	<b><u>74,171</u></b>	<b><u>139</u></b>	<b><u>1,414</u></b>	<b><u>1,510</u></b>	<b><u>6,642</u></b>	<b><u>63,466</u></b>

Note: (1) Includes amounts of US\$542m (2008: US\$542m; 2007: US\$546m) falling due after 2 years through 5 years

### 38. Employee benefits

#### *Defined benefit plans*

	<u>As at 30 November 2007</u>	<u>As at 30 November 2008</u>	<u>As at 30 November 2009</u>
	US\$m		
<b>US\$m</b>			
Present value of unfunded obligations . . . . .	40	64	58
Present value of funded obligations . . . . .	<u>61</u>	<u>37</u>	<u>52</u>
<b>Total present value of obligations . . . . .</b>	<b>101</b>	<b>101</b>	<b>110</b>
Fair value of plan assets . . . . .	(56)	(50)	(53)
<b>Present value of net obligations . . . . .</b>	<b>45</b>	<b>51</b>	<b>57</b>
Unrecognised past service (cost)/benefit . . . . .	—	(1)	(1)
<b>Net recognised defined benefit obligations . . . . .</b>	<b><u>45</u></b>	<b><u>50</u></b>	<b><u>56</u></b>
<b>Recognised defined benefit deficits . . . . .</b>	<b><u>53</u></b>	<b><u>68</u></b>	<b><u>76</u></b>
<b>Recognised defined benefit surpluses . . . . .</b>	<b><u>(8)</u></b>	<b><u>(18)</u></b>	<b><u>(20)</u></b>

The AIA Group operates funded and unfunded defined benefit plans that provide life and medical benefits for participating employees after retirement and a lump sum benefit on cessation of employment. The locations covered by these plans include Hong Kong, Singapore, Malaysia, Thailand, Taiwan, Indonesia, the Philippines and Korea.

Plan assets comprise:

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
<b>US\$m</b>			
Equity securities . . . . .	3	2	1
Debt securities . . . . .	1	—	1
Real estate . . . . .	40	38	39
Investment contracts issued by third party financial institutions . . . . .	10	9	12
Bank deposits . . . . .	<u>2</u>	<u>1</u>	<u>—</u>
<b>Total</b> . . . . .	<b><u>56</u></b>	<b><u>50</u></b>	<b><u>53</u></b>

*Movement in the present value of defined benefit obligations*

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
At 1 December . . . . .	86	101	101
Benefits paid by the plan . . . . .	(3)	(6)	(6)
Current service costs and interest (see next page) . . . . .	15	17	19
Actuarial losses/(gains) . . . . .	(3)	2	(11)
Plan settlement, curtailment or amendment . . . . .	—	1	(1)
Foreign exchange movements . . . . .	<u>6</u>	<u>(14)</u>	<u>8</u>
<b>At 30 November</b> . . . . .	<b><u>101</u></b>	<b><u>101</u></b>	<b><u>110</u></b>

*Movement in the fair value of plan assets*

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
At 1 December . . . . .	37	56	50
Contributions paid into the plan . . . . .	6	7	4
Benefits paid by the plan . . . . .	(3)	(6)	(7)
Expected return on plan assets . . . . .	3	5	5
Actuarial gains/(losses) . . . . .	7	(2)	(2)
Foreign exchange movements . . . . .	6	(10)	4
Asset distributed on settlement . . . . .	<u>—</u>	<u>—</u>	<u>(1)</u>
<b>At 30 November</b> . . . . .	<b><u>56</u></b>	<b><u>50</u></b>	<b><u>53</u></b>

*Expense recognised in consolidated income statement*

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
Current service costs . . . . .	10	11	13
Interest on obligation . . . . .	5	6	6
Expected return on plan assets . . . . .	(3)	(5)	(5)
Actuarial (gains)/losses recognised . . . . .	(11)	5	(8)
Settlement/curtailment (gains)/losses recognised . . . . .	<u>—</u>	<u>—</u>	<u>—</u>
<b>Total</b> . . . . .	<b><u>1</u></b>	<b><u>17</u></b>	<b><u>6</u></b>

The expense is recognised within the following line items in the consolidated income statement:

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
Operating expenses . . . . .	1	17	6

### Actuarial assumptions

Principal actuarial assumptions at the reporting date are in the following ranges:

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
Expected return on plan assets at the start of the reporting period . . . . .	2.5 — 10.5%	2.75 — 9.75%	2.75 — 12.5%
Future salary increases . . . . .	3.0 — 9.0%	3.0 — 10.0%	3.0 — 10.0%
Healthcare trend rate:			
Immediate trend rate . . . . .	4.0 — 12.5%	4.0 — 12.5%	4.0 — 10.5%
Ultimate trend rate . . . . .	4.0 — 10.5%	4.0 — 10.5%	4.0 — 10.5%
Year in which the ultimate trend rate is reached . . . . .	2008 — 2013	2009 — 2013	2010 — 2013
Discount rate at the end of the reporting period . . . . .	2.75 — 11.0%	1.5 — 15.0%	1.5 — 15.0%

The overall expected long-term rate of return is based on the portfolios as a whole and not on the sum of the returns on individual asset categories. The return is based on historical returns without adjustment.

Assumptions regarding future mortality rates are based on published statistics and mortality tables. Average retirement ages and life expectancies are set out below for the principal locations with defined benefit post retirement benefit.

	Hong Kong	Singapore	Thailand	Malaysia	Philippines
Retirement age . . . . .	65	62	60	55 — 60	65
Average life expectancy on retirement					
Males . . . . .	18.5 years	21.5 years	18.1 years	19.2 — 23.3 years	17.3 years
Females . . . . .	20.4 years	24.1 years	21.2 years	25.5 — 29.9 years	20.8 years

Assumed healthcare cost trend rates affect the amounts recognised in profit or loss. A 1% change in assumed healthcare cost trend rates would have the following effects (expressed as weighted averages):

	1% increase			1% decrease		
	2007	2008	2009	2007	2008	2009
<b>US\$m</b>						
Effect on the aggregate service and interest cost . . . . .	—	—	1	—	(1)	(1)
Effect on defined benefit obligation . . . . .	1	7	4	(1)	(5)	(3)

### Historical information

	As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
<b>US\$m</b>			
Present value of the defined benefit obligation . . . . .	101	101	110
Fair value of plan assets . . . . .	(56)	(50)	(53)
Deficits of the plans . . . . .	45	51	57
Experience gain/(loss) arising on plan liabilities . . . . .	(2)	(14)	(7)
Experience gain/(loss) arising on plan assets . . . . .	6	(2)	(2)

Contributions to funded and unfunded defined benefit plans during the year ended 30 November 2009 are not expected to be material.

### Defined contribution plans

The AIA Group operates a number of defined contribution pension plans. The total expense relating to these plans in the current period was US\$30m (2007: US\$20m; 2008: US\$27m).

The outstanding liability for defined contribution benefit plans is US\$1m (2007: nil; 2008: US\$1m).

### 39. Share based compensation

#### *Stock compensation plans*

The AIA Group's employees have participated in seven different stock based compensation arrangements of AIG; the AIG 1999 Stock Option Plan, as amended ('the 1999 plan'), the AIG 1996 Employee Stock Purchase Plan, as amended ('the 1996 plan'), the 2002 and the 2007 AIG Stock Incentive Plans, as amended (collectively 'the AIG stock incentive plans'), various SICO Plans, the Deferred Compensation Profit Participation Plan ('DCPPP') and the Partners Plan.

Under IFRS, share based compensation is recognised and measured based on the fair value of the equity instruments granted measured at grant date. The AIA Group is required to continue to recognise an expense in respect of share based compensation based on the fair value of the options at grant date.

On 30 June 2009, AIG completed a one-for-twenty reverse stock split. The comparative information presented for number of shares and option exercise prices reflects the reverse stock split. The reverse stock split did not result in any changes to the underlying terms or value of the share awards.

#### *The 1999 plan*

Under the 1999 plan, options to purchase a certain number of shares of AIG's common stock have been granted to officers and other key employees of the AIA Group and its subsidiaries at prices not less than the fair market value of those shares at the date of grant. The maximum number of options granted under the Plan in total is 2,250,000 and the maximum number of shares that may be granted to any employee in any one year is 45,000. Under this plan, 25% of the options become exercisable on the anniversary of the date of grant in each of the four years following that grant and expire 10 years from the date of grant. Each vesting tranche is accounted for as a separate grant for the purposes of recognising the expense over the vesting period.

	Year ended 30 November 2007		Year ended 30 November 2008		Year ended 30 November 2009	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
<b>Options</b>						
Outstanding at 1 December . . . . .	47,622	\$1,222.63	46,769	\$1,240.01	47,539	\$1,232.40
Granted . . . . .	3,800	\$1,413.45	3,750	\$1,132.66	—	—
Transfers in . . . . .	6,795	\$1,221.91	2,325	\$1,237.60	1,264	\$1,237.04
Exercised . . . . .	(1,047)	\$1,126.07	—	—	—	—
Transfers out . . . . .	(8,695)	\$1,221.67	(3,451)	\$1,235.41	(2,411)	\$1,224.94
Forfeited or expired . . . . .	<u>(1,706)</u>	<u>\$1,238.86</u>	<u>(1,854)</u>	<u>\$1,223.14</u>	<u>(4,873)</u>	<u>\$1,139.50</u>
Outstanding at 30 November . . . . .	46,769	\$1,239.78	47,539	\$1,232.42	41,519	\$1,232.47
Options exercisable at 30 November . . .	27,459	\$1,194.24	33,678	\$1,216.39	35,742	\$1,226.56
Weighted average fair value per share of options granted during the year . . . . .		\$ 468.93		\$ 415.81		N/A

Information about options outstanding and options exercisable by the AIA Group's employees and directors as at the end of each reporting period are as follows:

Range of exercise prices	Options outstanding			Options exercisable		
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price US\$	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price US\$
<b>30 November 2007</b>						
Range of exercise prices:						
Less than or equal to US\$1,000 . . . . .	5,663	5.25	940.00	5,663	5.25	940.00
US\$1,000.01 — US\$1,100.00 . . . . .	12	4.67	1,058.00	12	4.67	1,058.00
US\$1,100.01 — US\$1,200.00 . . . . .	7,104	7.83	1,186.98	3,589	7.83	1,186.97
US\$1,200.01 — US\$1,300.00 . . . . .	21,301	6.19	1,268.20	15,522	5.97	1,261.51
US\$1,300.01 — US\$1,400.00 . . . . .	8,780	8.16	1,322.67	2,164	8.08	1,319.80
More than US\$1,400.01 . . . . .	3,909	8.59	1,429.55	509	5.74	1,492.73
<b>Total</b> . . . . .	<b>46,769</b>	<b>6.90</b>	<b>1,239.78</b>	<b>27,459</b>	<b>6.22</b>	<b>1,194.24</b>
<b>30 November 2008</b>						
Range of exercise prices:						
Less than or equal to US\$1,000 . . . . .	5,411	4.25	940.00	5,411	4.25	940.00
US\$1,000.01 — US\$1,100.00 . . . . .	237	8.96	1,029.96	12	3.67	1,058.00
US\$1,100.01 — US\$1,200.00 . . . . .	9,789	7.59	1,171.48	4,821	6.83	1,186.97
US\$1,200.01 — US\$1,300.00 . . . . .	19,938	5.18	1,268.01	17,954	5.09	1,265.70
US\$1,300.01 — US\$1,400.00 . . . . .	8,255	7.17	1,322.85	4,046	7.13	1,321.36
More than US\$1,400.01 . . . . .	3,909	7.59	1,429.55	1,434	6.74	1,446.05
<b>Total</b> . . . . .	<b>47,539</b>	<b>6.13</b>	<b>1,232.42</b>	<b>33,678</b>	<b>5.52</b>	<b>1,216.39</b>
<b>30 November 2009</b>						
Range of exercise prices:						
Less than or equal to US\$1,000 . . . . .	4,728	3.25	940.00	4,728	3.25	940.00
US\$1,000.01 — US\$1,100.00 . . . . .	224	8.25	1,028.39	56	8.25	1,028.39
US\$1,100.01 — US\$1,200.00 . . . . .	8,921	6.65	1,169.69	6,628	6.15	1,179.59
US\$1,200.01 — US\$1,300.00 . . . . .	16,838	4.17	1,267.57	16,838	4.17	1,267.57
US\$1,300.01 — US\$1,400.00 . . . . .	6,902	6.19	1,323.43	5,111	6.15	1,322.24
More than US\$1,400.01 . . . . .	3,906	6.59	1,429.49	2,381	6.28	1,435.57
<b>Total</b> . . . . .	<b>41,519</b>	<b>5.18</b>	<b>1,232.47</b>	<b>35,742</b>	<b>4.85</b>	<b>1,226.56</b>

*The 1996 plan*

Under the 1996 plan, full time employees of AIG and its subsidiaries who have been employed for one or more years of service at the time of offering are eligible to purchase common stock of AIG at 85% of the fair market value as at the date of grant of the purchase right. Purchase rights of eligible employees are granted quarterly and are limited to the number of whole shares that can be purchased by an amount equal to 10% of their annual basic salary (excluding year end bonus) to a maximum of US\$10,000 payable in 12 monthly instalments and may be cancelled at any time after commencement but before the last instalment date and receive a full return of contribution to date.

For the years ended 30 November 2008 and 2009, nil shares were purchased by employees of AIA Group (2007: 2,244 shares purchased at prices ranging from US\$1,142.80 to US\$1,190.60). 188 subscribed shares were cancelled during 2007. The weighted average fair value per share of the purchase rights granted in 2007 was US\$222.80.

The subscriptions were cancelled from October 2007 based on the market value of the common stock of AIG.

*The AIG stock incentive plans*

These plans provide equity based or equity related awards to employees of AIG and its subsidiaries.

Prior to March 2008, substantially all time-vested RSUs were scheduled to vest on the fourth anniversary of the date of grant. Effective March 2008, the vesting of the December 2005, 2006 and 2007 grants was accelerated to vest on the third anniversary of the date of grant.

### *SICO plans*

Starr International Company Inc ('SICO') provided compensation participation plans ('SICO plans') to certain AIA Group employees. The SICO plans came into being in 1975 when the voting shareholders and the board of directors of SICO, a private holding company whose principal asset consisted of common stock in AIG, decided that a portion of the capital value of SICO should be used to provide an incentive plan for current and succeeding management of all companies in the wider group headed by AIG. Certain directors and employees of the AIA Group participate in the SICO plans. Historically, SICO's board of directors could elect to pay participants cash in lieu of shares of common stock of AIG. On 9 December 2005, SICO notified participants that essentially all subsequent distributions would be made only in shares, and not cash.

### *DCPPP*

Effective from 21 September 2005, AIG adopted the DCPPP, which provides equity based compensation to key employees of the wider group, including senior executive officers. The DCPPP was modelled on the SICO plans.

The DCPPP contingently allocated a fixed number of shares to each participant if AIG's cumulative adjusted earnings per share for 2005 and 2006 exceeded that for 2003 and 2004. This goal was met. At the end of the performance period, common shares are contingently allocated. The service period and related vesting consists of three pre-retirement tranches and a final retirement tranche at age 65. Due to a modification in March 2008 the vesting period was shortened to vest in three instalments, with the final instalment vesting in January 2012.

### *Partners Plan*

On 26 June 2006, AIG's Compensation Committee approved two grants under the Partners Plan. The first grant has a performance period which runs from 1 January 2006 through 31 December 2007. The second grant has a performance period which runs from 1 January 2007 through 31 December 2008.

In December 2007, the Compensation Committee approved a grant with a performance period from 1 January 2008 through 31 December 2009. The Compensation Committee approved the performance metrics for this grant in the first quarter of 2008. The first and the second grants vest 50% on the fourth and sixth anniversaries of the first day of the related performance period. The third grant vest 50% on the third and fourth anniversaries of the first day of the performance period.

Similar to the stock option plan, each vesting tranche is accounted for as a separate grant for the purpose of recognising the expense over the vesting period.

All grants were modified in March 2008. In 2007 and 2008 no compensation cost was recognised as the performance targets for these awards were not met, and the compensation cost recognised in 2006 was reversed as a result.

### *Valuation methodology*

The AIA Group utilises a binominal lattice model to calculate the fair value of AIG stock option grants. A more detailed description of the valuation methodology is provided below.

The following weighted average assumptions were used for stock options granted for the following periods:

	<u>Year ended 30 November 2007</u>	<u>Year ended 30 November 2008</u>	<u>Year ended 30 November 2009</u>
%			
Expected annual dividend yield . . . . .	1.39%	3.77%	N/A
Expected volatility . . . . .	32.82%	53.27%	N/A
Risk free interest rate . . . . .	4.08%	4.43%	N/A
Expected term . . . . .	7 years	4 years	N/A

The dividend yield is determined at the grant date. The expected volatility is the average of historical volatility (based on seven years of daily stock price changes) and the implied volatility of actively traded options on AIG's shares and the interest rate curves used in the valuation model were the US Treasury STRIP rates with terms from three months to 10 years. In 2008, the expected term is four years based on the average time to exercise which is derived from the output of the valuation model. In 2007 and 2006, the contractual term of the option is generally 10 years with an expected term of seven years calculated based on an analysis of historical employee exercise behaviour and employee turnover (post vesting terminations). The early exercise rate is a function of time elapsed since the grant. 15 years of historical data was used to estimate the early exercise rate.

The fair value of each award granted under the 1996, 1999 and AIG stock incentive plans, the DCP PP, the Partners Plan and the SICO Plans considers, as required, the above factors as well as the closing price of the former ultimate parent company's stock on the date of grant.

A summary of shares relating to outstanding awards to the AIA Group's employees and directors unvested under the AIG stock incentive plans, SICO plans, DCP PP and Partners Plan is presented below:

	Number of shares				Weighted average grant date fair value (US\$)			
	AIG stock incentive plans	SICO	DCPPP	Partners Plan	AIG stock incentive plans	SICO	DCPPP	Partners Plan
<b>Year ended 30 November 2007</b>								
At 1 December . . . . .	5,614	10,388	13,100	13,409	1,256.03	1,241.63	1,103.68	1,138.25
Granted . . . . .	7,779	—	1,288	838	1,387.28	—	1,122.44	1,295.85
Transfers in . . . . .	1,741	—	—	2,210	1,280.74	—	—	1,127.80
Issued/exercised . . . . .	(282)	(1,775)	—	—	1,233.02	1,291.07	—	—
Transfers out . . . . .	(645)	(2,361)	(1,901)	(2,865)	1,324.91	1,230.00	1,089.60	1,128.41
Forfeited . . . . .	(1,272)	(150)	(180)	(428)	1,315.55	1,209.00	1,093.80	1,126.12
<b>At 30 November . . . . .</b>	<b><u>12,935</u></b>	<b><u>6,102</u></b>	<b><u>12,307</u></b>	<b><u>13,164</u></b>	<b><u>1,329.51</u></b>	<b><u>1,259.98</u></b>	<b><u>1,148.09</u></b>	<b><u>1,149.65</u></b>
<b>Year ended 30 November 2008</b>								
At 1 December . . . . .	12,935	6,102	12,307	13,164	1,329.51	1,259.98	1,148.09	1,149.65
Granted . . . . .	13,654	—	—	10,532	1,082.54	—	—	1,085.36
Transfers in . . . . .	1,039	1,648	1,030	1,054	1,315.40	1,217.33	1,154.07	1,138.48
Issued/exercised . . . . .	(390)	(1,325)	—	—	1,286.67	1,294.40	—	—
Transfers out . . . . .	(1,084)	(345)	(360)	(878)	1,321.62	1,198.53	1,152.27	1,108.50
Forfeited . . . . .	(3,378)	(520)	(760)	(2,624)	1,215.81	1,193.07	1,151.25	1,113.34
<b>At 30 November . . . . .</b>	<b><u>22,776</u></b>	<b><u>5,560</u></b>	<b><u>12,217</u></b>	<b><u>21,248</u></b>	<b><u>1,198.77</u></b>	<b><u>1,248.82</u></b>	<b><u>1,173.52</u></b>	<b><u>1,125.62</u></b>
<b>Year ended 30 November 2009</b>								
At 1 December . . . . .	22,776	5,560	12,217	21,248	1,198.80	1,248.80	1,173.60	1,125.60
Granted . . . . .	—	—	2,851	—	—	—	1,131.95	—
Transfers in . . . . .	1,705	220	448	1,010	1,193.62	1,175.27	1,147.78	1,097.40
Issued/exercised . . . . .	(4,054)	(750)	(8,310)	(395)	1,252.97	1,277.28	1,157.70	1,132.78
Transfers out . . . . .	(1,948)	(400)	(647)	(1,645)	1,206.05	1,235.13	1,159.08	1,101.89
Forfeited . . . . .	(3,520)	(1,240)	(1,779)	(9,134)	1,243.14	1,189.50	1,146.87	1,129.60
<b>At 30 November . . . . .</b>	<b><u>14,959</u></b>	<b><u>3,390</u></b>	<b><u>4,780</u></b>	<b><u>11,084</u></b>	<b><u>1,182.33</u></b>	<b><u>1,208.53</u></b>	<b><u>1,142.31</u></b>	<b><u>1,107.19</u></b>

*Recognised compensation cost*

The total recognised compensation cost (net of expected forfeitures) related to share based compensation awards granted under the 1999 plan, the AIG stock incentive plans, the DCP PP, the Partners Plan and the SICO Plans are as follows:

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
1999 plan . . . . .	3	2	1
AIG stock incentive plans . . . . .	4	10	7
DCPPP . . . . .	3	3	—
Partners Plan . . . . .	—	4	—
SICO Plans . . . . .	<u>1</u>	<u>—</u>	<u>—</u>
<b>Total . . . . .</b>	<b><u>11</u></b>	<b><u>19</u></b>	<b><u>8</u></b>

The increase in the recognised compensation expense for AIG stock incentive plans in 2008 of US\$10m (2007: US\$4m) relates to the reduction of vesting periods and additional share grants during 2008.

### Unrecognised compensation cost

The total unrecognised compensation costs (net of expected forfeitures) related to non-vested share based compensation awards granted under the 1999 and AIG stock incentive plans, the DCP, the Partners Plan and the SICO Plans are as follows:

	<u>Remaining weighted average vesting period at 30 November 2009</u>	<u>Unrecognised compensation costs at 30 November 2009</u>
<b>US\$m</b>		
1999 plan . . . . .	3 years	—
AIG stock incentive plans . . . . .	Within 1 year	6
DCP . . . . .	Within 1 year	1
Partners Plan . . . . .	Within 1 year	<u>1</u>
Total AIG plans . . . . .	3 years	8
SICO plans . . . . .	5 years	<u>2</u>
<b>Total</b> . . . . .		<b><u>10</u></b>

## 40. Remuneration of directors and key management personnel

### Directors' remuneration

The Executive Directors receive compensation in the form of salaries, bonuses, contributions to pension schemes, long term incentives, housing and other allowances, and benefits in kind subject to applicable laws, rules and regulations. Bonuses and long term incentives represent the variable components in the Executive Directors' compensation and are linked to the performance of the AIA Group and the individual Executive Directors. The share and share option awards presented relate to the AIG schemes described in note 39.

The AIA Group's remuneration of individuals that were directors of AIA at 30 November 2009 is included for all years presented in the tables below. There were no other directors of AIA between the date of its incorporation on 24 August 2009 and 30 November 2009.

Directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

	<u>Year ended 30 November 2007</u>	<u>Year ended 30 November 2008</u>	<u>Year ended 30 November 2009</u>
<b>US\$</b>			
Directors' fees . . . . .	—	—	—
Salaries, allowances and benefits in kind . . . . .	1,426,708	1,415,907	2,646,129
Bonuses . . . . .	1,140,000	475,000	2,394,779
Share based payment . . . . .	126,035	692,174	687,214
Pension scheme contributions . . . . .	45,861	60,080	60,180
Post employment benefits . . . . .	9,686	13,007	13,334
<b>Total</b> . . . . .	<b><u>2,748,290</u></b>	<b><u>2,656,168</u></b>	<b><u>5,801,636</u></b>

Note: In March 2010, share and cash awards with a total value of \$4.7 million were granted to a director in respect of 2009 remuneration, in addition to the figures listed above. The cost associated with these awards does not form part of 2009 AIA Group Historical Financial Information as the awards were not made during the year ended 30 November, 2009.

### Key management personnel remuneration

Key management personnel have been identified as the members of the AIA Group's Exco and members of the AIA Board as at 30 November 2009. The remuneration of these individual has been included for all periods presented.

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$</b>			
<b>Key management compensation and other expenses</b>			
Salaries and other short term employee benefits <sup>(1)</sup> . . . . .	7,108,733	7,793,734	14,900,774
Post employment benefits — defined contribution . . . . .	277,866	372,026	315,858
Post employment benefits — defined benefit . . . . .	10,676	12,511	29,517
Post employment benefits — medical & life . . . . .	30,100	38,981	40,159
Other long term benefits . . . . .	—	—	2,586,969
Share based payment . . . . .	<u>626,551</u>	<u>1,993,218</u>	<u>1,418,414</u>
<b>Total</b> . . . . .	<b><u>8,053,926</u></b>	<b><u>10,210,470</u></b>	<b><u>19,291,691</u></b>

#### 41. Related party transactions

##### *Transactions with related parties*

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
<b>Transactions with related parties</b>			
Reinsurance related parties (income)/expense			
Premiums assumed . . . . .	(9)	(64)	(63)
Premiums ceded to reinsurers . . . . .	607	171	21
Claims recovered from reinsurers . . . . .	(324)	(75)	(5)
Claims paid on inwards reinsurance . . . . .	—	35	48
Recapture fee (see Note 5) . . . . .	—	190	—
Commissions and fee income . . . . .	<u>(41)</u>	<u>(13)</u>	<u>—</u>
	<b>233</b>	<b>244</b>	<b>1</b>
Non-insurance related party income			
Interest income . . . . .	(36)	(30)	(3)
Income from services provided . . . . .	<u>(45)</u>	<u>(46)</u>	<u>(39)</u>
	<b>(81)</b>	<b>(76)</b>	<b>(42)</b>
Non-insurance related party expenses			
Interest expense . . . . .	9	7	1
Purchases of services . . . . .	57	68	34
Corporate service fees . . . . .	<u>29</u>	<u>33</u>	<u>23</u>
	<b>95</b>	<b>108</b>	<b>58</b>
<b>Total</b> . . . . .	<b><u>247</u></b>	<b><u>276</u></b>	<b><u>17</u></b>
<b>Term deposits held with related parties</b> . . . . .	<b><u>47</u></b>	<b><u>78</u></b>	<b><u>—</u></b>
<b>Amounts due from related parties</b>			
Insurance related amounts receivable . . . . .	83	9	1
Loans receivable . . . . .	1,589	29	87
Other amounts receivable . . . . .	<u>95</u>	<u>33</u>	<u>1</u>
<b>Total</b> . . . . .	<b><u>1,767</u></b>	<b><u>71</u></b>	<b><u>89</u></b>
<b>Amounts due to related parties</b>			
Insurance related amounts payable . . . . .	76	7	3
Loans payable . . . . .	812	20	50
Other amounts payable . . . . .	<u>12</u>	<u>29</u>	<u>51</u>
<b>Total</b> . . . . .	<b><u>900</u></b>	<b><u>56</u></b>	<b><u>104</u></b>

Transactions with related parties are transactions with fellow subsidiaries of AIG with the exception of premiums assumed from joint ventures and associates US\$nil (2007: US\$1m; 2008: US\$1m). Certain group companies receive amounts on behalf of and pay amounts on behalf of fellow subsidiaries. These amounts are included within other amounts receivable/payable. Refer to Note 1 for transactions relating to the AIA Group Reorganisation.

The recapture fee of US\$190m in 2008 relates to an amount paid by the AIA Group to its then immediate parent, AIRCO, in full and final settlement of the recapture of the reinsurer's share of certain risks ceded. Refer to Note 5 for additional information.

The above amounts receivable from and due to related parties are all balances with fellow subsidiaries of AIG. Insurance related and other amounts due from/to related parties are unsecured, non-interest bearing balances which are expected to be settled within one year.

The AIA Group has entered into securities lending agreements with related parties. During 2009, the AIA Group sold certain debt securities for proceeds of US\$864m to related parties, resulting in a recognised realised loss of US\$91m. These debt securities were purchased with collateral received from the securities lending program. See Note 30 for further information.

Remuneration of directors and key management personnel is disclosed in Note 40.

Derivative financial instruments are disclosed in Note 22.

## 42. Commitments and contingencies

### (a) Commitments under operating leases

Total future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
<b>Properties and others expiring</b>			
Not later than one year . . . . .	64	69	76
Later than one and not later than five years . . . . .	121	136	102
Later than five years . . . . .	<u>117</u>	<u>101</u>	<u>94</u>
<b>Total</b> . . . . .	<b><u>302</u></b>	<b><u>306</u></b>	<b><u>272</u></b>

The AIA Group is the lessee in respect of a number of properties and items of office equipment held under operating leases. The leases typically run for an initial period of one to seven years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually increased at the end of the lease term to reflect market rates. None of the leases include contingent rentals.

### (b) Investment commitments

	Year ended 30 November 2007	Year ended 30 November 2008	Year ended 30 November 2009
<b>US\$m</b>			
Not later than one year . . . . .	—	107	90
Later than one and not later than five years . . . . .	143	51	36
Later than five years . . . . .	<u>—</u>	<u>131</u>	<u>138</u>
<b>Total</b> . . . . .	<b><u>143</u></b>	<b><u>289</u></b>	<b><u>264</u></b>

Investment commitments consist of commitments to invest in private equity partnerships.

### (c) Contingencies

The AIA Group is subject to regulation in each of the geographical markets in which it operates by insurance, securities, capital markets, pension, data privacy and other regulators and is exposed to the risk of regulatory actions in response to perceived or actual non-compliance with regulations relating to suitability, sales or underwriting practices, claims payments and procedures, product design, disclosure, administration, denial or delay of benefits and breaches of fiduciary or other duties. The AIA Group believes that these matters have been adequately provided for in the AIA Group Historical Financial Information.

The AIA Group is exposed to legal proceedings, complaints and other actions from its activities including those arising from commercial activities, sales practices, suitability of products, policies and claims. The AIA Group believes these matters are adequately provided for in the AIA Group Historical Financial Information.

The AIA Group is the reinsurer in a residential mortgage credit reinsurance agreement covering residential mortgages in Australia. Due to a change in law, further cessions under this contract ended in July 2008. This reinsurance is fully retroceded to a subsidiary of AIG. The AIA Group is exposed to the risk of losses in the event of the failure of the counterparty retrocessionaire to honour its obligations. The principal balance outstanding of mortgage loans to which the reinsurance agreement relates were approximately US\$3,588m at 30 November 2009 (2008: US\$3,147m, 2007 US\$4,507m). The liabilities and related reinsurance assets, which totalled US\$24m (2008: US\$32m and 2007: US\$31m), respectively, arising from these agreements are reflected and presented on a gross basis in the AIA Group Historical Financial Information in accordance with the AIA Group's accounting policies. The AIA Group expects to fully recover amounts outstanding at the balance sheet date under the terms of this agreement from the retrocessionaire. In the event of a change in control, either party has the right to terminate the retrocession cover with the AIA Group electing whether the termination is on a run-off basis or clean cut basis.

The AIA Group provided reinsurance and retrocession of general insurance business which was primarily underwritten in the 1970s and 1980s. In the absence of any claim notifications in the three years ended 30 November 2009, the AIA Group does not expect any further material liabilities to arise. At the time AIA-B was transferred to the AIA Group pursuant to the Reorganisation, AIRCO, the former owner of AIA-B, provided AIA Co with an uncapped indemnification for losses with respect to claims made before 1 November 2010 that result from the underwriting activities of the Bermuda office of AIA-B prior to 28 February 2009.

The AIA Group has issued capital guarantees and minimum guaranteed rates of return ranging from 0% to 5% to holders of units of pension funds that have an accumulation value of approximately US\$1,260m (2008: US\$1,232m, 2007: US\$1,272m). The AIA Group has the ability to reduce the guaranteed rates of return, subject to obtaining approvals of applicable regulators.

The status of the licenses of the AIA Group is reviewed from time to time by the AIA Group's regulators in light of a number of factors including the legal structure of the AIA Group.

### 43. Subsidiaries

The principal subsidiary companies which materially contribute to the net income of the AIA Group or hold a material element of its assets and liabilities are:

	Place of incorporation and operation	Principal activity	Issued share capital	AIA Group's interest%		
				As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
American International Assurance Company Limited <sup>(1)</sup> ("AIA Co")	Hong Kong	Insurance	805,902,610 shares of US\$5 each	100%	100%	100%
American International Assurance Company (Bermuda) Limited ("AIA-B")	Bermuda	Insurance	3,000,000 shares of US\$1.20 each	100%	100%	100%
American International Assurance Company (Australia) Limited	Australia	Insurance	1,972,800 shares of AUD 1 each and 95,500 redeemable preference shares	100%	100%	100%
AIA Pension and Trustee Company Limited	British Virgin Islands	Trusteeship	1,300,000 ordinary shares of US\$1 each	100%	100%	100%
American International Assurance Berhad	Malaysia	Insurance	241,706,000 ordinary shares of RM1 each	—	100%	100%
PT AIA Financial (formerly known as PT AIG Life)	Indonesia	Insurance	477,711,032 shares of Rp1,000 each	100%	100%	100%
PT Asuransi AIA Indonesia <sup>(2)</sup>	Indonesia	Insurance	450 shares of Rp10 million each	60%	60%	—
The Philippine American Life & General Insurance Company	Philippines	Insurance	200,000,000 shares of P\$10 each	99.78%	99.78%	99.78%
AIA Life Insurance (Vietnam) Company Limited (formerly known as AIG Life Insurance (Vietnam) Company Limited)	Vietnam	Insurance	Contributed capital of VND 960,902,899,000	100%	100%	100%
Grand Design Development Limited	British Virgin Islands	Investment holding company	10,000 shares of US\$100 each	100%	100%	100%

	Place of incorporation and operation	Principal activity	Issued share capital	AIA Group's interest%		
				As at 30 November 2007	As at 30 November 2008	As at 30 November 2009
Bayshore Development Group Limited	British Virgin Islands	Investment holding company	100 shares of US\$1 each	90%	90%	90%
BPI-Philam Life Assurance Corporation (formerly known as Ayala Life Assurance Inc.)	Philippines	Insurance	749,993,979 shares of PHP\$1 each	—	—	51%

Note: (1) AIA's subsidiary

Note: (2) Disposed of during 2009

All subsidiaries are unlisted.

#### 44. Immediate and ultimate controlling party

Prior to 30 November 2009, the immediate controlling party of AIA Co was AIRCO, a Bermuda company whose ultimate parent company was AIG, an insurance and financial services group in the United States of America.

In September 2008, AIG entered into a US\$85 billion revolving credit agreement (the 'Credit Agreement') and a guarantee and pledge agreement with the FRBNY. In conjunction with the Credit Agreement, AIG agreed to issue a series of convertible participating preferred stock ('the Series C Preferred Stock') to a trust to be established for the sole benefit of the United States Treasury (the 'AIG Credit Facility Trust'). The Series C Preferred Stock was issued to the AIG Credit Facility Trust on 4 March 2009. The Series C Preferred Stock is entitled to vote with the AIG common stock on all matters, and holds approximately 79.8% of the aggregate voting power of AIG shareholders entitled to vote, on an as converted basis. The AIG Credit Facility Trust has three independent trustees. Pursuant to the terms of the Trust Agreement, the trustees have absolute discretion and ultimate control over the preferred stock, subject to the terms of the Trust Agreement, and exercise all rights, powers and privileges of a shareholder of AIG.

The direct shareholders of AIA Co did not change as a result of the actions described above. However, a change of control occurred at the level of AIG, the ultimate parent of AIA. Through its ownership of the Series C Preferred Stock, the Trust owns an indirect interest in all domestic and international subsidiaries owned directly or indirectly by AIG, and is the ultimate controlling party of AIG.

On 2 March 2009, AIG and the FRBNY announced their intent to enter into certain transactions that would, amongst other things, reduce AIG's obligations under the Credit Agreement mentioned above. Accordingly, the FRBNY Agreement was entered into on 25 June 2009. The following transactions were effected in accordance with the FRBNY Agreement:

- on 11 August 2009, AIG Life Holdings (International) LLC ("AIG Life") formed a special purpose vehicle, AIA Aurora LLC;
- on 24 August 2009, AIA Aurora LLC formed AIA Group Limited;
- on 8 October 2009, AIG Life transferred AIA Aurora LLC to AIRCO;
- on 30 November 2009, AIRCO transferred AIA Co to AIA Group Limited;
- on 1 December 2009, AIRCO transferred to the FRBNY a preferred interest, with a US\$16 billion liquidation preference, in AIA Aurora LLC;
- AIG retained 100% of the common interest of AIA Aurora LLC (1% directly and 99% indirectly through AIRCO) as at 1 December 2009; and
- as consideration for the preferred interests in AIA Aurora LLC received by the FRBNY, the outstanding balance owed by AIG under the Credit Agreement was reduced by US\$16 billion.

Accordingly, with effect from 30 November 2009, AIA Group Limited became the immediate controlling party of AIA Co, after AIRCO, the former immediate parent company of AIA, transferred AIA Co to AIA Group Limited.

#### 45. Events after the reporting period

On 22 December 2009 the Ministry of Finance of the People's Republic of China issued a new standard on accounting for insurance contracts. The AIA Group has made a preliminary assessment of the impact of this standard and whilst it will not impact the valuation of insurance and investment contract liabilities as presented in

the AIA Group Historical Financial Information, it is expected to have an impact on the future recognition of deferred tax assets and liabilities and current taxes payable. This is not expected to be material to the financial position of the AIA Group.

On 27 January 2010, the sale of the disposal group held for sale (see note 11) was completed.

On 4 February 2010, AIA issued 44 million shares to its immediate parent company, AIA Aurora LLC. As of 30 November 2009, these shares were reflected as shares yet to be issued as consideration had been received prior to that date.

On 1 March 2010, AIG announced that it had entered into a definitive agreement to sell the AIA Group to Prudential plc. The transaction is subject to approval of Prudential plc shareholders, regulatory approvals and customary closing conditions. The AIA Group is in the process of evaluating the contractual, regulatory and legal impacts of the change in control that would arise on completion of this transaction. The AIA Group Historical Financial Information does not reflect any impact arising from any requirement to sell or otherwise divest operations or other assets to complete the transaction. In connection with this transaction, interim operating covenants have been imposed on the AIA Group which restrict it from engaging in certain transactions without the prior consent of Prudential plc and establish a protocol for the approval of certain actions.

### III. FINANCIAL INFORMATION OF AIA

#### STATEMENT OF FINANCIAL POSITION AS AT 30 NOVEMBER 2009

US\$m	<u>Notes</u>	<u>30 November 2009</u>
<b>Assets</b>		
Investments in subsidiaries . . . . .	2	13,994
Cash and cash equivalents . . . . .		<u>44</u>
<b>Total assets</b> . . . . .		<b><u>14,038</u></b>
<b>Liabilities</b>		
Borrowings . . . . .	4	50
Provisions . . . . .	5	<u>30</u>
<b>Total Liabilities</b> . . . . .		<b><u>80</u></b>
<b>Equity</b>		
Issued share capital and shares yet to be issued . . . . .	6	12,044
Share premium . . . . .	6	1,914
Retained earnings . . . . .		<u>—</u>
<b>Total equity</b> . . . . .		<b><u>13,958</u></b>
<b>Total liabilities and equity</b> . . . . .		<b><u>14,038</u></b>

Note: (1) The historical financial information for AIA is presented for the period from initial formation on 24 August 2009 to 30 November 2009. The historical financial information for AIA should be read in conjunction with the consolidated AIA Group Historical Financial Information of the AIA Group.

(2) AIA's net profit for the period ended 30 November 2009 was US\$nil.

## NOTES TO FINANCIAL INFORMATION OF AIA

### 1. Accounting policies

Where applicable, the accounting policies of AIA are the same as for the AIA Group as set out on pages 11 to 35.

### 2. Investments in subsidiaries

Movements in AIA's investments in its subsidiaries are as follows:

	<u>Period ended 30 November 2009</u>
US\$m	
On formation . . . . .	—
Acquisitions . . . . .	13,994
Disposals . . . . .	—
<b>At 30 November . . . . .</b>	<b><u>13,994</u></b>

See note 43 of the AIA Group's Historical Financial Information for further information of AIA's subsidiaries.

### 3. Cash and cash equivalents

The cash and cash equivalents balance consists of cash of US\$44m and cash equivalents of US\$nil.

### 4. Borrowings

Borrowings represent a loan from AIG. The balance is non-interest bearing with no fixed maturity.

### 5. Provisions

In connection with AIA's acquisition of AIA Co a provision for expected transfer costs has been recognised.

### 6. Share capital and share premium

Details of share capital and share premium are presented in note 34 of the AIA Group's Historical Financial Information.

### 7. Risk management

Risk management in the context of the AIA Group is discussed in note 37 of the AIA Group's Historical Financial Information.

The business of AIA is managing its investments in subsidiaries, associates and joint venture operations. Its risks are considered to be the same as those described in the context of the consolidated group. Such investments are held by AIA at cost in accordance with accounting policy 2.4.

Financial assets, other than investments in subsidiaries, associates and joint ventures, largely consist of cash and cash equivalents.

Financial liabilities owed by AIA as at 30 November 2009 consist of borrowings from AIG.

### 8. Related party transactions

AIA receives dividend and interest income from subsidiaries and pays interest and expenses to those subsidiaries in the normal course of business.

Except as disclosed elsewhere in the AIA Group Historical Financial Information, there are no other material related party transactions.

## IV. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by AIA or any of its subsidiaries in respect of any period subsequent to 30 November 2009. No dividend has been declared, made or paid by the Company or any of its subsidiaries in respect of any period subsequent to 30 November.

## C. AIA EEV Information — Consulting Actuaries' Report

*The following is the text of a report from KPMG LLP for the purpose of incorporation in this prospectus.*



**KPMG LLP**  
8 Salisbury Square  
London  
EC4Y 8BB  
United Kingdom

The Directors  
Prudential plc  
Governors House  
Laurence Pountney Hill  
London  
EC4R 0HH

17 May 2010

Dear Sirs

### **Consulting Actuaries' Report**

#### **1 Introduction**

- 1.1 This report sets out the European Embedded Value (“EEV”) results of AIA Group as at 30 November 2009 as prepared by Prudential. Further, it sets out the contribution to the EEV of new covered business written in the twelve months prior.
- 1.2 Prudential has prepared these EEV results with the intention of complying with the EEV Principles issued by the CFO Forum of European Insurance Companies with the exception of certain disclosure requirements. The EEV results for AIA Group are prepared for “covered business”, as defined by the EEV Principles.
- 1.3 The EEV results do not reflect any consequences of the proposed acquisition of AIA Group by Prudential or events subsequent to 30 November 2009.
- 1.4 KPMG LLP has been engaged by Prudential to consider its preparation of the EEV results and provide an opinion in relation to those results and their compliance with the EEV Principles.

#### **2 Overview of AIA Group**

- 2.1 AIA Group is incorporated in Hong Kong and operates through a number of subsidiaries and branches. AIA (American International Assurance Company Limited) is a subsidiary of AIA Group. AIA-B (American International Assurance Company (Bermuda) Limited) is a subsidiary of AIA.
- 2.2 AIA, which directly writes business in Hong Kong and Macau\*, has subsidiaries in Australia, the Philippines (Philamlife) and Malaysia, and a subsidiary AIA Pension and Trustee Company Limited\* which also writes business in Hong Kong. AIA also has branches in China, Singapore, Brunei and Thailand.
- 2.3 AIA-B has subsidiaries in Vietnam and Indonesia (PT AIA Financial), together with branches in Hong Kong and Macau\*, Korea, New Zealand and Taiwan, and an associate in India, Tata AIG.

#### ***Insurance company fund structures***

- 2.4 The insurance businesses within the different countries that AIA Group operates are structured in a number of different ways.
- 2.5 In Thailand, the Philippines and Taiwan, there is no segregation of different funds and all assets and liabilities are maintained within a single fund. The fund structures of the other businesses are discussed below.

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\* Note these three entities are referred to as AIA Hong Kong (see 2.7 below)

- 2.6 There are a number of territories in which AIA writes general insurance business, i.e. Thailand, Hong Kong and Malaysia. The business written as general insurance in Thailand is Personal Accident, and in Hong Kong, Personal Accident and Group Medical, whilst only Malaysia writes “true” general insurance business, such as motor and fire. Within a number of territories (Thailand, China, Korea, Singapore and the Philippines) there are other entities, such as property management and asset management companies, which are small relative to the rest of the business.

### ***Hong Kong***

- 2.7 AIA Hong Kong writes business in Hong Kong, with a small amount in Macau. Policies are denominated in a mixture of US and Hong Kong dollars, and AIA Hong Kong comprises:
- Hong Kong and Macau business written directly by AIA;
  - Hong Kong and Macau branches of AIA-B; and
  - AIA Pension and Trustee Company Limited (“AIAPT”).
- 2.8 AIA Hong Kong maintains a shareholders’ fund which contains assets available to meet capital requirements and the liabilities of general insurance business together with separate funds for life assurance including annuities, for linked long term business, for permanent health business and various other funds for pensions business.
- 2.9 The proportion of the surplus that arises on participating business and which is distributed to policyholders varies by product.

### ***Malaysia***

- 2.10 AIA Malaysia maintains a shareholders’ fund which contains assets available to meet capital requirements and separate funds for participating business, non-participating business, investment-linked business and general insurance business. Shareholders are entitled to up to 10% of the profits arising from the participating fund.

### ***Singapore***

- 2.11 The Singapore branch of AIA maintains a shareholders’ fund which contains assets available to meet capital requirements together with a separate policyholder fund for participating business where shareholders are entitled to 10% of the profits arising from the fund. The vast majority of the participating business is Singapore dollar denominated. Separate funds are also maintained for non-participating business and investment-linked business.

### ***Brunei***

- 2.12 The Brunei branch of AIA maintains a shareholders’ fund which contains assets available to meet capital requirements. A separate policyholder fund for participating business is maintained where shareholders are entitled to 20% of profits arising from the fund. Separate funds for non-participating business and investment-linked business are also maintained.

### ***China***

- 2.13 The China branch maintains a general fund covering traditional non-participating business and non-unit reserves from both universal life and unit-linked business, plus surplus assets which are available to meet solvency capital requirements and are attributable to shareholders. A separate policyholder fund is maintained for participating business where shareholders are entitled to either 20% or 30% of the profits arising from the fund depending on the product. There are also separate policyholder funds for universal life business and for investment-linked business. The funds are segregated as required by the regulators.

### ***Korea***

- 2.14 The Korea branch maintains a Separate Account fund which contains the assets and liabilities related to Variable Universal Life (VUL) products and variable annuities. VUL products comprise most of the Separate Account business. There is also a General Account fund which contains all other assets and liabilities except those related to VUL products and variable annuities.

### ***Indonesia***

- 2.15 AIA Indonesia maintains a general fund which contains the assets and liabilities in respect of all non unit-linked business and includes shareholder funds. Shareholders are entitled to 100% of the surpluses arising from participating business after payment of policyholder dividends. A separate fund for investment-linked policies is also maintained.

### ***Australia***

- 2.16 AIA Australia maintains a shareholders' fund where assets are available to meet capital requirements. It also maintains a statutory fund which includes participating and non-participating sub-funds, as well as an annuity sub-fund and shareholder participation varies in these sub-funds. A separate statutory fund for investment-linked business is also maintained.

### ***Vietnam***

- 2.17 AIA Vietnam maintains a shareholders' fund where assets are available to meet capital requirements. A separate policyholder fund is maintained for participating business where shareholders are entitled to up to 30% of the profits arising, depending on the product. A separate policyholder fund for non-participating business is also maintained.

### ***Shareholders' interest in emerging profits***

- 2.18 The limits on distributions from policyholder funds to shareholder funds that have been allowed for in determining the EEV figures are:
- limits on participation by shareholders in segregated participating funds;
  - local regulatory reserving and capital requirements; and
  - Hong Kong reserving and capital requirements for the Hong Kong entities and their branches.
- 2.19 For all funds other than segregated participating funds, the shareholders are entitled to 100% of profits arising, subject to the above limitations.
- 2.20 With regards to distributions from the local businesses to AIA Group, AIA may be limited by regulators in distributing surpluses from one part of the group to another. No such restrictions were anticipated in the EEV projections.

## **3 Basis of preparation**

- 3.1 With the exception of certain disclosure requirements which are set out below, the EEV basis results have been prepared in accordance with the EEV Principles issued by the CFO Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005.
- 3.2 The following areas are not in compliance with the Additional Guidance on EEV Disclosures:
- Sensitivities have not been disclosed in respect of a 100 basis points pa reduction in the interest rate environment, a 10% decrease in equity / property capital values, or a 100 basis points pa increase in the yield on equity / property assets.
  - As an alternative to the above sensitivities, a 100 basis points pa increase and reduction in the projected earned rates assumed in valuing the in-force and new business has been disclosed.
  - An analysis of the return on embedded value has not been included. As embedded value reporting was not a component of AIA Group's day to day management reporting, embedded values have not been calculated at prior period ends.
- 3.3 The Directors of Prudential are responsible for the preparation of the embedded value information in this report in accordance with the EEV Principles, with the exceptions noted above.

### ***Covered business***

- 3.4 The EEV results for the AIA Group business are prepared for "covered business", as defined by the EEV Principles, and are shown net of any minority interests in the subsidiaries of AIA Group. Covered business represents AIA Group's long term insurance business for which the value of new and in-force contracts is

attributable at least in part to shareholders. Tata AIG, which is 26% owned by AIA-B, is included in the adjusted net worth on an IFRS basis.

- 3.5 The definition of long term insurance business comprises those contracts falling under the definition of long term insurance business for regulatory purposes. For the sake of clarity, this excludes internal asset management business, general insurance business and property management business. Personal accident and group medical expenses business is included in the definition of covered business. Net assets of the non-covered business are included in the net assets of the total EEV on an IFRS basis.

## **4 Methodology**

### *Overview*

- 4.1 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 AIA 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 a deduction for the cost of locked-in (required) capital;
  - locked-in (required) capital; and
  - the shareholders' net worth in excess of required capital (free surplus).
- 4.2 The value of future new business is excluded from the embedded value.
- 4.3 Notwithstanding the basis of presentation of results, no smoothing of market or account balance values, unrealised gains or investment return is applied to determine the embedded value.

### *Valuation of new business*

- 4.4 The contribution from new business represents the profits determined by applying the same operating and economic assumptions as those used for the 30 November 2009 value of in-force business. The only exception to this is for Hong Kong and Thailand where the long term returns were used for the whole projection period as opposed to grading to market yields. The impact of this difference is immaterial.
- 4.5 For Business Units that are in a development phase, or where the 2009 new business volumes are significantly lower than in previous years, expected acquisition expenses as opposed to actual acquisition expenses have been used.

### *Value of in-force business*

- 4.6 The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency, morbidity and mortality. 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 covered business that are not otherwise allowed for.
- 4.7 The total profit that emerges over the lifetime of an individual contract, as calculated using the embedded value basis, is the same as the total calculated under the IFRS basis. Under embedded value methodology, the profit emergence is advanced as the embedded value basis reflects discounted future cash flows, thus more closely aligning the timing of the recognition of profits with the efforts and risks of current management actions, particularly with regard to business sold during the year.

### *Cost of capital*

- 4.8 A charge is deducted from the embedded value for the cost of capital supporting AIA Group's long-term business. This capital is referred to as required capital. 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 investment earnings (net of tax and investment management expenses) on the capital.
- 4.9 The capital assumed in the calculation of the cost of capital is consistent with the definition of "Level of required capital" set out further below. The local regulatory and capital requirements are projected at the country specific earned rates assumed in the embedded value (after allowing for any investment management expenses and tax), and discounted at the country specific discount rates. Any additional capital required to meet the higher of the Hong Kong regulatory capital basis and the local basis is

projected at the Hong Kong earned rates (net of tax and investment expenses), and discounted at the discount rate relevant to Hong Kong.

- 4.10 The annual result will be 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 the run-off of business.

#### *Nature of options and guarantees in AIA Group's long term business*

- 4.11 The principal options and guarantees in AIA are those in relation to participating contracts which offer discretionary bonuses, some of which when added to the contracts form a guarantee, together with dividend and coupon accumulation contracts which when added to contracts are also guaranteed.
- 4.12 For the majority of participating business, the assets and liabilities are maintained in a separate fund, some of which are segregated funds and the cost of any options and guarantees accrue to the fund in the first instance. The key exception is Thailand where one fund exists for all assets and liabilities, and bonuses and dividends are at the discretion of AIA Thailand.
- 4.13 The dividend and accumulation contracts generally have minimum crediting rates of zero, except on pre-1977 Singapore and Hong Kong business which has a guaranteed minimum crediting rate of 3%. Thailand has guaranteed minimum crediting rates which vary from 2% to 6.5%. Thailand also offers a settlement option to policyholders where maturity proceeds can be placed on deposit with guaranteed rates of interest of 6% for dates of entry 1991 to 2003 and 2% from 2005 to 2008.
- 4.14 A number of territories have universal life contracts with guaranteed minimum crediting rates as follows: Singapore 3%, Malaysia 2%, Thailand 1%, China 1.75% to 2%, Vietnam 4%, Korea 2% to 5%.

#### *Time value of options and guarantees*

- 4.15 The embedded value methodology implemented for AIA Group makes implicit allowance for all sources of risk in the business including the cost of investment return guarantees and policyholder options, asset / liability mismatch risk, credit risk and the economic cost of capital through the use of a risk adjusted discount rate. Typically, the higher the risk discount rate, the greater the implied allowance for these factors.
- 4.16 The time value of options and guarantees arises from the variability of economic outcomes in the future. For major territories stochastic techniques have confirmed that the implicit quantum for risk as derived from AIA Group's embedded value methodology is sufficient to cover the cost of options and guarantees if they were explicitly valued, after an allowance for the cost of non-hedgeable risk.

#### *Level of required capital*

- 4.17 The more onerous of the local entity reserving and regulatory capital basis and the Hong Kong basis (at 150% of regulatory capital) for branches of AIA and AIA-B has been assumed. At 30 November 2009, the most onerous for AIA and AIA-B was the Hong Kong basis, and so for all territories other than the Philippines, Malaysia, Australia, Vietnam and Indonesia, the capital basis used was 150% of the Hong Kong regulatory basis. For the Philippines, Malaysia, Australia, Vietnam and Indonesia the impact of holding capital at the higher of the local entity reserving and regulatory capital basis and the Hong Kong basis (at 150% of regulatory capital) was considered but this was found to make no material impact on the embedded value results. The subsidiary nature of these companies led to the conclusion that it was more appropriate to include the local capital basis for these companies in the embedded value.
- 4.18 At the time of the global financial crisis certain regulatory authorities put in place measures that resulted in dividends and excess capital being held within the countries in question rather than flowing up to AIA Group. It has been assumed in the EEV results that any such regulatory restrictions on cash flows have been lifted.

#### *Allowance for risk and risk discount rates*

##### *Overview*

- 4.19 Under the EEV Principles, discount rates used to determine the present value of future cash flows are set equal to risk-free rates plus a risk margin. The risk margin reflects any non-diversifiable risk associated with the emergence of distributable earnings that is not allowed for elsewhere in the valuation.

- 4.20 Risk margins have generally been derived assuming that AIA Group is financed only with equity capital. The cost of equity capital is calculated using an estimated long term risk-free interest rate, an equity risk premium and a risk factor (beta).
- 4.21 The EEV Principles require that allowance is made in the embedded value for the potential impact on future shareholder cash flows of all financial options and guarantees within the in-force covered business. This allowance must include the time value of financial options and guarantees based on stochastic techniques consistent with the methodology and assumptions used in the underlying embedded value. Financial options and guarantees are not explicitly valued under the EEV methodology for AIA Group, but work has been performed using stochastic models to confirm that the allowance for risk implicit in the risk discount rates is sufficient.
- 4.22 The risk margin represents the aggregate of the allowance for market risk, additional allowance for credit risk where appropriate, allowance for non-diversifiable non-market risk, and uncertainty in non-market risks.

#### *Market risk allowance*

- 4.23 The allowance for market risk is represented by the multiple of beta and equity risk premium. The beta of a portfolio or product measures its relative market risk.

#### *Additional credit risk allowance*

- 4.24 The allowance for credit risk incorporated in the projected rates of return and the market risk allowance are sufficient. Accordingly, no additional allowance for credit risk is required.

#### *Allowance for non-diversifiable non-market risks*

- 4.25 The allowance for non-diversifiable non-market risk which is implicit in the risk discount rate is sufficient to cover the allowance of 50 basis points in the risk discount rate which Prudential assumes for the majority of its own business.

#### *Management actions*

- 4.26 In assessing whether the implicit allowance for the time value of financial options and guarantees in the risk discount rate is sufficient, the stochastic model used assumes no management actions in response to emerging investment and fund solvency conditions.

#### *Pension costs*

- 4.27 There are no material defined benefit pension schemes within AIA Group.

#### *Debt capital*

- 4.28 There are no core structural debt liabilities and no market traded debt liabilities. At 30 November 2009 AIA Group had borrowings totalling US\$688m, of which US\$603m was on variable interest rate terms.

#### *Inter-company arrangements*

- 4.29 The embedded value results include the effects of both internal and external reinsurance. The embedded value results for covered business incorporate the effect of any inter-company reinsurance arrangements that are in place and consistency of assumptions is maintained between the covered territories involved in any such arrangement.

#### *Foreign currency translation*

- 4.30 Foreign currency embedded value and value of new business results have been translated at the prevailing rate on 30 November 2009.

**Table 1**

<u>Local Currency: US\$1</u>	<u>Closing rate at 30 November 2009</u>
AIA Hong Kong . . . . .	7.750
AIA Thailand . . . . .	33.24
AIA Singapore . . . . .	1.385
AIA Malaysia . . . . .	3.392
AIA China . . . . .	6.828
AIA Korea . . . . .	1,163
AIA Australia . . . . .	1.094
AIA Brunei . . . . .	1.385
AIA Indonesia . . . . .	9,434
AIA New Zealand . . . . .	1.400
Philamlife . . . . .	47.21
AIA Taiwan . . . . .	32.17
AIA Vietnam . . . . .	18,518

## 5 Assumptions

### *Best estimate assumptions*

5.1 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.

### *Principal economic assumptions*

5.2 Returns on existing fixed income assets have been set to be consistent with the valuation of the assets backing the policy liabilities, i.e. current market yields. In determining returns on fixed interest assets the company allows for the risk of default and this allowance varies by credit rating of the underlying asset.

5.3 Long term returns for fixed income assets reflect expected returns having regard to historical returns, estimates of long term forward rates from yields available on Government bonds and current bond yields.

5.4 Equity returns have been determined by reference to the projected long term yield on 10-year government bonds plus an equity risk premium which varies by territory with a maximum risk premium of 600 basis points.

5.5 For each Business Unit, certain distinct product groups have been identified within the non-linked portfolio and the returns for each of these product groups have been derived by considering current and future targeted asset mix and associated investment returns for major investment classes. Where returns on existing fixed interest assets differ markedly from long term returns, returns are assumed to grade to the long term returns linearly over the estimated mean term of the existing fixed interest assets.

5.6 For unit-linked and universal life business, fund growth assumptions have been determined using actual fund mix at the valuation date and expected long term returns for major asset classes.

5.7 The table below summarises the principal financial assumptions:

**Table 2**

	<u>AIA Australia</u>	<u>AIA China</u>	<u>AIA Hong Kong</u>	<u>AIA Indonesia (US\$ denominated)</u>	<u>AIA Indonesia (Rupiah denominated)</u>	<u>AIA Korea</u>	<u>AIA Malaysia</u>
Risk discount rate . . . . .	9.0%	10.00%	8.00%	12.50%	17.00%	10.00%	9.00%
Expected long term rate of inflation . .	2.5%	2.0%	2.0%	6.0%	6.0%	3.5%	3.0%
10 year Government bond yield . . . . .	5.75%	3.74%	3.83%	6.92%	11.00%	5.16%	4.46%
	<u>AIA New Zealand</u>	<u>Philamlife</u>	<u>AIA Singapore &amp; Brunei</u>	<u>AIA Taiwan</u>	<u>AIA Thailand</u>	<u>AIA Vietnam</u>	
Risk discount rate . . . . .	9.00%	14.00%	7.50%	8.00%	10.00%	16.00%	
Expected long term rate of inflation . .	2.0%	4.5%	2.0%	1.0%	2.0%	5.0%	
10 year Government bond yield . . . . .	6.30%	7.47%	2.93%	1.73%	4.16%	9.25%	

Weighted risk discount rate <sup>1</sup>	
- New business . . . . .	9.2%
- In-force . . . . .	8.7%

<sup>1</sup> The weighted risk discount rates shown above have been determined by weighting each country's risk discount rates by reference to the EEV basis new business result and the closing value of in-force business.

### **Demographic assumptions**

5.8 Persistency, mortality and morbidity assumptions are based on an analysis of recent experience but may also reflect best expectations of future experience where this is expected to be markedly different to short term historic data.

### **Expense assumptions**

5.9 Expense levels are based on internal expense analysis investigations and are appropriately allocated to the acquisition of new business and the renewal of in-force business within individual Business Units. Certain expenses incurred by AIA Group are not included in this allocation.

5.10 Unallocated Group office expenses, after excluding one off items, have been allocated between acquisition and maintenance activities. Group office acquisition expenses have been deducted from the value of new business and the present value of projected future Group office maintenance expenses has been deducted from the EEV. Unallocated Group office expenses allocated to maintenance activities have also been allowed for in the maintenance expense assumptions used to determine the value of new business.

5.11 For Business Units that are in a development phase, maintenance expenses are assumed to reach their long term levels within a defined period based on projected new business levels. The present value of this implied short term expense overrun is a deduction from the value of in-force business based on overruns as follows:

**Table 3**

<u>US\$ m</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
AIA China . . . . .	17	9			
AIA Vietnam . . . . .	4	4	3	3	1

5.12 For Business Units that are in a development phase (China and Vietnam), or where the 2009 new business volumes were significantly lower than in previous years (most notably Hong Kong and Singapore), the value of new business has been determined using expected future acquisition expense assumptions rather than actual acquisition expenses during the valuation period. Much of AIA Group's distribution expenses are fixed in the short term and this, coupled with short term incentive payments made to retain high performing agents, meant the reduced new business volumes resulted in an excess of actual acquisition expenses compared to acquisition expense allowances. There was a significant increase in new business volumes during the second half of the year, ie. 1 June 2009 to 30 November 2009. This rebound in new business volumes led to the conclusion that it was more meaningful to present the value of new business excluding the expense overrun, with the overruns being disclosed separately. The excess of 2009 acquisition expenses above those reflected in the value of new business is as follows:

**Table 4**

<u>US\$ m</u>	<u>Excess expenses</u>
AIA China . . . . .	34
AIA Vietnam . . . . .	6
AIA Hong Kong . . . . .	52
AIA Singapore . . . . .	25
Other markets . . . . .	10
<b>Total . . . . .</b>	<b><u>127</u></b>

- 5.13 The present value of future after-tax Group office expenses has been deducted from the Group embedded value. These group expenses have been allocated to acquisition and maintenance activities. A deduction is made from the value of new business and value of in-force business respectively.

**Taxation and other legislation**

- 5.14 As at 31 December 2009, the Ministry of Finance of China introduced new principles-based reserving standards. These changes were not allowed for in the embedded value calculated at 30 November 2009 since the reserving and capital requirements are based on the Hong Kong basis and the changes would not have a significant impact on value.

**6 Summary of AIA Group's embedded value as at 30 November 2009**

**Table 5**

US\$m	Free surplus	Required capital	Adjusted net worth	Value of in-force business after tax and before cost of capital	Cost of capital	Value of in-force business after tax and after cost of capital	Embedded value
Hong Kong . . . . .	3,196	838	4,034	5,272	223	5,049	9,082
Singapore & Brunei . . . . .	601	771	1,372	1,973	357	1,616	2,988
Thailand . . . . .	2,602	298	2,900	1,687	184	1,503	4,403
Korea . . . . .	411	259	671	985	162	823	1,494
China . . . . .	252	35	287	952	63	889	1,176
Malaysia . . . . .	219	289	508	470	106	363	871
Other markets . . . . .	1,011	409	1,420	800	145	655	2,075
Value of Group office expenses . . . . .	—	—	—	(545)	—	(545)	(545)
Other assets <sup>1</sup> . . . . .	<u>1,044</u>	<u>—</u>	<u>1,044</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,044</u>
<b>Total on local statutory basis . . . . .</b>	<b>9,335</b>	<b>2,899</b>	<b>12,234</b>	<b>11,595</b>	<b>1,241</b>	<b>10,353</b>	<b>22,587</b>
Adjustment to reflect Hong Kong reserving and cost of capital requirements . . . . .	<u>(5,313)</u>	<u>844</u>	<u>(4,469)</u>	<u>3,957</u>	<u>122</u>	<u>3,834</u>	<u>(635)</u>
<b>Total on Hong Kong statutory basis . . . . .</b>	<b><u>4,022</u></b>	<b><u>3,742</u></b>	<b><u>7,765</u></b>	<b><u>15,552</u></b>	<b><u>1,364</u></b>	<b><u>14,188</u></b>	<b><u>21,953</u></b>

1 The other assets line of US\$1,044m relates to adjustments of the IFRS balance sheet of approximately US\$756m for third party interests, cash equivalent holdings and fair valuation adjustments of certain equity type assets, a revaluation of real estate of approximately US\$340m and certain tax and intangible asset effects.

## 7 Analysis of new business contribution

Table 6

	2009 US\$m							2009	
	New business premiums		Annual premium and contribution equivalents (APE)	Present value of new business premiums (PVNBP)	Pre-tax new business contribution <sup>1</sup>	Tax <sup>2</sup>	Post-tax new business contribution	Pre-tax new business margin	
	Single	Regular						APE	PVNBP
Hong Kong	650	421	486	2,092	206	—	206	42%	9.8%
Singapore & Brunei	409	128	169	1,375	132	27	105	78%	9.6%
Thailand	126	376	389	2,044	218	93	124	56%	10.6%
Korea	7	374	375	1,622	103	27	76	27%	6.3%
China	167	171	188	914	73	25	47	39%	7.9%
Malaysia	32	109	112	576	45	16	29	40%	7.8%
Other markets	51	370	375	2,139	127	39	88	34%	5.9%
Value of Group office expenses					(40)		(40)		
<b>Total on local statutory basis</b>	<b>1,443</b>	<b>1,949</b>	<b>2,094</b>	<b>10,761</b>	<b>862</b>	<b>227</b>	<b>635</b>	<b>41%</b>	<b>8.0%</b>
Adjustment to reflect Hong Kong reserving and cost of capital requirements					(26)		(26)		
<b>Total on Hong Kong statutory basis</b>	<b>1,443</b>	<b>1,949</b>	<b>2,094</b>	<b>10,761</b>	<b>837</b>	<b>227</b>	<b>610</b>	<b>40%</b>	<b>7.8%</b>

1 Pre-tax new business contribution is taken as the reported value of new business, adding back the present value of local tax for all countries other than Singapore, Malaysia, Hong Kong and the Philippines. For Hong Kong and the Philippines, tax is premium driven and is treated as an expense and hence is not included as shareholder tax. For Singapore and Malaysia, the corporate tax rate is used for grossing up as the cash-flow taxes include policyholder tax.

2 The tax rates assumed in the value of new business reflect the corporate tax rate relevant to the AIA entity in question and allows for the impact of tax on income on the capital requirements where relevant. For Thailand, the corporate tax rate on profits is 30%, but due to the fact that the tax is accelerated and is payable before the statutory profits are made, the implied effective tax rate is significantly higher than 30%.

3 For Hong Kong, Group office expenses are the same before tax as after tax as only premium tax is payable.

## 8 Holding company net borrowings

Table 7

	2009 US\$m		
	IFRS basis	Mark to market value adjustment	EEV basis at market value
Borrowings <sup>1</sup>	688	—	688

<sup>1</sup> AIA borrowings at 30 November 2009 were US\$688 million comprising bank loans of US\$549 million, bank overdrafts of US\$85 million and other loans of US\$54 million. As the interest rates on loans reflect market rates, fair value approximates to market value. The most material financing transaction is a five year variable rate term loan facility dated 23 November 2007 relating to the refinancing of a loan facility for AIA Central, the AIA Group headquarters in Hong Kong. The available facility and amount outstanding as of 30 November 2009 was US\$542 million.

## 9 New business capital usage

Table 8

	2009 US\$m		
	Free Surplus invested in new business <sup>1</sup>	Post-tax new business contribution	Post-tax new business contribution per US\$1m free surplus invested
<b>Total</b>	<b>982</b>	<b>610</b>	<b>0.62</b>

<sup>1</sup> Free surplus invested in new business is the sum of the statutory loss on new business as at 30 November 2009 (US\$683m) and the required capital invested (US\$299m). Both the free surplus invested and the post tax new business contribution include Group office expenses.

## 10 Expected transfer of value of in-force business to free surplus

10.1 The table below shows how the value of in-force business generated by the in-force business at 30 November 2009 and the associated required capital is modelled as emerging into free surplus over future years.

**Table 9**

	2009 US\$m									
	2009 total as shown in Table 5	Expected period of conversion of future post-tax distributable earnings and required capital flows to free surplus								
		Year 1	Year 2	Year 3	Year 4	Year 5	Years 6-10	Years 11-15	Years 16-20	Years 20+
Total . . . . .	17,930 <sup>1</sup>	2,053	1,745	1,504	1,357	1,217	4,353	2,616	1,348	1,737
Annual conversion . . . . .		11.4%	9.7%	8.4%	7.6%	6.8%	24.3%	14.6%	7.5%	9.7%
Cumulative conversion . . . . .		11.4%	21.1%	29.5%	37.1%	43.9%	68.2%	82.8%	90.3%	100%

<sup>1</sup> The modelled cash flows use the same methodology underpinning AIA Group's embedded value reporting methodology and so are subject to the same assumptions and sensitivities. The 2009 total of US\$17,930m is consistent with Table 5 and equals the value of in-force business after tax and after cost of capital plus the required capital.

## 11 Sensitivity analysis

### *Sensitivity analysis — economic assumptions*

11.1 The tables below show the sensitivity of the embedded value and value of new business as at 30 November 2009 and the new business contribution after the effect of required capital to the following:

- 1% increase and decrease in the discount rates; and
- 1% increase and decrease in projected earned rates, excluding consequential changes (for the avoidance of doubt, there is no change to the risk discount rate or to the market values of fixed interest assets).

11.2 In each sensitivity calculation, all other assumptions remain unchanged except for the investment return sensitivity where the projected with-profits bonus rates were changed to be consistent with the investment returns.

**Table 10**

Embedded value of long term operations at 30 November 2009 (US\$m)	As reported	Discount rates 1% increase	Discount rates 1% decrease	Investment return 1% increase	Investment return 1% decrease
		1% increase	1% decrease	1% increase	1% decrease
Hong Kong . . . . .	9,082	8,545	9,742	9,863	8,315
Singapore & Brunei . . . . .	2,988	2,793	3,222	3,347	2,634
Thailand . . . . .	4,403	4,293	4,527	4,853	3,917
Korea . . . . .	1,494	1,422	1,576	1,884	1,102
China . . . . .	1,176	1,107	1,256	1,593	760
Malaysia . . . . .	871	824	925	960	782
Other markets . . . . .	2,075	2,026	2,135	2,316	1,836
Value of Group office expenses . . . . .	(545)	(510)	(586)	(545)	(545)
Other assets . . . . .	1,044	1,044	1,044	1,044	1,044
<b>Total on local statutory basis . . . . .</b>	<b>22,587</b>	<b>21,544</b>	<b>23,841</b>	<b>25,316</b>	<b>19,844</b>
Adjustment to reflect Hong Kong reserving and cost of capital requirements . . . . .	(635)	(910)	(323)	(269)	(1,016)
<b>Total on Hong Kong statutory basis . . . . .</b>	<b>21,953</b>	<b>20,635</b>	<b>23,519</b>	<b>25,048</b>	<b>18,829</b>

**Table 11**

Post-tax new business contribution for 2009 <sup>1</sup> (US\$m)	As reported	Discount rates	Discount rates	Investment return	Investment return
		1% increase	1% decrease	1% increase	1% decrease
Hong Kong	206	182	234	252	159
Singapore & Brunei	105	91	122	120	89
Thailand	124	106	145	151	98
Korea	76	65	88	102	49
China	47	39	57	71	24
Malaysia	29	25	34	35	23
Other markets	88	78	101	102	74
Value of Group office expenses	(40)	(38)	(42)	(40)	(40)
<b>Total on local statutory basis</b>	<b>635</b>	<b>547</b>	<b>740</b>	<b>794</b>	<b>476</b>
Adjustment to reflect Hong Kong reserving and cost of capital requirements	(26)	(38)	(12)	(8)	(45)
<b>Total on Hong Kong statutory basis</b>	<b>610</b>	<b>509</b>	<b>728</b>	<b>785</b>	<b>431</b>

<sup>1</sup> Business written in the 12 months ending 30 November 2009

### Sensitivity analysis — non-economic assumptions

11.3 The tables below show the sensitivity of the embedded value and the value of new business as at 30 November 2009 and the new business contribution after the effect of required capital for 2009 to the following:

- 10% proportionate decrease in maintenance expenses (a 10% sensitivity on a base assumption of £10 per annum would represent an expense assumption of £9 per annum);
- 10% proportionate increase and decrease in lapse rates (a 10% decrease sensitivity on a base assumption of 5% would represent a lapse rate of 4.5% per annum); and
- 5% proportionate increase and decrease in base mortality and morbidity rates (i.e. decreased and increased longevity respectively).

**Table 12**

Embedded value of long-term operations at 30 November 2009 (US\$m)	As reported	Maintenance expenses	Lapse rates	Lapse rates	Mortality and morbidity	Mortality and morbidity
		10% decrease	10% increase	10% decrease	5% increase	5% decrease
Hong Kong	9,082	9,146	8,983	9,197	8,883	9,286
Singapore & Brunei	2,988	3,020	2,938	3,044	2,864	3,107
Thailand	4,403	4,433	4,354	4,456	4,329	4,476
Korea	1,494	1,551	1,459	1,532	1,362	1,627
China	1,176	1,216	1,167	1,184	1,159	1,193
Malaysia	871	885	854	889	834	908
Other markets	2,075	2,121	2,042	2,114	2,025	2,125
Value of Group office expenses	(545)	(490)	(545)	(545)	(545)	(545)
Other assets	1,044	1,044	1,044	1,044	1,044	1,044
<b>Total on local statutory basis</b>	<b>22,587</b>	<b>22,925</b>	<b>22,296</b>	<b>22,913</b>	<b>21,954</b>	<b>23,222</b>
Adjustment to reflect Hong Kong reserving and cost of capital requirements	(635)	(636)	(636)	(627)	(611)	(655)
<b>Total on Hong Kong statutory basis</b>	<b>21,953</b>	<b>22,290</b>	<b>21,661</b>	<b>22,287</b>	<b>21,344</b>	<b>22,568</b>

**Table 13**

Post-tax new business contribution for 2009 <sup>1</sup> (US\$m)	As reported	Maintenance expenses 10% decrease	Lapse rates 10% increase	Lapse rates 10% decrease	Mortality and morbidity 5% increase	Mortality and morbidity 5% decrease
Hong Kong . . . . .	206	211	199	213	189	223
Singapore & Brunei . . . . .	105	108	98	113	92	118
Thailand . . . . .	124	129	109	141	113	136
Korea . . . . .	76	84	67	85	63	88
China . . . . .	47	50	45	51	44	51
Malaysia . . . . .	29	31	26	32	24	34
Other markets . . . . .	88	98	78	100	65	111
Value of Group office expenses . . . . .	(40)	(38)	(40)	(40)	(40)	(40)
<b>Total on local statutory basis . . . . .</b>	<b>635</b>	<b>673</b>	<b>582</b>	<b>695</b>	<b>549</b>	<b>721</b>
Adjustment to reflect Hong Kong reserving and cost of capital requirements . . . . .	(26)	(22)	(24)	(27)	(25)	(26)
<b>Total on Hong Kong statutory basis . . . . .</b>	<b>610</b>	<b>651</b>	<b>558</b>	<b>668</b>	<b>524</b>	<b>695</b>

<sup>1</sup> Business written in the 12 months ending 30 November 2009

## 12 KPMG LLP opinion

12.1 In our opinion, subject to the reliances and limitations set out in this Report:

- the methodology used by Prudential in the calculation of the EEV components for AIA Group complies with the EEV Principles in all material respects;
- the material assumptions used by Prudential in the calculation of the EEV components for AIA Group comply with the EEV Principles; and
- the EEV components for AIA Group calculated by Prudential have been prepared using the methodology and assumptions set out in Sections 4 and 5 of this report and comply with the EEV Principles and Guidance with the exception of the disclosure points set out in the Basis of preparation in Section 3, in all material respects.

## 13 Reliances and limitations

13.1 In carrying out our work we have relied without independent verification upon the accuracy and completeness of the data and information provided to us, both in written and oral form, by Prudential. We have also relied on the Directors of Prudential having brought to our attention any other information or data which ought to have been made available to us which might materially affect our opinion set out herein. The Directors of Prudential have provided a letter of representation verifying the accuracy and completeness of the information utilised for this report.

13.2 Reliance has been placed upon, but not limited to, the following information:

- returns to local regulatory authorities and the return to the Hong Kong insurance regulatory authority for the financial year ending 30 November 2009 and supplementary information regarding actuarial reserving bases and mathematical reserves prepared during 2009, including the impact of restating liabilities to a Hong Kong statutory reserving basis;
- new business data for the period 1 December 2008 to 30 November 2009 for AIA Group;
- information on expenses incurred by Business Units, together with forecast future expense levels and new business volumes and unallocated group level expenses;
- details of past operating experience including persistency, mortality, morbidity, tax and expense analysis;
- details of AIA Group's embedded value manual;
- details of the assumptions used in the EEV calculations and their derivation;

- information relating to the process and control environment in which computer projection models used for the calculations were run;
- summaries of results from the projection models;
- information on current investment strategy;
- information relating to products, guarantees, options and fund structures for the Business Units within AIA Group;
- asset valuations at 30 November 2009;
- basis for taxation; and
- details of reinsurance arrangements.

13.3 This report must be considered in its entirety as it may be misleading to consider individual sections only.

13.4 This report was produced for the Directors of Prudential only to meet their requirements.

13.5 We have not assessed the value, quality or suitability of AIA Group's assets. We have also not investigated, or made any allowance for, any claims against AIA Group other than those made by policyholders under normal contractual terms of life insurance business. In particular, no account has been taken of liabilities in respect of pension entitlements, service contracts, leases, breaches of legislation, regulatory rules or guidance.

13.6 No investigation has been made into the accuracy of unit pricing and unit allocation procedures.

13.7 Prudential has made assumptions for AIA Group about future experience, including economic and investment experience, expenses, discontinuance rates, morbidity, mortality, taxation, legislation and reinsurance. We have considered these assumptions on the basis that they are reasonable estimates but actual future experience is likely to differ from these estimates due to random fluctuations, changes in the operating environment and other such factors. These variations could have a significant effect on the results and conclusions of the report. KPMG LLP gives no warranty that the assumptions made will be reflected in the actual future experience.

13.8 This report was based on data at 30 November 2009 and takes no account of any developments after that date.

13.9 Within certain calculations shown in this report, figures may not cast exactly due to rounding.

13.10 Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report, required by and given solely for the purposes of complying with paragraph 23.1 of Annex I of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

### ***Declaration***

For the purposes of Prospectus Rule 5.5.3R (2)(f) we are responsible for this report as part of the prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the prospectus in compliance with paragraph 1.2 of Annex I of the Prospectus Directive Regulation.

Yours faithfully

Trevor A. D. Jones  
Partner, KPMG LLP

Nick C. Dexter  
Partner, KPMG LLP

PART XVI

UNAUDITED PRO FORMA FINANCIAL INFORMATION

A. Pro forma net asset statement and pro forma income statement

The unaudited pro forma net asset statement has been prepared to illustrate the effect on the net assets of the Prudential Group as if the proposed Transactions had taken place on 31 December 2009. The unaudited pro forma income statement has been prepared to illustrate the effect on Prudential Group as if the proposed Transactions had taken place on 1 January 2009. The unaudited pro forma net asset statement and unaudited pro forma income statement have been prepared for illustrative purposes and because of their nature address a hypothetical situation and, therefore, do not represent the Enlarged Group's actual financial result or financial position following the Transactions.

The unaudited pro forma net asset statement and unaudited pro forma income statement of the Enlarged Group does not constitute financial statements.

Unaudited pro forma net asset statement

	Prudential Group as at 31 December 2009 <sup>(1)</sup> £m	Adjustments			Pro forma Enlarged Group £m
		AIA Group as at 30 November 2009 <sup>(2)(4)</sup> \$m	AIA Group as at 30 November 2009 <sup>(3)</sup> £m	Purchase and Rights Issue adjustments <sup>(5)(6)</sup> £m	
<b>Assets</b>					
Goodwill and fair value acquisition adjustments other than for incremental value of acquired in-force business . . . .	1,434	123	75	8,606	10,115
Other intangible assets . . . . .	163	110	67	—	230
Deferred acquisition costs . . . . .	3,939	10,976	6,688	—	10,627
Incremental value of acquired in-force business <sup>(5)</sup> . . . . .	53	—	—	4,083	4,136
Other non-investment and non-cash assets . . . . .	8,133	1,748	1,065	—	9,198
Investments of long-term business and other operations . . . . .	208,722	75,125	45,778	—	254,500
Assets held for sale . . . . .	3	58	35	—	38
Cash and cash equivalents . . . . .	5,307	3,405	2,075	—	7,382
<b>Total assets</b> . . . . .	<u>227,754</u>	<u>91,545</u>	<u>55,783</u>	<u>12,689</u>	<u>296,226</u>

	Adjustments				Pro forma Enlarged Group £m
	Prudential Group as at 31 December 2009 <sup>(1)</sup> £m	AIA Group as at 30 November 2009 <sup>(2)(4)</sup> \$m	AIA Group as at 30 November 2009 <sup>(3)</sup> £m	Purchase and Rights Issue adjustments <sup>(5)(6)</sup> £m	
<b>Liabilities</b>					
Policyholder liabilities and unallocated surplus of with-profits funds . . . . .	<u>196,417</u>	<u>71,583</u>	<u>43,619</u>	<u>—</u>	<u>240,036</u>
Core structural borrowings of shareholder-financed operations:					
Subordinated debt . . . . .	<u>2,691</u>	<u>—</u>	<u>—</u>	<u>4,334</u>	<u>7,025</u>
Other . . . . .	<u>703</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>703</u>
Total . . . . .	<u>3,394</u>	<u>—</u>	<u>—</u>	<u>4,334</u>	<u>7,728</u>
Other borrowings:					
Operational borrowings attributable to shareholder-financed operations . . . . .	<u>2,751</u>	<u>688</u>	<u>419</u>	<u>—</u>	<u>3,170</u>
Borrowings attributable to with-profits funds . . . . .	<u>1,284</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,284</u>
Other non-insurance liabilities <sup>(5)(7)</sup> . . . . .	<u>17,605</u>	<u>3,942</u>	<u>2,402</u>	<u>402</u>	<u>20,409</u>
<b>Total liabilities</b> . . . . .	<u>221,451</u>	<u>76,213</u>	<u>46,440</u>	<u>4,736</u>	<u>272,627</u>
<b>Net assets</b> . . . . .	<u>6,303</u>	<u>15,332</u>	<u>9,343</u>	<u>7,953</u>	<u>23,599</u>

#### Represented by

	Adjustments				Pro forma Enlarged Group £m
	Prudential Group as at 31 December 2009 <sup>(1)</sup> £m	AIA Group as at 30 November 2009 <sup>(2)(4)</sup> \$m	AIA Group as at 30 November 2009 <sup>(3)</sup> £m	Purchase and Rights Issue adjustments <sup>(5)(6)</sup> £m	
<b>Equity</b>					
Shareholders' equity <sup>(7)</sup> . . . . .	<u>6,271</u>	<u>15,252</u>	<u>9,294</u>	<u>7,953</u>	<u>23,518</u>
Minority interests . . . . .	<u>32</u>	<u>80</u>	<u>49</u>	<u>—</u>	<u>81</u>
<b>Total equity</b> . . . . .	<u>6,303</u>	<u>15,332</u>	<u>9,343</u>	<u>7,953</u>	<u>23,599</u>

	Adjustments				Pro forma Enlarged Group
	Prudential Group as at 31 December 2009 <sup>(1)</sup>	AIA Group as at 30 November 2009 <sup>(2)(4)</sup>	AIA Group as at 30 November 2009 <sup>(3)</sup>	Purchase and Rights Issue adjustments <sup>(5)(6)(8)</sup>	
Net tangible assets £m <sup>(9)</sup> . . . . .	<u>4,674</u>	<u>15,019</u>	<u>9,152</u>	<u>(653)</u>	<u>13,173</u>
Shares in issue (millions) . . . . .	<u>2,532</u>	<u>n/a</u>	<u>n/a</u>	<u>15,988</u>	<u>18,520</u>
Net assets per share (£) <sup>(9)</sup> . . . . .	<u>2.48</u>	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>	<u>1.27</u>
Net tangible assets per share (£) <sup>(9)</sup> . . . . .	<u>1.85</u>	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>	<u>0.71</u>

#### Notes

- Information on the total assets and total liabilities for the Prudential Group has been extracted without material adjustment from the historical financial information for Prudential as set out in Section B of Part XIV of this document.
- The US dollar figures on the total assets and liabilities for the AIA Group have been extracted without material adjustment from the historical financial information for AIA Group as set out in Section B of Part XV of this document.
- The GBP information on the total assets and liabilities for the AIA Group has been translated at the 30 November 2009 rate of exchange of £1= US\$1.6411.
- Certain asset and liability items have been condensed in respect of the AIA Group to enable the aggregation of Prudential Group and AIA Group asset and liability items. In the net asset statement above, for the AIA Group:
  - Other non-investment and non-cash assets of US\$1,748 million comprise accrued investment income of US\$854 million, Property, Plant and Equipment of US\$395 million, Reinsurance assets of US\$284 million and other assets of US\$215 million.

- Policyholder liabilities and unallocated surplus of with-profits funds of US\$71,583 million comprise insurance and investment contract liabilities of US\$63,803 million and \$7,780 million respectively.
  - Other non-insurance liabilities of US\$3,942 million comprise trade and other payables of US\$1,162 million, deferred tax liabilities of US\$1,047 million, third party interests in consolidated investment funds of US\$397 million, payables from purchases of investments of US\$396 million, provisions in respect of employee benefits, regulatory matters, litigation, reorganisation and restructuring of US\$285 million, obligations under securities lending and repurchase agreements of US\$284 million, current tax liabilities of US\$185 million, and other liabilities of US\$186 million.
- 5) Under IFRS acquisition accounting it is necessary to fair value the consideration paid and all of the assets and liabilities of the acquired business. In the context of the acquisition of AIA Group a significant part of that adjustment will be for fair valuation of the projected cash flows attaching to the AIA Group's in force life assurance contracts. In the pro forma net assets statement no adjustments have been made to the fair values of the individual net assets of the AIA Group to reflect any restatement to fair value which may arise on the Acquisition. However, in order to provide a pro forma indication of the effect of valuing the projected cash flows of the AIA Group in force insurance contracts to meet this IFRS requirement, the EEV basis information included in Section C of this Unaudited Pro forma Financial Information has been used. The EEV basis shareholders' funds of £13,377 million shown in that section represents the aggregate of the adjusted net worth and value of in force business contracts after tax and after cost of capital. The difference between this amount and the IFRS reported net assets, including deferred acquisition costs, provides an indication of the fair value adjustment for the in force insurance contracts. This difference of £4,083 million has been included in the pro forma net assets statement as the incremental value of in force business. The goodwill and other fair value adjustments of £8,606 million is included as a separate item. Note 6 shows the derivation of the goodwill and other fair value adjustments. The estimated consideration for the acquisition of the AIA Group which will be determined as the cash and fair value of debt and equity instruments at their time of issue is £21,983 million (US\$35,500 million) net of expenses attributable to the issue of shares under the rights issue and the debt securities. Transaction costs of £100 million not related to these instruments have been included in the adjustments in the table above. Provision for the costs is shown within the adjustment of £402 million for other non-insurance liabilities and the £100 million charge is reflected as a deduction within shareholders' equity. These Transaction costs exclude the effect of any amounts in respect of the foreign currency hedging arrangements that Prudential has put in place to convert the pounds sterling proceeds of the Rights Issue into US dollars, which is the currency in which New Prudential must pay the cash element of the consideration. Note 5 to the pro forma income statement provides additional explanation of these items.
- 6) The goodwill, acquired intangible assets, and other fair value adjustments arising on the basis described in Note 5 above have been calculated as follows:

	<u>\$m</u>	<u>£m</u>
Proceeds of rights issue (net of expenses) . . . . .	20,000	12,385
Ordinary Shares issued to AIG . . . . .	5,500	3,406
Mandatory Convertible Notes (see note 7) . . . . .	3,000	1,858
Tier I Preferred Securities . . . . .	2,000	1,238
Upper Tier 2 securities (net of expenses) . . . . .	2,901	1,796
Lower Tier 2 securities (net of expenses) . . . . .	<u>2,099</u>	<u>1,300</u>
Total consideration . . . . .	<u>35,500</u>	<u>21,983</u>
Less:		
Reported value of the AIA Group net assets (net of minority interest) . . . . .	<u>15,252</u>	<u>9,294</u>
Incremental value of acquired in-force business (see note 5) . . . . .	<u>6,701</u>	<u>4,083</u>
EEV basis shareholders' funds (as shown in section C) . . . . .	<u>21,953</u>	<u>13,377</u>
Goodwill and other fair value adjustments . . . . .	<u>13,547</u>	<u>8,606</u>

Note: Except for the reported values of the AIA Group net assets the incremental value of acquired in-force business and the EEV basis shareholders' funds, the dollar amounts have been translated at the 31 December 2009 rate of exchange of £1 = US \$1.6149. The AIA Group net assets (net of minority interest) and incremental acquired in-force value of business and the EEV basis shareholders' funds have been translated at the 30 November 2009 rate of exchange of £1 = US\$1.6411.

- 7) The obligations under the Mandatory Convertible Notes have been accounted for as US\$488 million (£302 million) within other non-insurance liabilities and US\$2,512 million (£1,556 million) as residual equity. The amount included in other non-insurance liabilities represents the aggregate of the present value of the future stream of coupon payments and the market value of the derivative liability to deliver additional shares beyond those to be delivered under the minimum fixed obligations reflected within the residual equity.
- The minimum number of shares varies with the reference share price with the maximum number being 125% of the minimum plus, as described in the section on the Conversion Adjustment Mechanism for the MCNs in note 3 of Part V of this prospectus, any additional shares if New Prudential does not make payment in cash in full of any fixed coupon or any distribution. Based on the Prudential share price at 31 December 2009 of £6.40, the MCNs would be converted into at least 479.2 million and, assuming the conditions set out above did not apply, no more than 598.8 million shares on the prescribed conversion date.
- Accounting for such instruments is complex and practice may evolve. Prudential has applied its judgment and believes that classifying the obligation to deliver a minimum number of shares as equity is the most appropriate treatment reflecting the substance of the Notes.
- 8) As set out in Part V "Information about the Transactions", Prudential proposes to raise cash from the proceeds of the Rights Issue and the issue of debt instruments. The consideration paid to AIA Aurora for the acquisition of AIA will be financed with this cash along with, the issue by New Prudential of New Prudential Shares and Mandatory Convertible Notes to AIA Aurora. Shares issued in connection with the Transactions therefore include shares issued for the Rights Issue, new shares issued by New Prudential to AIA Aurora and Mandatory Convertible Notes.
- 9) For the purposes of calculating net asset and net tangible asset value per share, net assets are total shareholders' equity or total assets less total liabilities less minority interest. Net tangible assets are net assets excluding goodwill and other intangible assets. Net tangible assets include deferred acquisition costs and acquired value of in force business as they do not fall within the scope of intangible assets under IAS 38 "Intangible Assets". Net asset and net tangible asset value per share is net assets or net tangible assets divided by ordinary shares in issue.

- 10) No account has been taken of the issue of shares under any options granted or which may be granted under employee shares schemes of Prudential after 31 December 2009.
- 11) No account has been taken of the trading or other transactions of the AIA Group for the period since 30 November 2009 and the Prudential Group since 31 December 2009 in preparing the pro forma net assets statement.

### Unaudited pro forma income statement

	Adjustments				
	Prudential Group Year Ended 31 December 2009 <sup>(1)</sup> £m	AIA Group Year Ended 30 November 2009 <sup>(2)</sup> \$m	AIA Group Year Ended 30 November 2009 <sup>(3)</sup> £m	Purchase and Rights Issue adjustments £m <sup>(5)(7)</sup>	Pro forma Enlarged Group £m
Total revenue, net of reinsurance <sup>(4)</sup> . . . .	48,099	19,243	12,383	—	60,482
Total charges, net of reinsurance <sup>(4)</sup> . . . .	(46,535)	(16,642)	(10,709)	(480)	(57,724)
Share of loss from associates and joint ventures . . . . .	—	(21)	(14)	—	(14)
Profit (loss) before tax (being tax attributable to shareholders' and policyholders' returns) . . . . .	1,564	2,580	1,660	(480)	2,744
Tax charge attributable to policyholders' returns . . . . .	(818)	(137)	(88)	—	(906)
Profit (loss) before tax attributable to shareholders <sup>(8)</sup> . . . . .	746	2,443	1,572	(480)	1,838
Tax charge . . . . .	(873)	(643)	(414)	105	(1,182)
Less: tax attributable to policyholders' returns . . . . .	818	137	88	—	906
Tax charge attributable to shareholders' returns . . . . .	(55)	(506)	(326)	105	(276)
<b>Profit (loss) from continuing operations after tax</b> . . . . .	691	1,937	1,246	(375)	1,562
Discontinued operations (net of tax) . . . .	(14)	—	—	—	(14)
Profit (loss) for the year . . . . .	<u>677</u>	<u>1,937</u>	<u>1,246</u>	<u>(375)</u>	<u>1,548</u>

#### Notes

- 1) The figures for the Prudential Group are extracted without material adjustment from the historical financial information for Prudential as set out in Section B of Part XIV of this document.
- 2) The US dollar figures for the AIA Group have been extracted without material adjustment from the historical financial information for AIA Group as set out in Section B of Part XV of this document.
- 3) The US dollar income statement for AIA Group has been translated into pounds sterling using the average rates of exchange of £1 = \$1.554 for the 12 months to 30 November 2009.
- 4) The income statement format has been abridged. Total revenue, net of reinsurance comprises premiums net of reinsurance, investment return and other income. Total charges, net of reinsurance comprises benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance, acquisition costs and other operating expenditure, finance costs for interest on core structural borrowings of shareholder-financed operations and for the loss on Prudential's sale of its Taiwan agency business.
- 5) The adjustment of £(480) million comprises £(380) million for interest costs on the debt component of the financing of the purchase consideration and £(100) million for transaction costs. The transaction costs represent an estimate of the costs incurred in relation to the Transactions other than those specific costs relating to the issuance of equity and debt instruments used to finance the Transactions. Costs in respect of the issue of equity are charged against the share premium account. Costs in respect of the issue of debt instruments are deducted from the carrying value of the liability. The transaction costs of £100 million exclude the effect of any amounts that may need to be charged to the income statement in respect of the foreign exchange hedging arrangements that Prudential has put in place to convert the pounds sterling proceeds of the rights issue into US dollars, which is the currency in which New Prudential must pay the cash element of the consideration. The hedging instruments in place fluctuate in value and the effect of re-measurement on the income statement and shareholders' equity on completion will depend upon market conditions at that time. At 14 May 2010, the latest practicable date for information to be included in this prospectus, the instruments entered into had given rise to a value reduction of £18 million. The impact of re-measurement at completion may be significantly higher or lower than this amount. The adjustment of £105 million is for the available tax relief on the interest costs attaching to the debt component of the financing costs of the purchase consideration.
- 6) No account has been taken of the trading activity or other transactions of the AIA Group for the period since 30 November 2009 and for the Prudential Group since 31 December 2009 in preparing the pro forma income statement.
- 7) No account has been taken of the amortisation of the incremental acquired value of in-force business of £4,083 million and other items subject to fair value acquisition accounting adjustment with a finite useful life. The amortisation and the subsequent measurement of the incremental value of acquired in force business will be consistent with the related liabilities.

- 8) The Prudential Group provides supplementary analysis of profit before and after tax attributable to shareholders that distinguishes operating profit based on longer-term investment returns from other constituent elements of the total profits. Details of the basis of preparation of this analysis are included in notes A3, A4, B1 and B2 of the historical financial information on Prudential as set out in Section B of Part XIV of this document.

For the AIA Group, supplementary analysis of profit before and after tax is also provided, as explained in notes 2.2 and 5 of the historical financial information the AIA Group as set out in Section B of part XV of this document.

Under IFRS 8 the historical financial information of the Prudential Group and the AIA Group included within this supplementary analysis “operating profits” applying the performance measure used by the two groups’ respective chief operating decision makers. The measure applied by the two groups differs. However, it is intended that following acquisition the performance measure used by Prudential of “operating profit based on longer-term investment returns” will be applied by the Enlarged Group. Due to the restrictions of IFRS8, that the performance measure applied should reflect that of the chief operating decision maker for the periods being reported upon it is not possible to restate the information to be on the Prudential basis in the AIA Group historical financial information contained in this document.

Accordingly, to provide an estimate of the effect of the change of performance measure, Prudential management have undertaken an exercise to restate the AIA operating profit onto the Prudential basis which entails ascertaining the basis of the AIA operating profit and making appropriate amendments to convert AIA’s analysis of profit after tax into an operating profit and other items such that it is consistent with the Prudential basis. All adjustments net to zero, with no change in the statutory basis profit for the year.

The following table presents an estimated supplementary analysis of profit attributable to shareholders on the Prudential basis for the Enlarged Group on a pro forma basis. This information is supplementary to the Unaudited pro forma Income Statement. The details of adjustments are described in greater detail in the subsequent footnotes.

	Prudential Group Year Ended 31 December 2009 (a) £m	Adjustments			Conformed AIA Group Year Ended 30 November 2009 £m	Purchase and Rights Issue adjustments £m	Pro forma Enlarged Group £m
		AIA Group Year Ended 30 November 2009 (as per part XV)(b) £m	Adjustments to conform AIA Group operating profit to Prudential Group operating profit measure (b) £m	Conformed AIA Group Year Ended 30 November 2009 (b) £m			
IFRS 8 performance reporting measure of operating profit (b)(c) . . . . .	1,405	1,835	1	1,836	1,181	(380)	2,206
Short-term fluctuations in investment returns (d) . . . . .	36	665	22	687	442	—	478
Shareholders’ share of actuarial and other gains and losses on defined benefit pension schemes (e) . . . . .	(74)	—	9	9	6	—	(68)
Loss on sale and results for Taiwan agency business . . . . .	(621)	—	—	—	—	—	(621)
AIA Group restructuring and separation costs . . . . .	—	(89)	—	(89)	(57)	—	(57)
AIA Group Other items (f) . . . . .	—	169	(169)	—	—	—	—
AIA Group policyholder tax (g) . . . . .	—	(137)	137	—	—	—	—
Expenses of combination other than for issue of rights issue shares and debt instruments . . . . .	—	—	—	—	—	(100)	(100)
<b>Total profit from continuing operations before tax attributable to shareholders but after deducting policyholder tax . . . . .</b>	<b>746</b>	<b>2,443</b>	<b>—</b>	<b>2,443</b>	<b>1,572</b>	<b>(480)</b>	<b>1,838</b>
<b>Tax charge attributable to shareholders (c)</b>							
Tax on IFRS8 operating profit measure . . . . .	(318)	(392)	42	(350)	(225)	105	(438)
Tax on non operating items . . . . .	263	(251)	95	(156)	(101)	—	162
AIA Group Policyholder tax (g) . . . . .	—	137	(137)	—	—	—	—
<b>Tax charge attributable to shareholders . . . . .</b>	<b>(55)</b>	<b>(506)</b>	<b>—</b>	<b>(506)</b>	<b>(326)</b>	<b>105</b>	<b>(276)</b>
<b>Profit from continuing operations after tax . . . . .</b>	<b>691</b>	<b>1,937</b>	<b>—</b>	<b>1,937</b>	<b>1,246</b>	<b>(375)</b>	<b>1,562</b>
Discontinued operations (net of tax) . . . . .	(14)	—	—	—	—	—	(14)
<b>Profit for the year . . . . .</b>	<b>677</b>	<b>1,937</b>	<b>—</b>	<b>1,937</b>	<b>1,246</b>	<b>(375)</b>	<b>1,548</b>
Minority interest							
Attributable to operating profit . . . . .	(2)	(5)	—	(5)	(3)	—	(5)
Attributable to non-operating profit . . . . .	1	(16)	—	(16)	(10)	—	(9)
Total minority interest . . . . .	(1)	(21)	—	(21)	(13)	—	(14)
Profit attributable to equity shareholders of the Company . . . . .	676	1,916	—	1,916	1,233	(375)	1,534

## Notes

- (a) The figures for the Prudential Group are extracted from note B1 to the financial information as set out in Section B of Part XIV of this document.
- (b) The information for the AIA Group shown in the table above has initially been extracted without material adjustment from the income statement and note 5 of the historical financial information for the AIA Group in Section B of part XV of this document. This information has been reconfigured for the adjustments explained in more detail below in notes (c) to (g) so as to show the analysis of profit from continuing operations before and after tax attributable to shareholders on the Prudential basis of presentation.

In summary, the changes on reconfiguration are for the following items:

- (i) With-profits business: To align the operating profit measure by replacing the AIA basis of operating profit recognition for with-profit business with that of Prudential.
- Note (c) below explains the difference in more detail. In addition, as the profit before shareholder tax measure for with-profit business for AIA reflects Prudential's policy, and it is also reflected as the Prudential basis of operating profit measure for this type of business, the with-profit elements of the other adjustments in note (f) and the policyholder tax referred to in note (g) are also relevant to an understanding of the reconfiguration for this type of business;
- (ii) To reallocate actuarial gains and losses on defined benefit pension schemes, and the difference between movements in the carrying value of investment properties between those on a depreciated cost and fair value basis, between various line items; and
- (iii) Investment returns: To include longer-term capital returns for investments backing non-linked non-participating business in the operating profit measure, as described in note (c), by reallocation from short-term fluctuations in investment returns.
- (c) The adjustments from the AIA basis operating profit to the Prudential basis operating profit based on longer-term investment returns and related tax reflect the following changes:
- (i) the Prudential basis operating profit based on longer-term returns includes the shareholder transfer for with-profit business, gross of tax rather than the shareholders' share of pre-bonus earnings of the funds, excluding realised and unrealised investment gains, as applied in the AIA basis operating profit, and
- (ii) the inclusion in the Prudential basis operating profit based on longer-term investment returns of longer-term capital returns on equities, investment properties, and debt securities held to back non-linked non-participating business. The longer term capital returns for equities and investment properties have been determined by distinguishing the long-term income and capital return elements of Prudential's assumed longer-term total rates of return for these types of investments. Longer-term returns for debt securities comprise the investment income and amortisation of interest-related realised gains and losses, and a deduction for an allowance for long-term default rates based on the credit ratings of the securities.

The transfer referred to in (i) above represents the gross of tax cash flow, for the shareholders' share of the cost of bonus for the year, from the with-profits funds to the shareholders' funds of the companies that conduct with-profits business. The AIA basis operating profit for the with-profits funds is included with the aggregate operating profits of US\$1,835 million shown in notes 5 and 7 of the historical financial information for AIA Group in Section B of Part XV of this prospectus.

The longer-term capital returns referred to in (ii) above have been calculated by application of the factors described above to the portfolio holdings backing the non-linked non-participating business as reflected in the balance sheet analyses included within the accounting records of the AIA Group.

The tax figures shown for AIA on the Prudential basis have been determined after making adjustments on a consistent basis from those applied at the pre-tax level to adjust from the AIA basis of operating profit to the Prudential basis of operating profit based on longer-term investment returns, as described above.

For the year ended 30 November 2009 the net effect of these changes is that the pre-tax Prudential basis "operating profit based on longer-term investment returns" for the AIA Group is US\$1,836 million. The pre-tax AIA basis "operating profit" for this period is US\$1,835 million. After tax and minority interest, the Prudential basis "operating profit based on longer-term investment returns" for AIA is US\$1,481 million for this period. The post-tax and minority interest AIA basis "operating profit" for this period is US\$1,438 million. The numerical difference between these two measures for other periods depends upon the net effect of the adjustments explained above.

The Prudential basis pre-tax operating profit based on longer-term investment returns for the Enlarged Group can be analysed as follows:

	<b>Prudential Group</b> Year End <b>31 December 2009</b> (see note) £m	<b>AIA Group</b> Year end <b>30 November 2009</b> (see note) £m	<b>Purchase and</b> <b>Rights Issue</b> <b>adjustments £m</b>	<b>Proforma</b> <b>Enlarged</b> <b>Group</b> <b>£m</b>
Asia . . . . .	408	1,181	—	1,589
Rest of Group . . . . .	<u>997</u>	<u>—</u>	<u>(380)</u>	<u>617</u>
Group total . . . . .	<u>1,405</u>	<u>1,181</u>	<u>(380)</u>	<u>2,206</u>

### Note

The information on the Prudential Group shown in the table above has been extracted and summarised from Note B1 of the historical Financial Information for the Prudential Group as set out in Section B of Part XIV of this document. The total of £1,405 million is also shown in the supplementary analysis of profit table in note 8 above. The Operating profit for AIA of £1,181 million and Purchase and Rights Issue Adjustments of £(380) million shown above have been extracted from the supplementary analysis of profit table in note 8 above.

(d) Short-term fluctuations in investment returns

The adjustment of \$22 million to the AIA basis non-operating investment return (shown above as short-term fluctuations in investment returns) of \$665 million to be consistent with the Prudential basis represents the net effect of

- Reallocating the other items of \$169 million (see note (f)),
- Reallocating longer-term capital returns for non-linked non-participating business from this category to operating profit based on longer-term investment returns
- Excluding the shareholders' share of realised and unrealised investment gains and losses for participating business, and
- Reallocating the element of actuarial gains and losses on defined benefit pension schemes to be shown separately that was previously included within the AIA basis non-operating investment return.

(e) The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes for the AIA Group has been shown separately as an item of non-operating profit to be consistent with the Prudential basis. The \$9m net credit is shown in note 38 of the AIA Group historical financial information in Section B of Part XV of this document.

(f) AIA Group other items

The AIA Group other items of \$169 million are described in note 5 of the AIA Group historical financial information in Section B of Part XV, and also shown in section 4.2 of the Operating and Financial Review for the AIA Group in Part XIII, of this document. This amount comprises other adjustments relating to the differences between those applied by AIA Group management, for decision making and internal performance management purposes and the accounting policies described in note 2 to the AIA Group historical financial information.

These adjustments are for the differences between

- The shareholders' share of pre-bonus earnings and the pre-tax statutory transfer of participating/with-profit funds,
- Movements on the carrying value of investment properties between those on a depreciated cost and fair value basis, and
- The movement in the financial position of the defined benefit pension schemes between those determined under "corridor" accounting and those with full recognition of actuarial gains and losses.

On conforming the presentation to be on the Prudential basis the constituent items are disaggregated and reallocated to other line items within the analysis.

(g) AIA Group policyholder tax

On the AIA basis, as shown in note 5 of part B of the AIA Group historical financial information in section B of part XV of this document, the supplementary analysis of profit is undertaken on profits before policyholder and shareholder tax. On the Prudential basis, consistent with the different approach to profit recognition for participating/with-profit funds the analysis undertaken is of profit before shareholder tax. Accordingly, the policyholder tax for the year is shown as a reconciling item in the table above.

(h) Consistent with the treatment explained in note 7 the profit from continuing operations before tax attributable to shareholders shown above excludes amortisation of the incremental value of acquired in force business. The supplementary analysis for the Enlarged Group will include this item separately as an item of non-operating profit. The amortisation of deferred acquisition costs of AIA will, as for Prudential, be included as a charge included in the determination of operating profit based on longer-term investment returns.

## **B. Accountants' report on pro forma income statement and pro forma net asset statement**

*The following is a text of the reports from Prudential's reporting accountants KPMG Audit Plc for the purposes of incorporation in this prospectus.*



**KPMG Audit Plc**  
Chartered Accountants  
8 Salisbury Square  
London  
EC4Y 8BB  
United Kingdom

### **Accountants' report — UK purposes**

The Directors  
Prudential plc  
Laurence Pountney Hill  
London, EC4R 0HH

**17 May 2010**

Dear Sirs

### **Prudential**

We report on the pro forma income statement and pro forma net asset statement (the "Pro forma financial information") set out in section A of Part XVI of the prospectus dated 17 May 2010, which has been prepared on the basis described therein, for illustrative purposes only, to provide information about how the Hong Kong Initial listing, the acquisition of AIA and the Rights Issue (the "Transaction") might have affected the financial information presented on the basis of the accounting policies adopted by Prudential plc in preparing the financial statements for the period ended 31 December 2009. This report is required by paragraph 20.2 of Annex 1 of the Prospectus Directive Regulation and is given for the purpose of complying with those paragraphs and for no other purpose.

### **Responsibilities**

It is the responsibility of the directors of Prudential plc to prepare the Pro forma financial information in accordance with paragraph 20.2 of Annex I of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, as required by paragraph 7 of Annex II of the Prospectus Directive Regulation, as to the proper compilation of the Pro forma financial information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 23.1 of Annex I of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

### **Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of Prudential plc.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of Prudential.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions, apart from the United Kingdom and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

### **Opinion**

In our opinion:

- the Pro forma financial information has been properly compiled on the basis stated; and
- such basis is consistent with the accounting policies of Prudential.

### **Declaration**

For the purposes of Prospectus Rule 5.5.3R (2)(f) we are responsible for this report as part of the prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the prospectus in compliance with paragraph 1.2 of Annex I of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

*The following is a text of the reports from Prudential's reporting accountants KPMG Audit Plc (Chartered Accountants) and KPMG (Certified Public Accountants) for the purposes of incorporation in this prospectus*



**KPMG Audit Plc**

Chartered Accountants  
8 Salisbury Square  
London  
EC4Y 8BB  
United Kingdom

**KPMG**

Certified Public Accountants  
Prince's Building  
10 Chater Road  
Central  
Hong Kong

**Accountants' report — HK purposes**

The Directors  
Prudential plc  
Laurence Pountney Hill  
London, EC4R 0HH

**17 May 2010**

Dear Sirs

**Prudential**

We report on the unaudited pro forma income statement and the unaudited pro forma net tangible asset statement (the "Pro Forma Financial Information") of Prudential and its subsidiaries (the "Prudential Group"), as enlarged by the acquisition of AIA Group Limited ("AIA") (the "Enlarged Group") set out in Section A of Part XVI of the prospectus dated 17 May 2010 (the "Prospectus"), which has been prepared by the directors of Prudential solely for illustrative purposes to provide information about how the Hong Kong initial listing, acquisition of AIA and the Rights Issue might have affected the financial information presented. The basis of preparation of the unaudited Pro Forma Financial Information is set out therein.

**Responsibilities**

It is the responsibility solely of the directors of Prudential to prepare the unaudited Pro Forma Financial Information in accordance with Paragraph 4.29 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "HK Listing Rules") and with reference to Accounting Guideline 7 "Preparation of Pro Forma Financial Information for inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

It is our responsibility to form an opinion, as required by paragraph 4.29(7) of the Listing Rules, on the unaudited Pro Forma Financial Information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

Save for any responsibility arising under the Hong Kong Listing Rules to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this opinion or our statement, required by and given solely for the purposes of complying with the Hong Kong Listing Rules, consenting to its inclusion in the Prospectus.

**Basis of opinion**

We conducted our work in accordance with Hong Kong Standard on Investment Circular Reporting Engagements ("HKSIR") 300 "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" issued by the HKICPA. Our work consisted primarily of comparing the unadjusted financial information with source documents, considering the evidence supporting the adjustments and discussing the unaudited Pro Forma Financial Information with the directors of the Company. The engagement did not involve independent examination of any of the underlying financial information.

Our work did not constitute an audit or review made in accordance with Hong Kong or International Standards on Auditing or Hong Kong or International Standards on Review Engagements issued by the HKICPA or the

International Auditing and Assurance Standards Board (“IAASB”) respectively, and accordingly, we do not express any such audit or review assurance on the unaudited Pro Forma Financial Information.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the unaudited Pro Forma Financial Information has been properly compiled by the directors of Prudential on the basis stated, that such basis is consistent with the accounting policies of Prudential and that the adjustments are appropriate for the purposes of the unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 4.29(1) of the Listing Rules.

Our procedures on the unaudited Pro Forma Financial Information have not been carried out in accordance with attestation standards or other standards and practices generally accepted in the United States of America or auditing standards of the Public Company Accounting Oversight Board (United States) and accordingly should not be relied upon as if they had been carried out in accordance with those standards and practices.

The unaudited Pro Forma Financial Information is for illustrative purposes only, based on the judgements and assumptions of the directors of Prudential, and because of its hypothetical nature, it does not provide any assurance or indication that any event will take place in the future and may not be indicative of the financial position of the Enlarged Group as at 31 December 2009 or any future date or the profit of the Enlarged Group for the period ended on 31 December 2009 or any future period.

We make no comments regarding the reasonableness of the amount of net proceeds from the issuance of the Prudential shares, the application of those net proceeds, or whether such use will actually take place as described under “Information about the Transactions” set out in Part V of the Prospectus.

### **Opinion**

In our opinion:

- a) the unaudited Pro Forma Financial Information has been properly compiled by the directors of the Company on the basis stated;
- b) such basis is consistent with the accounting policies of Prudential, and
- c) the adjustments are appropriate for the purposes of the unaudited Pro Forma Financial Information as disclosed pursuant to Paragraph 4.29(1) of the HK Listing Rules.

### **Yours faithfully**

KPMG Audit Plc  
Chartered Accountants  
London, United Kingdom

KPMG  
Certified Public Accountants  
Hong Kong

### C. Pro forma net worth and value-in-force on a European Embedded Value Basis

The unaudited pro forma information set out below has been prepared to illustrate the effect on the European Embedded Value net worth and value-in-force of Prudential Group as if the proposed transaction had taken place on 31 December 2009. The pro forma information has been prepared for illustrative purposes only and because of its nature addresses a hypothetical situation and, therefore, does not represent the Enlarged Group's actual financial result or financial position following the transaction.

The pro forma financial information has been prepared on the basis of the accounting policy for European Embedded Value (EEV) which is to follow the EEV principles and on the basis that the transaction took place on 31 December 2009. Both the EEV methodology adopted by Prudential plc and the EEV methodology adopted for AIA Group is in accordance with the EEV principles and guidance issued in May 2004 by the European Insurers' CFO forum and expanded by the additional guidance on EEV disclosures issued in October 2005 except for certain disclosure points referred to in the Consulting Actuaries' Report as set out in Section C of Part XV of this document.

	Prudential Group Year Ended 31 December 2009 <sup>(1)</sup> £m	Adjustments			Pro forma Enlarged Group £m
		AIA Group Year Ended 30 November 2009 <sup>(2)</sup> £m	AIA Group Year Ended 30 November 2009 £m	Purchase and Rights Issue Adjustments <sup>(3)</sup> £m	
Total net assets — EEV basis . . . . .	15,273	21,953	13,377	3,870	32,520

#### Notes:

- 1) The net worth and value-in-force — EEV basis for Prudential Group at 31 December 2009 has been extracted without material adjustment from the EEV basis Supplementary information set out in Section C of Part XIV of this document.
- 2) The net worth and value-in-force — EEV basis for AIA Group at 30 November 2009 has been extracted from the Consulting Actuaries' Report set out in Section C of Part XV of this document and converted to £ sterling using a 30 November 2009 exchange rate of £1 = USD1.6411, but without any further material adjustment.
- 3) The purchase adjustments shown in the table above are for goodwill and other fair value adjustments of £8,606 million, less debt instruments (net of expenses) of £4,334 million, the fair value of the liability for the coupons payments and delivery of additional shares, beyond those to be delivered under fixed obligations, of the Mandatory Convertible Notes of £302 million, and transaction expenses of £100 million. These Transaction costs exclude the effect of any amounts in respect of the foreign currency hedging arrangements that Prudential has put in place to convert the pounds sterling proceeds of the Rights Issue into US dollars, which is the currency in which New Prudential must pay the cash element of the consideration. Note 5 to the pro forma income statement provides additional explanation of these items.
- 4) No account has been taken of any trading or changes in financial position of Prudential Group after 31 December 2009 and of AIA Group after 30 November 2009
- 5) The EEV methodology adopted by Prudential Group is in accordance with the EEV principles and guidance issued in May 2004 by the European Insurers' CFO forum and expanded by the additional guidance on EEV disclosures issued in October 2005. The EEV methodology adopted for AIA Group is also in accordance with the EEV principles and guidance issued in May 2004 by the European Insurers' CFO forum and expanded by the additional guidance on EEV disclosures issued in October 2005, except for certain disclosure points referred to in the Consulting Actuaries' Report set out in Section C of Part XV of this document. As such, both companies have adopted EEV methodologies that are in accordance with the EEV principles although the principles do allow for different approaches to be taken by companies. There are two principal differences between the EEV methodology adopted by Prudential and that adopted for AIA Group. The first is in relation to the way that risk is allowed for in the embedded value calculations and the second is in relation to the way that long term economic assumptions are set. Both approaches are acceptable under the EEV principles. It is important to note that each of these differences should not be considered in isolation, but together with the other differences as part of the entire basis i.e. the risk discount rates should be considered in conjunction with the long term economic assumptions rather than separately, and vice versa.
- 6) The Prudential Group net assets of £15,273 million on the EEV basis at 31 December 2009 comprise £6,083 million in respect of Asian operations and £9,190 million for the Group's other operations. After addition of the AIA Group EEV basis net assets at 30 November 2009 of £13,377 million (as shown above) on an aggregate basis 68% of the Enlarged Group's EEV net assets, without applying adjustments for the Transactions or Rights Issue, was attributable to Asian businesses.

- 7) Included within the Total net worth and value-in-force-EEV basis results of Prudential Group and AIA Group is the value of new business for the twelve months ended 31 December 2009 and the twelve months ended 30 November 2009 respectively. The value of new business for the twelve months to 31 December 2009 for the Asian operations of the Prudential Group and to 30 November 2009 for the AIA Group are shown in the following table. Exchange rates used are average exchange rates for the year to 31 December 2009 for the Prudential Group and the rates at 30 November 2009 for the AIA Group. The value of new business for Prudential Group and AIA Group has been extracted from Section C of Part XIV of the document and Section C of Part XV of the document respectively.

	2009 £m		2009				2009			
	New business premiums		Annual premium and contribution	Present value of new business premiums	Pre-tax new business contribution	Tax	Post-tax new business contribution	Pre-tax new business margin	APE	PVNBP
	Single	Regular	equivalents (APE)	(PVNBP)	contribution		contribution	APE	PVNBP	
<b>Prudential Group (A)</b> . . . . .	14,495	1,447	2,896	21,195	1,607	(476)	1,131	56%	7.6%	
<b>Prudential Group — Total Asian operations (B)</b> . . . . .	842	1,177	1,261	6,245	713	(180)	533	57%	11.4%	
<b>AIA Group — Total (C)*</b> . . . . .	879	1,188	1,276	6,557	510	(138)	372	40%	7.8%	
<b>Total Asian operations (B) + (C)</b> . . . . .	<u>1,721</u>	<u>2,365</u>	<u>2,537</u>	<u>12,802</u>	<u>1,223</u>	<u>(318)</u>	<u>905</u>	<u>48%</u>	<u>9.6%</u>	
<b>Total Prudential Group AIA Group (A) + (C)</b> . . . . .	<u>15,374</u>	<u>2,635</u>	<u>4,172</u>	<u>27,752</u>	<u>2,117</u>	<u>(614)</u>	<u>1,503</u>	<u>51%</u>	<u>7.6%</u>	

\* Based on required capital and reserving consistent with Hong Kong statutory levels and after an allowance for Group expenses

## **D. Accountants' report on pro forma net worth and value-in-force on a European Embedded Value Basis**

*The following is the text of a report received from Prudential's reporting accountant, KPMG Audit Plc (Chartered Accountants), for the purpose of incorporation in this prospectus.*



**KPMG Audit Plc**  
Chartered Accountants  
8 Salisbury Square  
London  
EC4Y 8BB  
United Kingdom

The Directors  
Prudential plc  
Laurence Pountney Hill  
London, EC4R 0HH

**17 May 2010**

Dear Sirs

### **Prudential plc**

We report on the pro forma financial information (the "Pro Forma Financial Information") set out in Section C of Part XVI of the prospectus dated 17 May 2010, which has been prepared on the basis described therein, for illustrative purposes only, to provide information about how the transaction might have affected the net worth and value-in-force presented under the accounting policy for European Embedded Value (EEV) which is to follow the EEV principles issued by the Chief Financial Officers Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance on EEV Disclosures published in October 2005 (together, the "EEV Principles") in preparing the EEV basis supplementary information for the period ended 31 December 2009. This report is required by item 20.2 of Annex I of the Prospectus Directive Regulation and is given for the purpose of complying with those paragraphs and for no other purpose.

### **Responsibilities**

It is the responsibility of the Directors of Prudential to prepare the Pro Forma Financial Information in accordance with item 20.2 of Annex I of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, as required by item 7 of Annex II of the PD Regulation, as to the proper compilation of the Pro Forma Financial Information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro Forma Financial Information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 23.1 of Annex I of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

### **Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro Forma Financial Information with the Directors of Prudential.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro Forma Financial Information has been properly compiled on the basis stated and that such basis is consistent with the EEV Principles.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions, apart from the United Kingdom, and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

**Opinion**

In our opinion:

- the Pro Forma Financial Information has been properly compiled on the basis stated; and
- such basis is consistent with the accounting policies of the issuer.

**Declaration**

For the purposes of Prospectus Rule 5.5.3R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the prospectus in compliance with item 1.2 of Annex I of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

## PART XVII

### MANAGEMENT AND EMPLOYEES

#### 1. Directors

The Board of Directors currently consists of 14 Directors. In line with the requirements under the Combined Code, Prudential keeps succession considerations under regular review, in the expectation that there will be Board turnover in the ordinary course as part of the planned progressive refreshment process required by the Combined Code.

Since January 2009, the following changes have taken place to the Board of Directors: Tidjane Thiam, who had been Chief Financial Officer from 25 March 2008, succeeded Mark Tucker as Group Chief Executive on 1 October 2009, Mark Tucker having resigned from the Board with effect from 30 September 2009. Nic Nicandrou joined the Board as an executive director and Chief Financial Officer with effect from 28 October 2009. Following his decision to join Lloyds Banking Group as its Chairman, Sir Win Bischoff resigned as a non-executive director with effect from 15 September 2009. Rob Devey was appointed as executive director and Chief Executive Officer, Prudential UK and Europe on 16 November 2009, replacing Nick Prettejohn, who resigned as a director and Chief Executive Officer, Prudential UK and Europe, with effect from 30 September 2009.

Set forth below are the current Directors, including their names, positions, business experience and principal business activities performed outside of Prudential, as well as the dates of their initial appointment as Directors. The business address of all Directors is Laurence Pountney Hill, London EC4R 0HH, United Kingdom.

#### **Harvey Andrew McGrath** **Chairman and Chairman of the Nomination Committee**

*Harvey McGrath*, 58, was appointed as an independent non-executive Director on 1 September 2008 and became Chairman and Chairman of the Nomination Committee on 1 January 2009. Harvey has a long and distinguished career in the international financial services industry. He started his career at Chase Manhattan Bank in London and New York. From 1980 to 2007 he worked for Man Group plc first as Treasurer, then Finance Director, then President of Man Inc. in New York, before being appointed as Chief Executive of Man Group plc in London in 1990, and then Chairman in 2000. He left Man Group in 2007. Harvey is also Chairman of the London Development Agency, which works for the Mayor of London, coordinating economic development and regeneration across London, and Vice Chairman of the London Skills and Employment Board, which is tasked with developing a strategy for adult skills in London. He is the former Chairman of both London First and the East London Business Alliance, and a Member of the International Advisory Board of the School of Oriental and African Studies. Harvey is a trustee of a number of charities including New Philanthropy Capital, a research based charity which gives advice and guidance to donors and charities; the Royal Anniversary Trust which operates the Queen's Anniversary Prizes for Higher and Further Education; Children and Families Across Borders (CFAB), which protects the rights and welfare of children and vulnerable adults across borders; icould, an online careers resource; and the Prince's Teaching Institute, which promotes subject based professional development for teachers.

#### **Cheick Tidjane Thiam** **Group Chief Executive**

*Tidjane Thiam*, 47, has been an executive Director since 25 March 2008. He was the Chief Financial Officer until 30 September 2009, and became Group Chief Executive with effect from 1 October 2009. Tidjane was previously Chief Executive Officer, Europe at Aviva, where he also held successively the positions of Group Strategy and Development Director and Managing Director, Aviva International. Tidjane spent the first part of his professional career with McKinsey & Company in Paris, London and New York, serving insurance companies and banks. He then spent a number of years in Africa where he was Chief Executive and then Chairman of the National Bureau for Technical Studies and Development in Côte d'Ivoire and a cabinet member as Secretary of Planning and Development. Tidjane returned to France to become a partner with McKinsey & Company as one of the leaders of their Financial Institutions practice before joining Aviva in 2002. Tidjane was a non-executive director of Arkema in France until November 2009, when he resigned from the Arkema board. He is a member of the Council of the Overseas Development Institute (ODI) in London, a sponsor of Opportunity International and a member of the Africa Progress Panel, chaired by Kofi Annan.

**Nicolaos Andreas Nicandrou ACA**  
**Chief Financial Officer**

*Nic Nicandrou*, 44, has been an executive Director and Chief Financial Officer since 28 October 2009. Before joining Prudential, he worked at Aviva, where he held a number of senior finance roles, including Norwich Union Life Finance Director and Board Member, Aviva Group Financial Control Director, Aviva Group Financial Management and Reporting Director and CGNU Group Financial Reporting Director. Nic started his career at PricewaterhouseCoopers, where he worked in both London and Paris.

**Robert Alan Devey**  
**Executive Director**

*Rob Devey*, 41, has been an executive Director and Chief Executive, Prudential UK and Europe since 16 November 2009. In addition to carrying out this role, Rob is leading the project team responsible for the integration of Prudential Corporation Asia and the AIA Group. Rob joined Prudential from Lloyds Banking Group where he worked from 2002 in a number of senior leadership roles across insurance and retail banking including Managing Director, Direct Channels UK Retail Banking, Managing Director of HBOS Financial Services and Managing Director of HBOS General Insurance. Prior to joining HBOS, Rob was a consultant with the Boston Consulting Group (BCG) in the UK, US and Europe, working in financial services.

**Clark Preston Manning Jr. FSA MAAA**  
**Executive Director**

*Clark Manning*, 51, has been an executive Director since 2 January 2002. He is also President and Chief Executive Officer of Jackson National Life Insurance Company. Clark was previously Chief Operating Officer, Senior Vice President and Chief Actuary of Jackson National Life Insurance Company, which he joined in 1995. Prior to that, he was Senior Vice President and Chief Actuary for SunAmerica Inc, and prior to that Consulting Actuary at Milliman & Robertson Inc. Clark has more than 25 years' experience in the life insurance industry, and holds both a bachelor's degree in actuarial science and an MBA from the University of Texas. He also holds professional designations of Fellow of the Society of Actuaries (FSA) and Member of the American Academy of Actuaries (MAAA).

**Michael George Alexander McLintock**  
**Executive Director**

*Michael McLintock*, 49, has been an executive Director since 1 September 2000. He is also Chief Executive of M&G, a position he held at the time of M&G's acquisition by Prudential in 1999. Michael joined M&G in 1992. He previously also served on the board of Close Brothers Group plc as a non-executive director (2001-2008). Since October 2008, he has been a Trustee of the Grosvenor Estate.

**Barry Lee Stowe**  
**Executive Director**

*Barry Stowe*, 52, has been an executive Director since 1 November 2006, and Chief Executive, Prudential Corporation Asia since October 2006. He has also been a director of the Life Insurance Marketing Research Association (LIMRA) and the Life Office Management Association (LOMA) since October 2008, and a member of the Board of Visitors of Lipscomb University since May 2009. Previously, Barry was President, Accident & Health Worldwide for AIG Life Companies. He joined AIG in 1995, and prior to that was President and CEO of Nisus, a subsidiary of Pan-American Life, from 1992-1995. Before joining Nisus, Barry spent 12 years at Willis Corroon in the US.

**Keki Bomi Dadiseth FCA**  
**Independent Non-Executive Director and Member of the Remuneration Committee**

*Keki Dadiseth*, 64, has been an independent non-executive Director since 1 April 2005. During 2006, he was appointed as a non-executive director of ICICI Prudential Life Assurance Company Limited and ICICI Prudential Trust Limited. Keki is also a director of Britannia Industries Limited, Piramal Healthcare Limited, Siemens Limited, The Indian Hotels Company Limited and Godrej Properties Limited, all of which are quoted on the Bombay Stock Exchange. In addition, he acts as advisor to Goldman Sachs, Fleishman-Hillard Inc. and Oliver Wyman Limited, and as a trustee for a number of Indian charities. Keki is the non-executive Chairman of Omnicom India Marketing Advisory Services Private Limited, an unquoted Indian company and is also a board member of various other unquoted Indian companies, including his recent appointment as Chairman of Sony India Pvt Ltd and

Senior Advisor to Sony Group in India. Before he retired from Unilever in 2005, Keki was Director, Home and Personal Care, responsible for the HPC business of Unilever worldwide, a Board member of Unilever PLC and Unilever N.V., and a member of Unilever's Executive Committee. He joined Hindustan Lever Ltd in India in 1973 and in 1987, he joined the Board of Hindustan Lever and became Chairman in 1996.

**Michael William Oliver Garrett**

**Independent Non-Executive Director and Member of the Remuneration Committee**

*Michael Garrett, 67*, has been an independent non-executive Director since 1 September 2004. He worked for Nestlé from 1961, becoming Head of Japan (1990-1993), and then Zone Director and Member of the Executive Board, responsible for Asia and Oceania, and in 1996 his responsibilities were expanded to include Africa and the Middle East. Michael retired as Executive Vice President of Nestlé in 2005. He served the Government of Australia as Chairman of the Food Industry Council and as a Member of the Industry Council of Australia, and was also a member of the Advisory Committee for an APEC (Asia-Pacific Economic Cooperation) Food System, a Member of The Turkish Prime Minister's Advisory Group and the WTO (World Trade Organization) Business Advisory Council in Switzerland. Michael remains a director of Nestlé in India, and was appointed Chairman of the Evian Group in 2001, a think tank and forum for dialogue promoting free trade. He also serves as a non-executive director on the Boards of the Bobst Group in Switzerland, Hasbro Inc. in the USA, and Gottex Fund Management Holdings Limited in Guernsey. In addition, he is a member of the Development Committee of the International Business Leaders Forum (IBLF), as well as a Member of the Swaziland International Business Advisory Panel under the auspices of the Global Leadership Foundation (GLF) in London.

**Ann Frances Godbehere FCGA**

**Independent Non-Executive Director and Chairman of the Audit Committee**

*Ann Godbehere, 55*, has been an independent non-executive Director since 2 August 2007. She has been a member of the Audit Committee since October 2007 and became its Chairman on 1 October 2009. Ann began her career in 1976 with Sun Life of Canada, joining Mercantile & General Reinsurance Group in 1981, where she held a number of management roles rising to Senior Vice President and Controller for life and health and property/casualty businesses in North America in 1995. In 1996, Swiss Re acquired Mercantile & General Reinsurance Group, and Ann became Chief Financial Officer of Swiss Re Life & Health, North America. In 1997, she was made Chief Executive Officer of Swiss Re Life & Health, Canada. She moved to London as Chief Financial Officer of Swiss Re Life & Health Division in 1998 and joined the Property & Casualty Business Group, based out of Zurich, as Chief Financial Officer on its establishment in 2001. From 2003 until February 2007, Ann was Chief Financial Officer of the Swiss Re Group. Ann is also a non-executive director of Rio Tinto plc, Rio Tinto Limited, UBS AG, Ariel Holdings Limited, Atrium Underwriting Group Limited and Atrium Underwriters Limited. In 2008 and until January 2009, Ann was Chief Financial Officer and an executive director of Northern Rock.

**Bridget Ann Macaskill**

**Independent Non-Executive Director, Chairman of the Remuneration Committee, and member of the Nomination Committee**

*Bridget Macaskill, 61*, has been an independent non-executive Director since 1 September 2003. Bridget rejoined the Board of Prudential having previously resigned due to a potential conflict of interest in 2001. She has been a member of the Remuneration Committee since 2003 and became its Chairman in May 2006. Bridget joined First Eagle Investment Management, LLC, (formerly Arnhold and S. Bleichroeder Advisers, LLC), a US based investment management firm, as President and Chief Operating Officer in February 2009, and was appointed Chief Executive Officer in February 2010. She is a trustee of the TIAA-CREF funds and was previously also a non-executive director of the Federal National Mortgage Association — Fannie Mae (2005-2008), Scottish & Newcastle PLC (2004-2008) and J Sainsbury Plc (2002-2006). Prior to that, she spent 18 years at OppenheimerFunds Inc., a major New York based investment management company, the final ten years of which she was Chief Executive Officer.

**Kathleen Anne O'Donovan ACA**

**Independent Non-Executive Director and Member of the Audit Committee**

*Kathleen O'Donovan, 52*, has been an independent non-executive Director since 8 May 2003. She has been a member of the Audit Committee since 2003, and was its Chairman from May 2006 until 30 September 2009. Kathleen is also a director and Chairman of the Audit Committee of Trinity Mirror plc, a non-executive director of ARM Holdings plc, and Chairman of the Invensys Pension Scheme. Previously, Kathleen was a non-executive director and Chairman of the Audit Committees of Great Portland Estates PLC, EMI Group plc and the Court of the

Bank of England, and a non-executive director of O<sub>2</sub> plc. From 1991 to 2002, Kathleen was Chief Financial Officer of BTR and Invensys, and prior to that she was a partner at Ernst & Young.

### **James Hood Ross**

#### **Senior Independent Director and Member of the Remuneration and Nomination Committees**

*James Ross*, 71, has been an independent non-executive Director since 6 May 2004 and the Senior Independent Director since May 2006. He is also a non-executive director of Schneider Electric in France, and Chairman of the Leadership Foundation for Higher Education and of the Liverpool School of Tropical Medicine. James was previously a non-executive director of McGraw-Hill and Datacard Inc. in the United States, and prior to that Chairman of National Grid plc and Littlewoods plc. He was also Chief Executive of Cable and Wireless plc and Chairman and Chief Executive of BP America Inc., and a Managing Director of the British Petroleum Company plc.

### **Lord Turnbull KCB CVO**

#### **Independent Non-Executive Director and Member of the Audit Committee**

*Lord Turnbull*, 65, has been an independent non-executive Director since 18 May 2006, and a member of the Audit Committee since January 2007. He entered the House of Lords as a Life Peer in 2005. In 2002, he became Secretary of the Cabinet and Head of the Home Civil Service until he retired in 2005. Prior to that, he held a number of positions in the Civil Service, including Permanent Secretary at HM Treasury; Permanent Secretary at the Department of the Environment (later Environment, Transport and the Regions); Private Secretary (Economics) to the Prime Minister; and Principal Private Secretary to Margaret Thatcher and then John Major. He joined HM Treasury in 1970. Lord Turnbull is Chairman of BH Global Limited and a non-executive director of Frontier Economics Limited and The British Land Company PLC, and was formerly a non-executive director of the Arup Group (2006-2007). He also works part-time as a Senior Adviser to the London partners of Booz & Co (UK).

## **2. Company Secretary**

### **Margaret Ann Coltman**

*Margaret Coltman*, 54, was appointed as the Group General Counsel and Company Secretary on 1 January 2010. She was initially appointed to this role on an interim basis in July 2009. Margaret was previously General Counsel and Company Secretary at Lloyds Banking Group, where she was responsible for the group-wide legal function and Company Secretarial department. Margaret started her career as a solicitor at Norton Rose LLP, where she worked for 30 years. She was a partner with Norton Rose from 1986 to 2008, advising on numerous transactions for public and private companies, as well as being responsible for a number of the firm's leading clients.

## **3. Assistant Company Secretary**

### **Chan Ya Lai, Alice**

Alice Chan, the General Counsel of Prudential Corporation Asia since February 2009, has been appointed as Prudential's interim Assistant Company Secretary. Alice is a qualified solicitor in Hong Kong, England and Wales and the Australian Capital Territory with 20 years of post-qualification experience. Between 2004 and February 2009 she was the General Counsel and Company Secretary of Pacific Century Premium Developments Limited, a company listed on the Hong Kong Stock Exchange. She was a solicitor at Clifford Chance between 1995 and 2002 and became a partner of the firm in 1998, and had worked in their Hong Kong, Singapore and Bangkok offices. She specialised in corporate finance and capital markets matters. She taught commercial law and other subjects at the University of Hong Kong between 2002 and 2004. Alice was elected an Associate of The Institute of Chartered Secretaries and Administrators and The Hong Kong Institute of Chartered Secretaries in April 2008.

It is currently expected that Alice will act as Assistant Company Secretary until the completion of the Acquisition. A permanent Assistant Company Secretary who possesses the relevant qualifications under Rule 8.17 of the Hong Kong Listing Rules is expected to be appointed then. Upon appointment of such Assistant Company Secretary, Prudential and/or its Compliance Advisor (which Prudential has appointed in compliance with Rule 3A.19 of the Hong Kong Listing Rules) will make the confirmation to the Hong Kong Stock Exchange that the Assistant Company Secretary:

- (a) satisfies the requirements of Rule 8.17 of the Hong Kong Listing Rules;
- (b) appreciates the nature of his/her responsibilities;
- (c) understands the requirements of the Hong Kong Listing Rules and applicable laws and regulations in Hong Kong; and

- (d) expects to be able to honour his/her obligations under the Hong Kong Listing Rules and applicable laws and regulations in Hong Kong.

#### **4. Authorised representatives**

Prudential has appointed Nicolaos Andreas Nicandrou and Barry Lee Stowe as authorised representatives. Please refer to paragraph 1 of this Part XVII for the biographical details of Nicolaos and Barry.

#### **5. Other executive officers**

The heads of the Prudential Group's current business units are also Directors, as set out above, with the exception of John Foley, who is the Managing Director of Prudential Capital. John Foley has been designated a person discharging managerial responsibilities under the Disclosure and Transparency Rules.

#### **6. Board Committees**

Prudential has established audit, remuneration and nomination committees as standing committees of the Board with written terms of reference, which are kept under regular review. Following recent reviews of the governance of UK companies, the Board intends to establish a separate risk committee responsible for monitoring and overseeing risk, which will become operational in 2010. These committees are key elements of Prudential's corporate governance framework, and descriptions of each committee currently in operation are included below.

##### ***Group Audit Committee***

###### *Role of the Committee*

The Group Audit Committee's principal responsibilities consist of oversight over financial reporting, internal controls and risk management, and monitoring auditor independence. Its duties include gaining assurance on the control over financial processes and the integrity of the Prudential Group's financial reports, monitoring the performance, objectivity and independence of the external auditor, and reviewing the work of the internal auditor. Once the Board has established a separate risk committee with responsibility for risk monitoring and oversight, the Audit Committee's role will change accordingly.

In performing its duties, the Group Audit Committee has access to employees and their financial or other relevant expertise across the Prudential Group, and to the services of the Group-wide Internal Audit Director and the Company Secretary. The Group Audit Committee may also seek external professional advice at the Prudential Group's expense.

The Group Audit Committee's terms of reference are set by the Board and kept under regular review.

###### *Membership*

The Group Audit Committee is comprised exclusively of independent non-executive Directors, as set out below:

Ann Godbehere *FCGA* (Chairman)

Kathleen O'Donovan *ACA*

Lord Turnbull *KCB CVO*

Membership is selected to provide a broad set of financial, commercial and other relevant experience to meet the Group Audit Committee's objectives.

The Board has determined that Kathleen O'Donovan has recent and relevant financial experience for the purposes of the Combined Code. The Board has further determined that Ann Godbehere, who has a long-standing career in the financial services industry with notable insurance sector experience, brings additional recent and relevant financial experience to the Group Audit Committee. In May 2009 the Board designated Kathleen O'Donovan as its audit committee financial expert for Sarbanes-Oxley Act purposes. This will be reviewed during 2010 in conjunction with the publication of Prudential's annual report on Form 20-F.

###### *Meetings*

The Group Audit Committee met six times in 2008 and eight times in 2009. By invitation, the Chairman of the Board, the Chief Executive Officer, the Chief Financial Officer, the Group General Counsel and Company Secretary, the Group-wide Internal Audit Director, the Group Chief Risk Officer, and other senior staff from the finance, internal audit, risk, compliance and security functions where appropriate, as well as the lead partner of the

external auditor attended meetings. Other partners of the external auditor also attended some of the meetings to contribute to the discussions relating to their area of expertise.

A detailed forward agenda has been in operation for a number of years which is continually updated to ensure all matters for which the Group Audit Committee is responsible are addressed at the appropriate time of year. The Group Audit Committee's principal business during 2009 consisted of the following:

- Review of half-year and full-year results, the annual report and accounts and related external audit opinions, and other significant announcements where appropriate;
- Examination of critical accounting policies and key judgemental areas;
- Review of changes in and implementation of Group Accounting Policies in compliance with International Financial Reporting Standards and practices;
- Review of the Prudential Group's tax matters;
- Approval of the external auditor's management representation letter, review of the external auditor's full-year memorandum and external audit opinion;
- Review of US filings and related external audit opinions;
- Monitoring of auditor independence and the external auditor's plans and audit strategy, the effectiveness of the external audit process, the external auditor's qualifications, expertise and resources, and making recommendations for the re-appointment of the external auditor;
- Monitoring of the framework and effectiveness of the Prudential Group's systems of internal control, including the Turnbull compliance statement and Sarbanes-Oxley procedures;
- Monitoring the effectiveness of both the Prudential Group's risk framework and the management of key financial and operational risks;
- Review of the internal audit plan and resources, and monitoring of the audit framework and internal audit effectiveness;
- Monitoring the effectiveness of compliance processes and controls, and performance against the Prudential Group's compliance plan;
- Review of anti-money laundering procedures, and allegations received via the employee confidential reporting lines; and
- Review of its own effectiveness and its terms of reference.

The Chairman of the Group Audit Committee reports to the Board on matters of particular significance after each Group Audit Committee meeting, and the minutes of Group Audit Committee meetings are circulated to the Board.

The Group Audit Committee has sessions without the presence of executive management such as with external and internal auditors and the head of the security function. At all other times, management and auditors have open access to the Chairman of the Group Audit Committee.

### ***Internal Audit***

The group-wide internal audit function plays an important role in supporting the Group Audit Committee to fulfil its responsibilities under the Combined Code and the Sarbanes-Oxley Act, and provides independent assurance on Prudential's processes of identification and control of risk. The Group Audit Committee agreed the work programme of the internal audit function undertaken during 2009. Each of the Prudential Group's business units has an internal audit team, the heads of which report to the Group-wide Internal Audit Director. Internal audit resources, plans and work are overseen by the Group Audit Committee and by business unit audit committees. Across the Prudential Group, total internal audit headcount stands at 117 as at 31 December 2009. The Group-wide Internal Audit Director reports functionally to the Group Audit Committee and for management purposes to the Chief Financial Officer.

Formal reports are submitted to Group Audit Committee meetings, with interim updates where appropriate, and views are also sought at the private meetings between the Group Audit Committee and the internal auditors, as well as during regular private meetings between the Chairman of the Group Audit Committee and the Group-wide Internal Audit Director.

The Group Audit Committee assesses the effectiveness of the internal audit function by means of regular reviews, some of them carried out by external advisers, and through ongoing dialogue with the Group-wide Internal Audit Director. External reviews of internal audit arrangements and standards were last conducted in 2006 and 2007 to ensure that the activities and resources of internal audit are most effectively organised to support the oversight responsibilities of the Committee. These reviews, performed by Deloitte, confirmed that the internal audit function complies with the Institute of Internal Auditors' international standards for the professional practice of internal auditing and was operating effectively. An internal assessment of the internal audit function was performed by the Group-wide Internal Audit Director in 2008 and 2009, based on internal audit's ongoing self-assessment processes and using a maturity model derived from the review criteria used by Deloitte. The assessment confirmed that the internal audit function conforms to the Institute of Internal Auditors' international standards and continues to operate effectively in all areas of professional practice. The results of the assessment were reported in detail to the Group Audit Committee in February 2010.

### ***Remuneration Committee***

#### *Role of the Committee*

The Remuneration Committee determines the remuneration packages of the Chairman and executive Directors. It also agrees the principles and monitors the level and structure of remuneration for a defined population of senior management as determined by the Board. In framing its remuneration policy, the Remuneration Committee has given full consideration to the provisions of Schedule A to the Combined Code.

Except in relation to the remuneration of the Group Chief Executive, when only the Chairman is consulted, the Remuneration Committee consults the Chairman and the Group Chief Executive about the Remuneration Committee's proposals relating to the remuneration of all executive Directors. The Remuneration Committee has access to professional advice inside and outside Prudential.

The Remuneration Committee's terms of reference are set by the Board and kept under regular review. The terms of reference comply with all significant aspects of relevant investor guidelines, and require the Remuneration Committee to ensure that when setting remuneration policy, Prudential provides reward for enhancing shareholder value responsibly in relation to executive Directors' individual contributions, which Prudential believes is the appropriate policy to support the Prudential Group's business.

#### *Membership*

The Remuneration Committee is comprised exclusively of independent non-executive Directors of Prudential, as set out below.

Bridget Macaskill (Chairman)  
Keki Dadiseth FCA  
Michael Garrett  
James Ross

#### *Meetings*

The Remuneration Committee normally has scheduled meetings at least four times a year and a number of additional meetings, as required, to review remuneration policy and the application of that policy. While the Chairman and Group Chief Executive are not members, they attend meetings unless they have a conflict of interest. During 2009, a total of 11 Remuneration Committee meetings were held.

### ***Nomination Committee***

#### *Role of the Committee*

The Nomination Committee, in consultation with the Board, evaluates the balance of skills, knowledge and experience on the Board and identifies the role and capabilities required at any given time, taking into account the Prudential Group's business. Candidates are considered on merit against those criteria, and the Nomination Committee makes recommendations to the Board regarding suitable candidates for appointments. In appropriate cases, search consultants are used to identify candidates. The Nomination Committee also reviews conflicts of interest or potential conflicts of interest raised by Directors between Board meetings or for prospective new members of the Board. In cases where there might be an actual or potential conflict of interest, the Nomination Committee has powers to authorise any such actual or potential conflict situation on behalf of the Board, imposing

any terms and conditions it deems appropriate, or to make recommendations to the Board as to whether the conflict or potential conflict should be authorised, and on what terms.

The Nomination Committee's terms of reference are set by the Board and kept under regular review.

#### *Membership*

The Nomination Committee is comprised of independent non-executive directors and the Chairman, as set out below:

Harvey McGrath (Chairman)  
Bridget Macaskill  
James Ross

#### *Meetings*

The Nomination Committee meets as required to consider candidates for appointment to the Board and to make recommendations to the Board in respect of those candidates. The Group Chief Executive is closely involved in the work of the Nomination Committee and is invited to attend and contribute to meetings. During 2009, the Nomination Committee met six times.

### **7. Combined Code**

As at the date of this document, Prudential complies with the provisions of the Combined Code.

### **8. Employees**

The average numbers of staff employed by the Prudential Group for the last three completed financial years were:

	<u>Year ended 2007</u>	<u>Year ended 2008</u>	<u>Year ended 2009</u>
Business operations . . . . .			
UK operations . . . . .	7,732	6,231	4,516
US operations . . . . .	3,123	3,298	3,371
Asian operations . . . . .	16,807	20,154	19,502
Venture fund investment subsidiaries of the PAC with profits fund . . . . .	21,184	—	—
Discontinued bank operations . . . . .	770	—	—
<b>Total</b> . . . . .	<b><u>49,616</u></b>	<b><u>29,683</u></b>	<b><u>27,389</u></b>

## PART XVIII

### TAXATION CONSIDERATIONS

#### 1. UK taxation

*The following statements do not constitute tax advice and are intended only as a general guide to current UK law and the published practice of HMRC, as currently understood (which are both subject to change at any time, possibly with retrospective effect). They relate only to certain limited aspects of the UK taxation treatment of Qualifying Shareholders and are intended to apply only (except to the extent stated otherwise) to persons who are resident and, in the case of individuals, ordinarily resident in the UK for UK tax purposes, who are the absolute beneficial owners of Existing Shares and who hold them as investments. They may not apply to certain Qualifying Shareholders, such as dealers in securities, insurance companies and collective investment schemes, Qualifying Shareholders who are exempt from taxation and Qualifying Shareholders who have (or who are deemed to have) acquired their Existing Shares by virtue of an office or employment or anyone who is or has been an officer or employee of Prudential. Such persons may be subject to special rules. Any person who is in any doubt as to their tax position, or who is subject to taxation in any jurisdiction other than the UK, should consult their own professional adviser without delay.*

##### 1.1 Taxation of chargeable gains

###### 1.1.1 Issue of Rights Issue Shares

For the purposes of UK tax on chargeable gains, the issue of the Rights Issue Shares to a Qualifying Shareholder should be regarded as a reorganisation of the share capital of Prudential. Accordingly, a Qualifying Shareholder should not be treated as making any disposal of all or part of his holding of Existing Shares and therefore no liability to UK tax on chargeable gains should arise to a Qualifying Shareholder to the extent that the Qualifying Shareholder takes up his/her entitlement to Rights Issue Shares in full. On that basis, for the purposes of UK tax on chargeable gains, Rights Issue Shares allotted to a Qualifying Shareholder pursuant to the Rights Issue will be treated as the same asset as, and having been acquired at the same time as, the Qualifying Shareholder's Existing Shares. The amount paid to acquire the Rights Issue Shares should be added to the base cost of the Qualifying Shareholder's existing holding(s).

###### 1.1.2 Disposal or lapse of rights to acquire Rights Issue Shares

If a Qualifying Shareholder disposes of all or some of his/her rights to acquire Rights Issue Shares, or if he/she allows or is deemed to have allowed his/her rights to lapse and receives a cash payment in respect of them, he/she may, depending on his/her circumstances, incur a liability to tax on any chargeable gain realised. However, if the proceeds resulting from the disposal or lapse of those rights are "small" as compared with the value of the Existing Shares in respect of which the rights arose, the proceeds will instead be deducted from the base cost of his/her holding of Existing Shares for the purposes of computing any chargeable gain or allowable loss on a subsequent disposal of Existing Shares to which the rights related. HMRC will normally treat proceeds as "small" if the amount of the proceeds either does not exceed 5% of the market value of the Existing Shares held (measured immediately before disposal or lapse) or does not exceed £3,000. This treatment will not apply where the base cost of the relevant Qualifying Shareholder's Existing Shares is less than the proceeds, or the Qualifying Shareholder elects to disregard these "small disposal" rules and treat the proceeds as triggering a part disposal of his/her Existing Shares for chargeable gains purposes.

###### 1.1.3 Disposal of Rights Issue Shares

###### (A) Individual shareholders

A disposal of Rights Issue Shares may give rise to a chargeable gain (or allowable loss) for the purposes of UK capital gains tax, depending on the circumstances and subject to any available exemption or relief. Capital gains tax is charged at a flat rate of 18% for individuals, trustees, and personal representatives on the disposal of Rights Issue Shares, irrespective of how long the shares have been held.

###### (B) Corporate shareholders

Where a Qualifying Shareholder is within the charge to corporation tax, a disposal of Rights Issue Shares may give rise to a chargeable gain (or allowable loss) for the purposes of UK corporation tax, depending on the circumstances and subject to any available exemption or relief. Corporation tax is charged on chargeable gains at the rate

applicable to that company. Indexation allowance will apply to the amount paid for the Rights Issue Shares only from the date on which the payment to acquire the Rights Issue Shares is made.

### *(C) Territorial scope*

Subject to the provisions summarised below in relation to temporary non-residents, Qualifying Shareholders who are not resident or, in the case of individuals, ordinarily resident in the UK for tax purposes and who are not carrying on a trade, profession or vocation in the UK through a branch or agency or permanent establishment will not generally be subject to UK tax on chargeable gains as a consequence of the disposal of their Rights Issue Shares. However, a non-UK resident individual (or other non-corporate) Qualifying Shareholder may be liable to UK tax on capital gains if, at the time of a disposal of those Rights Issue Shares, that Qualifying Shareholder carries on a trade, profession or vocation in the UK through a branch or agency and, at or before the time when any capital gain accrues, the Rights Issue Shares have been used in or for the purposes of that trade, profession or vocation or have been used, held or acquired for the purposes of that branch or agency. A non-UK resident corporate Qualifying Shareholder may be liable to UK tax on chargeable gains if, at the time of a disposal of those Rights Issue Shares that corporate Qualifying Shareholder carries on a trade in the UK through a permanent establishment and, at or before the time when any capital gain accrues, the Rights Issue Shares have been used in or for the purposes of that trade or have been used, held or acquired for the purposes of that permanent establishment. Such Qualifying Shareholders may be subject to foreign taxation on any gain, subject to the terms of an applicable double taxation treaty.

In addition, a Qualifying Shareholder who is an individual and who is only temporarily resident outside the UK for UK capital gains tax purposes at the date of a disposal of all or part of his or her Rights Issue Shares may, on becoming resident or ordinarily resident for tax purposes in the UK again, be liable to UK tax on chargeable gains in respect of disposals made while he or she was temporarily resident outside the UK.

### *1.2 Stamp duty and SDRT*

The following statements are intended as a general guide to the current UK stamp duty and SDRT position and apply regardless of whether or not a Qualifying Shareholder is resident or ordinarily resident in the UK.

No UK stamp duty or SDRT should generally be payable on the issue of Provisional Allotment Letters or split Provisional Allotment Letters or on the crediting of Nil Paid Rights or Fully Paid Rights to stock accounts in CREST. Where Rights Issue Shares represented by such documents or rights are registered in the name of the Qualifying Shareholder entitled to such shares, or where Rights Issue Shares are credited to the Qualifying Shareholder entitled to such shares in uncertificated form in CREST, no liability to UK stamp duty or SDRT should generally arise.

Persons who purchase (or are treated as purchasing) rights to Rights Issue Shares represented by Provisional Allotment Letters or split Provisional Allotment Letters (whether nil paid or fully paid but excluding Provisional Allotment Letters relating to shares on the Hong Kong Register), or Nil Paid Rights or Fully Paid Rights held in CREST will normally be liable to pay UK SDRT at the rate of 0.5% of the consideration payable.

Where such a purchase is effected through a stockbroker or other financial intermediary, that person will normally account to HMRC for the SDRT and should indicate that this has been done in any contract note issued to the purchaser. In other cases, the purchaser of the rights to the Rights Issue Shares represented by a Provisional Allotment Letter or a split Provisional Allotment Letter is liable to pay the SDRT and must account for it to HMRC. Any SDRT arising on the transfer of Nil Paid Rights or Fully Paid Rights held in CREST should be collected and accounted for to HMRC by Euroclear.

The issue or transfer of Provisional Allotment Letters, split Provisional Allotment Letters, Existing Shares, Rights Issue Shares, Nil Paid Rights or Fully Paid Rights to, (a) a person whose business is or includes the provision of clearance services (or their nominee or agent) or (b) a person whose business is or includes issuing depositary receipts (or their nominee or agent), may give rise to UK stamp duty or SDRT at the higher rate of 1.5% of the issue price, the consideration payable or, in certain circumstances, the value of the Existing Shares, Provisional Allotment Letters, split Provisional Allotment Letters, Nil Paid Rights, Fully Paid Rights or Rights Issue Shares as the case may be unless, in the case of an issue or transfer to a person falling within paragraph (a) (or their nominee or agent), that person has made an election under section 97A of the Finance Act 1986 which has effect in relation to such securities.

It is HMRC's view that the issue or transfer of Existing Shares, Provisional Allotment Letters, Rights Issue Shares, Nil Paid Rights or Fully Paid Rights into CDP will give rise to stamp duty or SDRT at the higher rate of 1.5%. Subsequent transfers of, or agreements to transfer, Existing Shares, Rights Issue Shares, Provisional Allotment

Letters, Nil Paid Rights or Fully Paid Rights within CDP should not generally give rise to any UK stamp duty or SDRT and subject to the special rules relating to clearance services and depositary receipts referred to above.

On 1 October 2009, the European Court of Justice ruled that such a charge, when levied in respect of an issue of shares by a limited liability company incorporated under English law into a clearance service, was prohibited by Article 11(a) of Council Directive 69/335/EEC. On the same day, HMRC announced that, with immediate effect, the 1.5% charge to SDRT on the issue of shares into a clearance service within the EU would no longer be applied. On 9 December 2009, HMRC extended this to the issue of shares into a depositary system within the European Union. There may be further implications of this decision, in particular for the issue of shares into systems outside the EU. The law in this area may be particularly susceptible to change. Section 54 of the Finance Act 2010 has removed certain exemptions which applied to transfers from clearance systems or issuers of depositary receipts based in the EU to clearance systems or issuers of depositary receipts based outside the EU.

The issue or transfer of Provisional Allotment Letters, split Provisional Allotment Letters or Rights Issue Shares to, or the crediting of Nil Paid Rights, Fully Paid Rights or Rights Issue Shares in CREST to, the US Depositary should not give rise to UK stamp duty or SDRT at the higher rate of 1.5% provided that no depositary receipt is, has been or will be issued in respect of them.

Further, HMRC have confirmed that no UK stamp duty or SDRT should be payable on the entry into, or subsequent settlement or clearance in, CCASS of shares registered on the Hong Kong Register or Provisional Allotment Letters relating to shares registered on the Hong Kong Register provided that no instrument of transfer is executed in the UK in respect of them and subject, in the case of transfers of such shares or Provisional Allotment Letters within CCASS to CDP, to the special rules relating to clearance services and depositary receipts referred to above.

Transfers of, or agreements to transfer, Existing Shares or Rights Issue Shares which are registered on the Hong Kong Register outside of CCASS and transfers of Existing Shares or Rights Issue Shares which are registered on the Irish Register should not give rise to any UK stamp duty or SDRT provided that no instrument of transfer is executed in the United Kingdom in respect of them and, in the case of both stamp duty and SDRT, subject to the special rules relating to clearance services and depositary receipts referred to above.

No UK stamp duty or SDRT should be payable when Existing Shares or Rights Issue Shares that are registered on the UK Register or the Irish Register are re-registered on the Hong Kong Register or where Existing Shares or Rights Issue Shares which are registered on the Hong Kong Register are re-registered on the UK Register or the Irish Register, provided that there is no change in the ownership of those Existing Shares or Rights Issue Shares.

Subject to a stamp duty exemption for certain low value transactions and to the special rules relating to clearance services and depositary receipts referred to above, subsequent dealings in Existing Shares and Rights Issue Shares which are not registered on the Hong Kong Register or the Irish Register will generally be subject to UK stamp duty or SDRT in the normal way. The transfer on sale of Existing Shares or Rights Issue Shares should generally be liable to ad valorem stamp duty at the rate of 0.5% of the consideration paid (rounded up to the nearest multiple of £5). An unconditional agreement to transfer such shares should generally be liable to SDRT at the rate of 0.5% of the consideration payable but such liability will be cancelled, or a right to a repayment of the SDRT paid will arise, if the agreement is completed by a duly stamped transfer within six years of the agreement having become unconditional. Stamp duty is normally paid by the purchaser and SDRT is the liability of the purchaser.

Subject to the special rules relating to clearance services and depositary receipts referred to above, no UK stamp duty or SDRT should arise on a transfer of Existing Shares or Rights Issues Shares which are not registered on the Hong Kong Register or the Irish Register into the CREST system provided that, in the case of SDRT, the transfer is not for money or money's worth. Transfers of such shares within CREST are liable to SDRT (at the rate of 0.5% of the consideration payable) and SDRT on relevant transactions settled in, or reported through, CREST will be collected by CREST.

It should be noted that certain categories of person, including market makers, brokers, dealers and other specified market intermediaries, are entitled to an exemption from UK stamp duty and SDRT in respect of purchases of securities in certain circumstances and there is an exemption for transfers to charities.

### **1.3 Dividends**

#### **1.3.1 General**

Prudential will not be required to withhold tax at source when paying a dividend.

### *1.3.2 Individual holders of Prudential Shares within the charge to UK Income Tax*

When Prudential pays a dividend to a shareholder who is an individual resident (for tax purposes) in the UK, the shareholder will be entitled to a tax credit equal to one-ninth of the dividend received. The dividend received plus the related tax credit (the “gross dividend”) will be part of the shareholder’s total income for UK income tax purposes and will be regarded as the top slice of that income. However, in calculating the shareholder’s liability to income tax in respect of the gross dividend, the tax credit (which equates to 10% of the gross dividend) is set off against the tax chargeable on the gross dividend.

#### *Basic Rate Taxpayers*

In the case of a shareholder who is liable to income tax at the basic rate, the shareholder will be subject to tax on the gross dividend at the ordinary dividend rate of 10%. The tax credit will, in consequence, satisfy in full the shareholder’s liability to income tax on the gross dividend.

#### *Higher Rate Taxpayers*

In the case of a shareholder who is liable to income tax at the higher rate, the shareholder will be subject to tax on the gross dividend at the dividend upper rate of 32.5%, to the extent that the gross dividend falls above the threshold for the higher rate of income tax when it is treated (as mentioned above) as the top slice of the shareholder’s income. This means that the tax credit will satisfy only part of the shareholder’s liability to income tax on the gross dividend, so that the shareholder will have to account for income tax equal to 22.5% of the gross dividend (which equates to 25% of the dividend received). For example, a dividend of £90 from Prudential would represent a gross dividend of £100 (after the addition of the tax credit of £10) and the shareholder would be required to account for income tax of £22.50 on the dividend, being £32.50 (i.e. 32.5% of £100.00) less £10 (the amount of the tax credit).

#### *Additional Rate Taxpayers*

In the case of a shareholder who is liable to income tax at the additional rate, the shareholder will be subject to tax on the gross dividend at the dividend additional rate of 42.5%, to the extent that the gross dividend falls above the threshold for the additional rate of income tax when it is treated (as mentioned above) as the top slice of the shareholder’s income. This means that the tax credit will satisfy only part of the shareholder’s liability to income tax on the gross dividend, so that the shareholder will have to account for income tax equal to 32.5% of the gross dividend (which equates to approximately 36.1% of the dividend received). For example, a dividend of £90 from Prudential would represent a gross dividend of £100 (after the addition of the tax credit of £10) and the shareholder would be required to account for income tax of £32.50 on the dividend, being £42.50 (i.e. 42.5% of £100.00) less £10 (the amount of the tax credit).

### *1.3.3 Corporate Shareholders within the charge to UK Corporation Tax*

Shareholders within the charge to UK corporation tax which are “small companies” (for the purposes of UK taxation of dividends) will not generally be subject to tax on dividends from Prudential.

Other shareholders within the charge to UK corporation tax will not be subject to tax on dividends (including dividends from Prudential) so long as the dividends fall within an exempt class and certain conditions are met. For example, dividends paid on shares that are “ordinary shares” and are not “redeemable” (both for UK tax purposes) and dividends paid to a person holding less than 10% of the issued share capital of the payer (or any class of that share capital) should generally fall within an exempt class.

### *1.3.4 No Payment of Tax Credit*

A shareholder (whether an individual, a company, a pension fund or a charity) who is not liable to tax on dividends from Prudential will not be entitled to claim payment of the tax credit in respect of those dividends.

### *1.3.5 Territorial Scope*

The right of a shareholder who is not resident (for tax purposes) in the UK to a tax credit in respect of a dividend received from Prudential and to claim payment of any part of that tax credit will depend on the existence and terms of any double taxation convention between the UK and the country in which the holder is resident. Shareholders who are not solely resident in the UK should consult their own tax adviser concerning their tax liabilities on dividends received, whether they are entitled to claim any part of the tax credit and, if so, the procedure for doing so.

## **1.4 Scheme**

Further information on certain tax consequences of the Scheme are set out in Part XVIII of the New Prudential Prospectus.

## **2. Taxation in non-UK jurisdictions — Hong Kong taxation**

*This section addresses the taxation of income and capital gains of holders of Nil Paid Rights and Rights Issue Shares under the laws of Hong Kong and the published practice of the Hong Kong Inland Revenue Department (which are both subject to change at any time), as currently understood. The following summary of the tax position in Hong Kong is based on current law and practice, is subject to changes therein and does not constitute legal or tax advice. This summary provides a general outline of the material tax considerations that may be relevant to a decision to acquire, purchase, own or dispose of the Rights Issue Shares and does not deal with all possible Hong Kong tax consequences applicable to all categories of investors.*

### **2.1 Dividends**

No tax will be payable in Hong Kong in respect of dividends Prudential pays to its shareholders. Dividends distributed to Prudential's shareholders will be free of withholding taxes in Hong Kong.

### **2.2 Taxation on gains of sale**

No tax is imposed in Hong Kong in respect of capital gains. However, trading gains from the sale of property by persons carrying on a trade, profession or business in Hong Kong where the trading gains are derived from or arise in Hong Kong will be chargeable to Hong Kong profits tax. Hong Kong profits tax is currently charged at the rate of 16.5% on corporations and at a maximum rate of 15% on individuals. Certain categories of taxpayers whose business consists of buying and selling shares are likely to be regarded as deriving trading gains rather than capital gains (e.g. financial institutions, insurance companies and securities dealers) unless these taxpayers can prove that the investment securities are held for long-term investment purposes.

Trading gains from the sale of the Nil Paid Rights or Rights Issue Shares effected on the Hong Kong Stock Exchange will be considered to be derived from Hong Kong. A liability for Hong Kong profits tax would thus arise in respect of trading gains from the sale of Nil Paid Rights or Rights Issue Shares effected on the Hong Kong Stock Exchange where such trading gains are realised by persons from a business carried on in Hong Kong.

### **2.3 Stamp duty**

Hong Kong stamp duty, currently charged at the ad valorem rate of 0.1% on the higher of the consideration for or the value of the Nil Paid Rights or the Rights Issue Shares, will be payable by the purchaser on a purchase and by the seller on a sale of Nil Paid Rights or Rights Issue Shares where the transfer is required to be registered in Hong Kong (i.e. a total of 0.2% is ordinarily payable on a sale and purchase transaction involving ordinary shares). In addition, a fixed duty of HK\$5.00 is currently payable on any instrument of transfer of ordinary shares.

### **2.4 Estate duty**

Hong Kong estate duty has been abolished with effect to all deaths occurring on or after 11 February 2006.

## **3. Taxation in non-UK jurisdictions — Singapore taxation**

*The following summary of the tax position in Singapore in respect of holders of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares is based on current Singapore taxation law and published tax authority practice (which are both subject to change at any time) as currently understood and does not constitute legal or tax advice. This summary provides a general outline of the material tax considerations that may be relevant to a decision to acquire, purchase, own or dispose of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares and does not deal with all possible Singapore tax consequences applicable to all categories of investors. The statements made herein do not purport to be a comprehensive or exhaustive description of all of the tax considerations that may be relevant to a decision to purchase, own or dispose of the Nil Paid Rights, Fully Paid Rights or Rights Issue Shares and do not purport to deal with the tax consequences applicable to all categories of investors some of which (such as dealers in securities) may be subject to special rules. Investors are advised to consult their own tax advisers as to the Singapore or other tax consequences of the acquisition, ownership or disposal of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares.*

### **3.1 Taxation on gains of sale**

#### **3.1.1 Disposal of the Nil Paid Rights, Fully Paid Rights or Rights Issue Shares**

Singapore does not impose tax on capital gains. There are no specific laws or regulations which deal with the characterization of whether a gain is income or capital in nature. Gains arising from the disposal of the Nil Paid Rights, Fully Paid Rights or Rights Issue Shares may be construed to be of an income nature and subject to Singapore income tax, especially if they arise from activities which are regarded as the carrying on of a trade or business and the gains are sourced in Singapore.

#### **3.1.2 Adoption of FRS 39 for Singapore Tax Purposes**

Investors who apply, or who are required to apply, the Singapore Financial Reporting Standard 39 Financial Instruments — Recognition and Measurement (“**FRS 39**”) for the purposes of Singapore income tax may be required to recognize gains or losses (not being gains or losses in the nature of capital) in accordance with the provisions of FRS 39 (as modified by the applicable provisions of Singapore income tax law) even though no sale or disposal is made. Taxpayers who may be subject to such tax treatment should consult their own accounting and tax advisers regarding the Singapore income tax consequences of their acquisition, holding and disposal of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares.

### **3.2 Dividend distributions**

As Prudential is incorporated in England and Wales and is not tax resident in Singapore for Singapore tax purposes, dividends paid by Prudential will be considered as sourced outside Singapore (unless the Rights Issue Shares are held as part of a trade or business carried out in Singapore in which event the holders of such shares may be taxed on the dividends as they are derived).

Foreign-sourced dividends received or deemed received in Singapore by an individual not resident in Singapore is exempt from Singapore income tax. This exemption will also apply in the case of a Singapore tax resident individual who receives his foreign-sourced income in Singapore on or after 1 January 2004 (except where such income is received through a partnership in Singapore).

Foreign-sourced dividends received or deemed received by corporate investors in Singapore will ordinarily be liable to Singapore tax.

However, foreign-sourced income in the form of dividends, branch profits and service income received or deemed to be received in Singapore by Singapore tax resident companies on or after 1 June 2003 can be exempt from tax if certain prescribed conditions are met, including the following:

- (i) such income is subject to tax of a similar character to income tax under the law of the jurisdiction from which such income is received; and
- (ii) at the time the income is received in Singapore, the highest rate of tax of a similar character to income tax (by whatever name called) levied under the law of the territory from which the income is received on any gains or profits from any trade or business carried on by any company in that territory at that time is not less than 15%.

Certain concessions and clarifications have also been announced by the Inland Revenue Authority of Singapore with respect to such conditions.

### **3.3 Stamp duty**

As Prudential is incorporated in England and Wales and the Prudential Shares and Rights Issue Shares are not registered on any register kept in Singapore, no stamp duty is payable in Singapore:

- (i) on the issuance of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares; and
- (ii) on any transfer of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares.

Existing Shares and Rights Issue Shares held or traded in Singapore through CDP will be registered on the HK Register. As such, Hong Kong stamp duty will be payable on a transfer of Existing Shares, Nil Paid Rights and Rights Issue Shares held or traded in Singapore through CDP. Please refer to the description of Hong Kong stamp duty at paragraph 2.3 of Part XVIII above.

All persons who hold or transact in Existing Shares, Nil Paid Rights and Rights Issue Shares in Singapore through the SGX-ST and/or CDP should expect that they will have to bear Hong Kong stamp duty in respect of transactions

in Existing Shares, Nil Paid Rights or Rights Issue Shares effected in Singapore through the SGX-ST and/or CDP. Such persons should consult their brokers, or custodians for information regarding what procedures may be instituted for collection of Hong Kong stamp duty from them.

### **3.4 Estate duty**

Singapore estate duty has been abolished with respect to all deaths occurring on or after 15 February 2008.

### **3.5 Goods and Services Tax**

There is no Goods and Services Tax (“GST”) payable in Singapore on the subscription or issuance of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares. The clearing fees, instruments of transfer deposit fees and share withdrawal fees are subject to GST at the prevailing standard-rate (currently 7%) if the services are provided to a holder of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares belonging in Singapore. However, such fees could be zero-rated when provided to a holder of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares belonging outside Singapore provided certain conditions are met. For a holder of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares belonging in Singapore who is registered for GST, the GST incurred is generally not recoverable as input tax credit from the Inland Revenue Authority of Singapore unless certain conditions are satisfied. These GST-registered holders of the Nil Paid Rights, Fully Paid Rights and Rights Issue Shares should seek the advice of their tax advisors on these conditions.

## **4. Taxation in non-UK jurisdictions — US Taxation**

**TO ENSURE COMPLIANCE WITH US TREASURY DEPARTMENT CIRCULAR 230, HOLDERS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF US FEDERAL INCOME TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY HOLDERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON HOLDERS UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS INCLUDED HEREIN BY PRUDENTIAL IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY PRUDENTIAL OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) HOLDERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.**

The following is a summary of certain material US federal income tax consequences of the receipt, exercise, ownership and disposition of Nil Paid Rights and Fully Paid Rights pursuant to the Rights Issue, as well as the acquisition, ownership and disposition of Rights Issue Shares by a US Holder (as defined below). This summary does not address the US federal income tax consequences of the Scheme or the acquisition, ownership and disposition of New Prudential Shares, which are discussed under the heading “US Taxation” in Part IV of the Circular and under the heading “US Taxation” in part XVIII of the New Prudential Prospectus, respectively. This summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to any particular investor, and does not discuss state, local, foreign or other tax laws. In particular, the summary does not deal with Nil Paid Rights, Fully Paid Rights or Rights Issue Shares that are not held as capital assets and does not address the tax treatment of holders that are subject to special rules, such as US expatriates, banks and other financial institutions, insurance companies, dealers in securities or currencies, regulated investment companies, partnerships or other pass-through entities, persons that elect mark-to-market treatment, persons holding Nil Paid Rights, Fully Paid Rights or Rights Issue Shares as a position in a synthetic security, straddle or conversion transaction, persons subject to the alternative minimum tax, persons who acquired Nil Paid Rights, Fully Paid Rights or Rights Issue Shares pursuant to the exercise of employee stock options or otherwise as compensation, individual accounts and other tax-deferred accounts, tax-exempt entities, persons that own, directly or indirectly, 10% or more of Prudential’s shares or ADRs and persons whose functional currency is not the US dollar.

For purposes of this summary, a “US Holder” is a beneficial owner of Nil Paid Rights, Fully Paid Rights or Rights Issue Shares that is a citizen or resident of the United States, a US domestic corporation, or otherwise subject to US federal income tax on a net income basis with respect to its Nil Paid Rights, Fully Paid Rights or Rights Issue Shares.

The US federal income tax treatment of a partner in a partnership that holds Nil Paid Rights, Fully Paid Rights or Rights Issue Shares will depend on the status of the partner and the activities of the partnership. Prospective purchasers that are partnerships should consult their tax advisers concerning the US federal income tax consequences to their partners of the acquisition, ownership and disposition of Nil Paid Rights, Fully Paid Rights or, Rights Issue Shares by the partnership.

This summary is based on the tax laws of the United States, including the Internal Revenue Code of 1986 (the “Code”), as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, as well as on the income tax treaty between the United States and the United Kingdom (the “Treaty”), all as of the date hereof and all subject to change at any time, possibly with retroactive effect.

**THE SUMMARY OF US FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING NIL PAID RIGHTS, FULLY PAID RIGHTS AND RIGHTS ISSUE SHARES, INCLUDING THEIR ELIGIBILITY FOR THE BENEFITS OF THE TREATY, THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.**

### **Taxation with respect to the Nil Paid Rights and Fully Paid Rights**

**Receipt of Nil Paid Rights.** While the issue is not free from doubt, Prudential believes that a US Holder should not be required to include any amount in income for US federal income tax purposes as a result of the receipt of Nil Paid Rights, notwithstanding that some holders may receive cash in respect of the Nil Paid Rights (as described in section 5.1 of Part IX of this prospectus). In respect of the US Holders receiving cash for their Nil Paid Rights (by the sale of the Rights Issue Shares by the Joint Global Co-ordinators as described in the foregoing section), Prudential believes that the US Holders should be deemed to have received a distribution of Nil Paid Rights and then to have disposed of such Rights or to have exercised the Rights and disposed of the Fully Paid Rights received upon such exercise, in either case, in a taxable transaction. Prudential will treat the Rights Issue consistently with the foregoing, and the following discussion assumes that this position is respected. However, Prudential’s position is not binding on the Internal Revenue Service (IRS), and there can be no assurance that such a position will not be challenged or, if challenged, upheld. If Prudential’s position were successfully challenged, then the fair market value of the Nil Paid Rights received by a US Holder would be taxable as a dividend, as described below under “Taxation with respect to the Rights Issue Shares — Dividends.”

If, on the date of receipt, the fair market value of the Nil Paid Rights is less than 15% of the fair market value of the shares with respect to which the Nil Paid Rights are received, the Nil Paid Rights will be allocated a zero tax basis unless, except as discussed below under “Expiration of Nil Paid Rights,” the US Holder affirmatively elects to allocate tax basis in proportion to the relative fair market values of the US Holder’s shares and Nil Paid Rights received determined as of the date of receipt.

If, on the date of receipt, the fair market value of the Nil Paid Rights is 15% or more of the fair market value of the shares with respect to which the Nil Paid Rights are received, then, except as discussed below under “Expiration of Nil Paid Rights”, the basis in the US Holder’s shares with respect to which Nil Paid Rights were received must be allocated between the shares and Nil Paid Rights received in proportion to their fair market values determined as of the date of receipt.

A US Holder’s holding period in the Nil Paid Rights will include the holding period in the shares with respect to which the Nil Paid Rights were distributed.

**Receipt of Fully Paid Rights.** A US Holder will not recognise taxable income upon the receipt of Fully Paid Rights pursuant to the exercise of Nil Paid Rights. A US Holder’s tax basis in the Fully Paid Rights will equal the sum of the US dollar value of the Issue Price determined at the spot rate on the date of exercise and the US Holder’s tax basis, if any, in the Nil Paid Rights exercised to obtain the Fully Paid Rights. For a U.S. Holder who receives Nil Paid Rights as a distribution from Prudential, the holding period in each Fully Paid Right acquired through the exercise of a Nil Paid Right should begin with and include the date of exercise.

**Sale or other disposition of Nil Paid Rights or Fully Paid Rights.** Upon a sale or other disposition of Nil Paid Rights or Fully Paid Rights, a US Holder will generally recognise capital gain or loss equal to the difference, if any, between the US dollar value of the amount realised (as determined on the date of the sale or other disposition) and the US Holder’s adjusted tax basis in the Nil Paid Rights or Fully Paid Rights. Such gain or loss generally will be US source gain or loss, and will be long-term capital gain or loss if the US Holder’s holding period in the Nil Paid Rights or Fully Paid Rights exceeds one year. A non-corporate US Holder may qualify for the preferential rates applicable to long-term capital gains. A US Holder’s ability to offset capital losses against ordinary income is limited. Prospective investors should consult their own tax advisors as to the US tax and foreign tax credits implications of such sale or other disposition of Nil Paid Rights or Fully Paid Rights.

The amount realised on a sale or other disposition of Nil Paid Rights or Fully Paid Rights for an amount in foreign currency will be the US dollar value of this amount on the date of sale or disposition. On the settlement date, the US Holder will recognise US-source foreign currency gain or loss (taxable as ordinary income or loss) equal to the

difference (if any) between the US dollar value of the amount received based on the exchange rates in effect on the date of sale or other disposition and the settlement date. However, in the case of Nil Paid Rights or Fully Paid Rights that are traded on an established securities market that are sold by a cash basis US Holder (or an accrual basis US Holder that so elects), the amount realised will be based on the exchange rate in effect on the settlement date for the sale, and no exchange gain or loss will be recognised at that time. If an accrual basis US Holder makes the election described above, it must be applied consistently from year to year and cannot be revoked without the consent of the IRS.

A US Holder that receives a payment from the Joint Global Co-ordinators in respect of the Nil Paid Rights as described in section 5.1 of Part IX of this prospectus will be required to recognise taxable gain or loss in respect of the transaction. A US Holder that receives such a payment should consult its own tax advisers regarding the manner in which such gain or loss should be calculated and treated for US federal income tax purposes.

***Expiration of Nil Paid Rights.*** If a US Holder who receives Nil Paid Rights in the Rights Issue allows the Nil Paid Rights to expire without selling or exercising them and does not receive any proceeds, such Holder will not recognise any loss upon the expiration of the Nil Paid Rights, and no basis will be allocated to the Nil Paid Rights.

***Receipt of Rights Issue Shares.*** A US Holder will not recognise gain or loss upon the receipt of Rights Issue Shares issued in respect of their Fully Paid Rights. A US Holder's tax basis in the Rights Issue Shares will equal the US Holder's tax basis in its Fully Paid Rights with respect to which the Rights Issue Shares are received. A US Holder's holding period in the Rights Issue Shares will include the holding period in the Fully Paid Rights with respect to which the Rights Issue Shares were distributed.

A US Holder that receives Rights Issue Shares pursuant to the exercise of Nil Paid Rights (without first receiving Fully Paid Rights) will not recognize taxable income upon the receipt of Rights Issue Shares pursuant to the exercise of Nil Paid Rights. Such US Holder's tax basis in the Rights Issue Shares will equal the sum of the US dollar value of the Issue Price determined at the spot rate on the date of exercise and the US Holder's tax basis, if any, in the Nil Paid Rights exercised to obtain the Rights Issue Shares. For a US Holder who receives Nil Paid Rights as a distribution from Prudential, the holding period in each Rights Issue Share acquired through the exercise of a Nil Paid Right should begin with and include the date of exercise.

#### **Taxation with respect to the Rights Issue Shares**

***Dividends.*** The gross amount of any cash distribution received by a US Holder (including the amount of any UK taxes withheld) with respect to its Rights Issue Shares generally will be subject to US federal income taxation as foreign-source dividend income. Any dividends paid in pounds sterling will be included in a US Holder's income in a US dollar amount calculated by reference to the exchange rate in effect on the date of a US Holder's receipt of the dividend, regardless of whether the payment is in fact converted into US dollars on such date. If such a dividend is converted into US dollars on the date of receipt, a US Holder generally should not be required to recognise foreign currency gain or loss in respect of the dividend income. Dividends paid on Rights Issue Shares generally will not be eligible for the dividends received deduction available to US corporate shareholders.

Subject to certain exceptions for short-term and hedged positions, the US dollar amount of dividends received by certain non-corporate US Holders with respect to Rights Issue Shares before 1 January 2011 will be subject to taxation at a maximum rate of 15% if the dividends are "qualified dividends." Dividends received with respect to Rights Issue Shares will be qualified dividends if Prudential (i) is eligible for the benefits of a comprehensive income tax treaty with the United States that the IRS has approved for purposes of the qualified dividend rules and (ii) was not, in the year prior to the year in which the dividend was paid, and is not, in the year in which the dividend is paid, a passive foreign investment company ("PFIC"). The current Treaty has been approved for purposes of the qualified dividend rules. Based on the nature of its business activities and its expectations regarding such activities in the future, Prudential believes that it was not treated as a PFIC within the meaning of the Code with respect to its 2009 taxable year and does not anticipate becoming a PFIC for its 2010 taxable year.

Dividends received by US Holders generally will constitute passive category income (or, in the case of certain US Holders, general category income) for US foreign tax credit purposes. UK tax withheld from dividends will be treated as a foreign income tax that, subject to generally applicable limitations under US tax law, is eligible for credit against the US federal income tax liability of US Holders or, if they have elected to deduct such taxes, may be deducted in computing taxable income. If a refund of the tax withheld is available under the laws of the UK or under the Treaty, the amount of tax withheld that is refundable will not be eligible for such credit against a US Holder's US federal income tax liability (and will not be eligible for the deduction against a US Holder's US federal taxable income). US Holders are urged to consult their tax advisers regarding the availability of the foreign tax credit under their particular circumstances.

***Sale or other disposition.*** A US Holder will recognise capital gain or loss on the sale, exchange or other disposition of the Rights Issue Shares in an amount equal to the US dollar value of the difference between the amount realised for the Rights Issue Shares and such Holder's adjusted tax basis (determined in US dollars) in the Rights Issue Shares. Such gain or loss generally will be US-source gain or loss, and will be long-term capital gain or loss if the US Holder's holding period in the Rights Issue Shares exceeds one year. A non-corporate US Holder may qualify for the preferential rates applicable to long-term capital gains. A US Holder's ability to offset capital losses against ordinary income is limited. Prospective investors should consult their own tax advisers as to the US tax and foreign tax credits implications of such sale or other disposition of Rights Issue Shares.

The tax basis of Rights Issue Shares purchased with foreign currency will generally be the US dollar value of the purchase price on the date of purchase, or the settlement date for the purchase, in the case of Rights Issue Shares traded on an established securities market that are purchased by a cash basis US Holder (or an accrual basis US Holder that so elects). The amount realised on a sale or other disposition of Rights Issue Shares for an amount in foreign currency will be the US dollar value of this amount on the date of sale or disposition. On the settlement date, the US Holder will recognise US source foreign currency gain or loss (taxable as ordinary income or loss) equal to the difference (if any) between the US dollar value of the amount received based on the exchange rates in effect on the date of sale or other disposition and the settlement date. However, in the case of Rights Issue Shares traded on an established securities market that are sold by a cash basis US Holder (or an accrual basis US Holder that so elects), the amount realised will be based on the exchange rate in effect on the settlement date for the sale, and no exchange gain or loss will be recognised at that time. If an accrual basis US Holder makes the election described above, it must be applied consistently from year to year and cannot be revoked without the consent of the IRS.

#### **US information reporting and backup withholding**

Dividend payments and proceeds paid from the sale or other disposition of the Nil Paid Rights, the Fully Paid Rights or the Rights Issue Shares by a US paying agent or certain other intermediaries will be subject to information reporting to the IRS and possible US federal backup withholding at a current rate of 28%. Certain exempt recipients (such as corporations) are not subject to the information reporting or backup withholding requirements if they establish an exemption. Backup withholding generally will not apply to a US Holder who furnishes a correct taxpayer identification number and makes any other required certification, or who otherwise establishes an exemption from backup withholding. US persons who are required to establish their exempt status generally must provide IRS Form W-9 (Request for Taxpayer Identification Number and Certification). Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against US Holders' US federal income tax liability. US Holders may obtain a refund of any excess amounts withheld under the backup withholding rules by timely filing the appropriate claim for a refund with the IRS and furnishing any required information. In addition, a US Holder should be aware that recently enacted legislation imposes new reporting requirements with respect to the holding of certain foreign financial assets, including stocks of non-US issuers, if the aggregate value of all of such assets exceeds US\$50,000. A US Holder should consult its own tax adviser regarding the application of the information reporting rules to Nil Paid Rights, Fully Paid Rights and Rights Issue Shares and the application of the recently enacted legislation to its particular situation.

## PART XIX

### ADDITIONAL INFORMATION

#### 1. Persons responsible for prospectus

##### *UK compliant responsibility statement*

The Directors, whose names appear at Part III of this prospectus, and Prudential, with registered office at Laurence Pountney Hill, London EC4R 0HH, United Kingdom, accept responsibility for the information contained in this prospectus. To the best knowledge of the Directors and Prudential (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

##### *Hong Kong compliant responsibility statement*

This prospectus includes particulars given in compliance with the Hong Kong Listing Rules for the purpose of giving information with regard to the issuer. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this prospectus and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

#### 2. Incorporation

Prudential was incorporated in England and Wales as a limited company on 1 November 1978 as Prudential Corporation Limited with registered number 1397169 under the Companies Act 1948 to 1976. Prudential was re-registered as a public company with limited liability on 20 January 1982. On 1 October 1999, Prudential changed its name to Prudential public limited company. The registered office of Prudential is at Laurence Pountney Hill, London EC4R 0HH, United Kingdom with telephone number +44 (0)20 7220 7588. The head office of Prudential is at 12 Arthur Street, London EC4R 9AQ, United Kingdom with telephone number +44 (0)20 7220 7588.

#### 3. Share capital

##### *3.1 Changes in share capital*

As at 14 May 2010 (the latest practicable date prior to the publication of this prospectus), the allotted, called up and fully paid share capital of Prudential consisted of £126,723,623.70 divided into 2,534,472,474 Prudential Shares. 4,538,026 Prudential Shares are expected to be issued on 27 May 2010 to shareholders who have elected to receive the scrip dividend alternative for the 2009 final dividend. These Prudential Shares will be taken into account when calculating entitlements to Rights Issue Shares. The ISIN for the Prudential Shares is GB0007099541.

The following tables sets out the changes in the share capital of Prudential in the last three financial years:

	<b>2007</b>		
	<u>Number of ordinary shares</u>	<u>Share capital</u> £m	<u>Share premium</u> £m
Issued shares of 5p each fully paid:			
At the beginning of the year . . . . .	2,444,312,425	122	1,822
Shares issued under share option schemes . . . . .	803,818	—	6
Shares issued in lieu of cash dividends . . . . .	24,900,997	1	175
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	—	—	(175)
At end of year . . . . .	2,470,017,240	123	1,828
			<b>2008</b>
	<u>Number of ordinary shares</u>	<u>Share capital</u> £m	<u>Share premium</u> £m
Issued shares of 5p each fully paid:			
At the beginning of the year . . . . .	2,470,017,240	123	1,828
Shares issued under share option schemes . . . . .	2,307,469	—	12
Shares issued in lieu of cash dividends . . . . .	24,622,979	2	156
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	—	—	(156)
At end of year . . . . .	2,496,947,688	125	1,840

	<b>2009</b>		
	<u>Number of ordinary shares</u>	<u>Share capital</u> £m	<u>Share premium</u> £m
Issued shares of 5p each fully paid:			
At the beginning of the year . . . . .	2,496,947,688	125	1,840
Shares issued under share option schemes . . . . .	605,721	—	3
Shares issued in lieu of cash dividends . . . . .	34,674,062	2	136
Transfer to retained earnings in respect of shares issued in lieu of cash dividends . . . . .	<u>—</u>	<u>—</u>	<u>(136)</u>
At end of year . . . . .	2,532,227,471	127	1,843

### 3.2 Share price history

The tables below set forth for the periods indicated the highest and lowest closing middle market quotations for the Prudential Shares, as derived from the Daily Official List of the London Stock Exchange, and the actual ADRs high and low closing sale prices on the New York Stock Exchange.

<u>Year</u>	<u>Prudential Shares (pence)</u>		<u>Prudential ADRs (US dollars)</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
2005 . . . . .	551.5	445	19.75	16.52
2006 . . . . .	743.5	538.5	28.18	19.10
2007 . . . . .	811	618	33.24	24.77
2008 . . . . .	726	245	28.78	7.40
2009 . . . . .	650.5	207	21.75	5.60

<u>Quarter</u>	<u>Prudential Shares (pence)</u>		<u>Prudential ADRs (US dollars)</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
<b>2008</b>				
First quarter . . . . .	714.5	573.5	28.64	23.32
Second quarter . . . . .	726.0	533.0	28.78	21.22
Third quarter . . . . .	600.0	480.5	23.32	16.70
Fourth quarter . . . . .	526.5	245.0	18.93	7.40
<b>2009</b>				
First quarter . . . . .	429.0	207.0	12.71	5.60
Second quarter . . . . .	475	336.75	15.3	10.06
Third quarter . . . . .	601.50	353	19.26	11.55
Fourth quarter . . . . .	650.50	550.50	21.75	17.88

### 2010

First quarter . . . . .	645.50	487.50	20.67	14.60
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### 3.3 Shareholder authorities

The existing mandates given to the Directors to allot shares were given under English law, the Listing Rules and guidelines issued by the Association of British Insurers. In common with a vast majority of other English public companies listed in London, Prudential seeks an annual authority from shareholders at its annual general meeting to allow it to allot shares and also to allow such shares to be allotted on a non-pre-emptive basis in certain circumstances.

At Prudential's last annual general meeting held on 14 May 2009, the shareholders passed a resolution giving the Directors authority to allot Prudential Shares up to an aggregate nominal value of £41,611,000 (representing 832,220,000 ordinary shares in Prudential) (the "**2009 Mandate**"). The Directors were also given additional authority in case of a rights issue to allot Prudential Shares in favour of ordinary shareholders up to an aggregate nominal amount equal to £83,223,000 (representing 1,664,460,000 ordinary shares in Prudential) less the nominal amount of any shares issued under the authority mentioned in the previous sentence.

The shareholders also passed a resolution to give the Directors authority to allot equity securities for cash without first being required to offer such securities to existing shareholders in proportion to their existing holdings, by the limited disapplication of section 89 of the Companies Act 1985. This authority is for the allotment of shares of a

maximum nominal value of £6,242,000 (representing 124,840,000 ordinary shares in Prudential) and only extends to the issue of Prudential Shares, including the sale of any treasury shares and to rights issues.

The authorities to allot shares and for the disapplication of pre-emption rights described above will expire at the earlier of 30 June 2010 or the conclusion of Prudential's Annual General Meeting in 2010.

At Prudential's Annual General Meeting to be held on 19 May 2010<sup>(63)</sup>, a resolution will be proposed to authorise the Directors to allot ordinary shares up to an aggregate nominal value of £42,236,000 (representing approximately 844,720,000 ordinary shares in Prudential) (the "**2010 Proposed Mandate**"). A resolution will also be proposed to give the Directors additional authority in the case of a rights issue to allot equity securities in favour of ordinary shareholders up to an aggregate nominal amount equal to £84,473,000 (representing 1,689,460,000 ordinary shares in Prudential) less the nominal amount of any shares issued under the previous sentence.

A special resolution will be proposed to give the Directors authority to allot equity securities for cash without first being required to offer such securities to existing shareholders in proportion to their existing holding, by the limited disapplication of section 561 of the Companies Act. The authority is sought for a maximum nominal value of £6,336,000 (representing approximately 126,720,000 ordinary shares in Prudential). As regards rights issues, the Directors believe the mechanics and delay of the procedure under section 561 are unduly restrictive and are therefore also seeking continuation of its disapplication in these circumstances.

This renewed authority, which complies with institutional investment guidelines, will expire at the earlier of 30 June 2011 or the conclusion of the annual general meeting of Prudential in 2011.

However, rule 13.36(2)(b) of the Hong Kong Listing Rules provides that a general mandate to allot shares can only be given by shareholders to directors up to a maximum of 20% of a company's current issued share capital as at the date of the shareholders' approval. It follows that after the introduction of the Prudential Shares to the Hong Kong Stock Exchange, the 2009 Mandate and the 2010 Proposed Mandate, if it is approved by shareholders at the 2010 annual general meeting, will differ from the requirements of rule 13.36(2)(b) of the Hong Kong Listing Rules.

In this connection, Prudential has confirmed that it will undertake that after the introduction of the Prudential Shares to the Hong Kong Stock Exchange no Directors will allot or issue such securities or grant any offers, agreements or options which would or might require securities to be issued, allotted or disposed of, whether during the term of the 2009 Mandate or the 2010 Proposed Mandate, if it is approved by shareholders at the 2010 annual general meeting, which would exceed the aggregate of 20% of the issued share capital of Prudential as at the date of the 2009 annual general meeting (in respect of the 2009 Mandate) and the 2010 annual general meeting (in respect of the 2010 Proposed Mandate, assuming that it is granted).

After the expiration of the 2010 Proposed Mandate (assuming that it is granted), any general mandate sought by Prudential from its shareholders to allot or issue securities will be sought in accordance with the requirements of applicable law, including the Hong Kong Listing Rules.

At the General Meeting, Prudential shareholders will be asked to consider and vote on the resolutions to allow the Rights Issue and Scheme to proceed. In summary, the resolutions seek shareholder approval for the following:

- (A) a special resolution approving matters necessary to implement the Scheme, including the Prudential Reduction of Capital, the establishment of New Prudential as the new holding company of the Prudential Group and ancillary matters including amendments to Prudential's Articles and authorisation of the allotment of Prudential Shares pursuant to the Scheme. This resolution is subject to the Scheme being approved at the Court Meeting;
- (B) an ordinary resolution granting the Directors the necessary authority to allot the Rights Issue Shares. This resolution is subject to the passing of resolution (A) above; and
- (C) ordinary resolutions, approving the adoption by New Prudential of the New Share Plans and authorising the establishment of additional employee share schemes by New Prudential for the benefit of overseas employees. These resolutions are subject to the Scheme referred to in (A) above becoming effective.

Prudential has applied for, and the Hong Kong Stock Exchange has granted, a waiver from strict compliance with the restrictions on further issue of securities within six months from the date on which the Prudential Shares are listed on the Hong Kong Stock Exchange and from which dealings in the Prudential Shares are permitted to commence on the Hong Kong Stock Exchange, as required by Rule 10.08 of the Hong Kong Listing Rules on the following conditions:

- (A) any issue of shares (or convertible securities) by Prudential during the first six months of listing must be either for cash to fund a specific acquisition or as part or full consideration for acquisitions; and

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(63) In order to minimise the inconvenience to shareholders of having two shareholder meetings within a short period, the Board proposes to adjourn the Annual General Meeting on 19 May 2010 and reconvene it at 11:00 a.m. on 7 June 2010.

- (B) any acquisitions mentioned in (A) above must be for assets or businesses that would contribute to the growth of Prudential's operations.

#### **4. Memorandum and Articles of Association**

In accordance with the Companies Act and since 1 October 2009, Prudential's Memorandum of Association contains only basic information about the original members of Prudential and the principal constitutive document of Prudential is its Articles of Association.

The following is a summary of both the rights of Prudential's shareholders and certain provisions of Prudential's Articles of Association. Rights of Prudential's shareholders are set out in Prudential's Articles of Association or are provided for by English law. This section is a summary and, therefore, does not contain full details of Prudential's Articles of Association. A complete copy of Prudential's Articles of Association, adopted at the annual general meeting on 14 May 2009 and effective on 1 October 2009, is available for inspection as set out at paragraph 26 of this Part XIX.

##### ***Share capital***

On 31 December 2009, Prudential's issued share capital consisted of 2,532,227,471 ordinary shares of 5 pence each, all fully paid up and listed on the London Stock Exchange. Prudential also has American Depositary Shares referenced to its ordinary shares, issued under a depositary agreement with JP Morgan Chase Bank and listed on the New York Stock Exchange.

The Companies Act abolished the requirement for a company to have an authorised share capital. The issued share capital of Prudential is not currently divided into different classes of shares. The Board has the power to issue preference shares but to date no preference shares have been issued. The Board shall determine whether any preference shares are to be redeemable, their dividend rights, their rights to a return of capital or to share in the assets of Prudential on a winding-up or liquidation and their rights to attend and vote at general meetings of Prudential prior to the date on which the preference shares are allotted. The Board, as permitted by the Companies Act, will have discretion to determine the terms and manner of redemption of redeemable shares when the shares are allotted. Prudential maintains an authority lasting for five years from 14 May 2009 to allot preference shares on the above terms.

The Board may only capitalise any amounts available for distribution in respect of any series or class of preference shares if to do so would mean that the aggregate of the amounts so capitalised would be less than the multiple, if any, determined by the Board of the aggregate amount of the dividends payable in the 12 month period following the capitalisation on the series or class of preference shares and on any other preference shares in issue which rank *pari passu* in relation to participation in profits. This restriction may be overruled with either: (i) the written consent of the holders of at least three-quarters in nominal value; or (ii) a special resolution passed at a general meeting of the holders of the class or series of preference shares.

##### ***Dividends and other distributions***

Under English law, Prudential may pay dividends only if distributable profits are available for that purpose. Distributable profits are accumulated, realised profits not previously distributed or capitalised, less accumulated, realised losses not previously written off in a reduction or reorganisation of capital. Even if distributable profits are available, Prudential may only pay dividends if the amount of its net assets is not less than the aggregate of its called-up share capital and undistributable reserves, including, for example, the share premium account, and the payment of the dividend does not reduce the amount of the net assets to less than that aggregate. Subject to these restrictions, the Directors may recommend to ordinary shareholders that a final dividend be declared, recommend the amount of any such dividend, determine whether to pay a distribution by way of an interim dividend, and the amount of any such interim dividend out of the profits of Prudential, but must take into account Prudential's financial position. Final dividends become a legal liability of a company upon the later of the date they are declared by shareholders and the date the shareholder approval expresses them to be payable. Interim dividends only become a legal liability of a company at the moment they are paid unless a company's articles of association provide for declarations of interim dividends by directors. Prudential's Articles do not provide for declaration of interim dividends.

Subject to any such terms attaching to preference shares in issue, the profits available for distribution and resolved to be distributed are distributed to the ordinary shareholders.

Prudential or the Directors determine the date on which Prudential pays dividends. Prudential pays dividends to the shareholders on the register on the record date (as determined by the company acting in accordance with guidelines and an annual dividend timetable published by the London Stock Exchange) in proportion to the amounts paid up on the shares held by each shareholder. There are no fixed dates on which entitlements to dividends arise. Interest is not payable on dividends or other amounts payable in respect of shares.

The Directors have the discretion to offer shareholders the right to elect to receive additional shares (credited as fully paid) instead of all or any part of a cash dividend. The aggregate value of additional shares that a shareholder may receive under such an election is as nearly as possible equal to (but not greater than) the cash amount the shareholder would have received. Prudential does not issue fractions of shares and the Directors may make such provision as they think appropriate to deal with any fractional entitlements. The Directors may exclude shareholders from the right to receive shares instead of cash dividends if the Directors believe that extending the election to such shareholders would violate the laws of any territory or for any other reason the Directors consider in their absolute discretion appropriate.

If a shareholder does not claim a dividend within 12 years of such dividend becoming due for payment, if the Board so resolves, such shareholder forfeits his right to receive it. Such unclaimed amounts may be invested or otherwise used for Prudential's benefit.

### ***Shareholder meetings***

English law provides for shareholders to exercise their power to decide on corporate matters at general meetings. In accordance with English law, Prudential is required to call and hold annual general meetings. At annual general meetings, shareholders receive and consider the statutory accounts and the reports by Prudential's auditor and its Directors, approve the Directors' remuneration report, elect and re-elect Directors, declare final dividends, approve the appointment of Prudential's auditor, authorise the Directors to determine the auditor's remuneration, and transact any other business which ought to be transacted at a general meeting, pursuant to either the Articles of Association or English law. General meetings to consider specific matters may be held at the discretion of the Directors and must be convened, in accordance with English law, following the written request of shareholders representing at least 5% of the voting rights of the issued and paid-up share capital. The quorum required under the Articles of Association for a general meeting is two shareholders present in person or by proxy.

Under the Shareholders' Rights Directive (which was implemented in the UK with effect from 3 August 2009) notice periods for all general meetings have to be 21 days, except for a meeting (i) which is not an annual general meeting, (ii) for which an electronic facility for voting and appointing proxies is available to all members, and (iii) in respect of which a company obtains shareholder approval annually to retain the shorter 14-day notice period. Prudential has been able to call general meetings (other than annual general meetings) on 14 days' notice and obtained shareholder approval at the annual general meeting on 14 May 2009 to enable it to continue to do so after the implementation of the Directive. The approval will be effective until the next annual general meeting when it is expected that a similar resolution will be proposed.

### ***Voting rights***

Voting at any meeting of shareholders is by a show of hands unless a poll is demanded as described below. On a show of hands every shareholder holding ordinary shares who is present in person, or a duly appointed proxy or in the case of a corporation, its duly authorised corporate representative, has one vote. On a poll, every shareholder who is present in person or by proxy and every duly authorised corporate representative has one vote for every share held. Only the holders of fully paid shares are allowed to attend, be counted in the quorum at meetings and vote. If more than one joint shareholder votes, only the vote of the shareholder whose name appears first in the register is counted. A shareholder whose shareholding is registered in the name of a nominee may only attend and vote at a general meeting if appointed by his or her nominee as a proxy or a corporate representative.

Resolutions of the shareholders generally require the approval of a majority of the shareholders to be passed. Such resolutions, referred to as ordinary resolutions, require:

- on a show of hands, a majority in number of the shareholders present and voting in person or by duly appointed proxies or (in the case of corporate shareholders) by authorised corporate representatives to vote in favour, or
- on a poll, more than 50% of the votes cast to be in favour.

Some resolutions, referred to as special resolutions, such as a resolution to amend the Articles of Association, require a 75% majority. Such special resolutions require:

- on a show of hands, at least 75% of the shareholders present and voting in person or by duly appointed proxies or (in the case of corporate shareholders) by authorised corporate representatives to vote in favour, or
- on a poll, at least 75% of the votes cast to be in favour.

Any shareholder who is entitled to attend and vote at a general meeting may appoint one or more proxies to attend and vote at the meeting on his or her behalf.

The following persons may demand a poll:

- the chairman of the meeting;

- at least five shareholders present in person, by corporate representative or by proxy having the right to vote on the resolution;
- any shareholder or shareholders present in person, by corporate representative or by proxy and representing at least 10% of the total voting rights of all shareholders having the right to vote on the resolution; or
- any shareholder or shareholders present in person, by corporate representative or by proxy and holding shares conferring a right to vote on the resolution on which an aggregate sum has been paid up equal to at least 10% of the total sum paid up on all shares conferring that right.

### ***Transfer of shares***

Transfers of shares may be made by an instrument of transfer. An instrument of transfer must be signed by or on behalf of the transferor and, unless the share is fully paid, by or on behalf of the transferee. The transferor remains the holder of the relevant shares until the name of the transferee is entered in the share register. Transfers of shares may also be made by a computer-based system (currently the CREST system) and transferred without a written instrument in accordance with English company law. The Directors may in certain circumstances refuse to register transfers of shares, but only if such refusal does not prevent dealings in the shares from taking place on an open and proper basis. If the Directors refuse to register a transfer, they must send the transferee notice of the refusal within two months stating the reason(s) for such refusal.

### ***Changes in share capital***

The Directors require authority to allot from shareholders before issuing new shares. The class and other rights attaching to new classes of shares may be determined by resolution of the shareholders or may be delegated by the shareholders to the Directors. The following changes in share capital may only take place after approval by an ordinary resolution of the shareholders:

- share consolidations, and
- subdivisions of shares.

Reductions in issued share capital and share premium account must be approved by a special resolution of the shareholders and must be confirmed by an order of the court.

### ***Purchase of own shares***

Prudential is subject to the provisions of the Companies Act and the Listing Rules in relation to repurchases of shares. As the Hong Kong Stock Exchange is not a recognised investment exchange for the purposes of the Companies Act, any proposed repurchases of shares on the Hong Kong Stock Exchange by Prudential would be an “off-market purchase” for the purposes of, and would accordingly need to comply with the provisions for off-market purchases set out in, the Companies Act. On this basis, Prudential does not currently intend to effect repurchases of shares through the facilities of the Hong Kong Stock Exchange.

In the absence of any prohibition in its Articles, Prudential may purchase its own shares (subject to, in the case of an on-market purchase, the passing of an ordinary resolution, and in the case of an off-market purchase, a special resolution by shareholders), unless the purchase would result in there no longer being any issued shares in the capital of the company other than redeemable shares or treasury shares. There is currently no such prohibition in the Articles. Only fully paid shares may be repurchased, and certain procedural requirements as set out in the Listing Rules must be followed.

Prudential may issue shares of any class which are redeemable at the option of either Prudential or the shareholder, on such terms and conditions and in such manner as shall be determined by the Board prior to the date on which such shares are allotted.

### ***Reasons for repurchases***

The Directors consider that there may be circumstances in which it would be desirable for Prudential to purchase its own shares in the market. Although the Directors have no immediate plans to make such purchases, they would like to be able to act if circumstances arose in which they considered such purchases to be desirable. Purchases would only be made if their effect would be to increase earnings per share and they would be for the benefit of shareholders generally.

### ***Renewal of authority for purchase of own shares***

At Prudential’s annual general meeting, a special resolution will be proposed to authorise Prudential to make market purchases of its ordinary shares up to a maximum nominal value of £12,672,000, representing 253,440,000 ordinary shares in Prudential, at prices not exceeding the highest of (i) 105 per cent of the average middle market value of an ordinary share for the five business days preceding the date of purchase and (ii) the higher of the price of the last

independent trade and the highest current independent bid on the trading venues where the purchase is being carried out.

Prudential may retain any shares it purchases as treasury shares, with a view to possible re-issue at a future date, or may cancel the shares. If Prudential were to purchase any of its own ordinary shares, it would consider holding them as treasury shares, pursuant to the authority conferred by this resolution. This would enable Prudential to re-issue treasury shares quickly and cost-effectively and would provide Prudential with additional flexibility in the management of its capital base. The Directors have no immediate plans to exercise this authority, which will expire at the earlier of 30 June 2011 or the conclusion of the annual general meeting of Prudential in 2011.

#### *Funding of repurchases*

In repurchasing securities, Prudential may only apply funds legally available for such purpose and must do so in accordance with its Memorandum of Association and Articles of Association, the Companies Act and the Listing Rules.

#### *Power of subsidiaries to own shares in Prudential*

Under English company law, a body corporate cannot be a member of a company which is its own holding company, and any allotment or transfer of shares in a company to its own subsidiary is void.

There are two exceptions to this general rule, where (i) the subsidiary is concerned only as either a personal representative or a trustee (unless either the holding company or the relevant subsidiary of the holding company is beneficially interested under the trust), and (ii) the shares in the holding company are held by the subsidiary in the ordinary course of its business as an intermediary (which must involve, among other requirements, carrying on a bona fide business of dealing in securities).

#### *Variation of rights*

If the share capital of Prudential is divided into different classes of shares, the rights of any class of shares may be changed or taken away only if such measure is approved by a special resolution passed at a separate meeting of the members of that class, or with the written consent of at least three quarters of the members of that class. Two persons holding or representing by proxy at least one-third in nominal amount of the issued shares of the class must be present at such a meeting in person or by proxy to constitute a quorum.

The Board may not authorise, create or increase the amount of, any shares of any class or any security convertible into shares of any class or any security which is convertible into shares of any class ranking, as regards rights to participate in the profits or assets in Prudential, in priority to a series or class of preference shares without the consent in writing of at least three-quarters in nominal value of, or the sanction of a special resolution of, the holders of such series or class of preference shares.

#### *Lien*

Prudential has a lien on every share that is not a fully paid share.

#### *Accidental omission to give notice*

Accidental omission to send notice of a meeting to any person entitled to receive it, or the non-receipt for any reason of any such notice, shall not invalidate the proceedings of that meeting.

#### *Shareholders resident abroad*

There are no limitations on non-resident or foreign shareholders' rights to own securities in Prudential or exercise voting rights where such rights are given under English company law.

#### *Procedures on liquidation*

Prudential is subject to the general insolvency law applicable to English companies.

On a winding-up or liquidation, voluntary or otherwise, the residue, if any, of the surplus assets of Prudential available for distribution among the members shall belong to the holders of ordinary shares and shall be divided among them in proportion to the amounts paid up or credited as paid up in the shares held by each respective member. This apportionment of surplus assets is subject to the special rights attaching to any preference shares or other class of shares in issue.

#### *Calls on shares and forfeiture of shares*

Subject to the terms of allotment, the Board may make calls on members to pay to Prudential any monies outstanding on their shares. If a call remains unpaid in whole or in part after it becomes due and payable, the Board may serve notice requiring payment of monies owed. In the event of non-compliance with that notice, the Board

may resolve that any share in respect of which the notice was sent is forfeited. The forfeiture shall include all unpaid dividends or other monies payable in respect of the forfeited share. A person shall cease to be a member in respect of any share which has been forfeited.

### ***Board of Directors***

The Board manages the business of Prudential. However, Prudential's shareholders must approve certain matters, such as changes to the share capital and the election and re-election of Directors. Directors are appointed subject to the Articles of Association. The Board may appoint Directors to fill vacancies and appoint additional Directors who hold office until the next annual general meeting. The Articles of Association require that each Director must have beneficial ownership of a given number of ordinary shares. The number of shares is determined by ordinary resolution at a general meeting and is currently 2,500. The minimum number of Directors is eight and the maximum number is 20. Shareholders may vary the limits on the number of Directors by ordinary resolution. As at the date of this prospectus there are 14 members on the Board.

At every annual general meeting, any Director who has been appointed by the Board since the last annual general meeting; or who held office at the time of the two preceding annual general meetings and who did not retire at either of them; or who has held office with Prudential, other than employment or executive office, for a continuous period of nine years or more at the date of the meeting, shall retire from office and may offer himself or herself for re-election by shareholders. Shareholders may remove any Director before the end of his or her term of office by ordinary resolution and may appoint another person in his or her place by ordinary resolution.

The Directors may exercise all the powers of Prudential to borrow money and to mortgage or charge any of its assets provided that the total amount borrowed does not, when aggregated with the total borrowing (which excludes, among other things, intra-group borrowings and amounts secured by policies, guarantees, bonds or contracts issued or given by Prudential or its subsidiaries in the course of its business) of all of its subsidiaries, exceed the aggregate of the share capital and consolidated reserves and of one-tenth of the insurance funds of Prudential and each of its subsidiaries as shown in the most recent audited consolidated balance sheet of the group prepared in accordance with English law.

The limits on the powers of the Directors to borrow money are imposed by the Articles of Association, not English company law. They can therefore be removed or altered by amending the Articles by special resolution. However, the inclusion of such borrowing restrictions is recommended by the Association of British Insurers ("ABI"), a body which represents many of the UK's largest institutional shareholders. If any attempt were made by Prudential to remove or loosen the restrictions, in contravention of the ABI's recommendation, the ABI could recommend that shareholders vote against the necessary resolution. It is therefore relatively unlikely, in practice, that such a resolution would be proposed as long as the ABI's current approach to borrowing restrictions is maintained.

The Directors have the power, to the extent permitted by law and subject to the provisions of Chapter 10 (Significant Transactions) of the Listing Rules, to dispose of any asset of Prudential.

There is no age restriction applicable to Directors in the Articles of Association.

### ***Directors' interests in contracts***

A Director may hold positions with or be interested in other companies and, subject to applicable legislation, contract with Prudential or any other company in which Prudential has an interest.

A Director may not vote or be counted in the quorum in relation to any resolution of the Board in respect of any contract in which he or she has an interest. This prohibition does not, however, apply to any resolution where that interest cannot reasonably be regarded as likely to give rise to a conflict of interest or where that interest arises only from certain matters specified in the Articles of Association, including the following:

- certain matters that benefit the Prudential Group (such as a guarantee, indemnity or security in respect of money lent or obligations undertaken by the Director at the request of or for the benefit of Prudential or one of its subsidiaries);
- certain matters that are available to all other Directors and/or employees (such as the provision to the Director of an indemnity where all other Directors are being offered indemnities on substantially the same terms or in respect of any contract for the benefit of group employees under which the Director benefits in a similar manner to the employees); and
- certain matters that arise solely from the Director's interest in shares or debentures of Prudential (such as where Prudential or one of its subsidiaries is offering securities in which offer the Director is entitled to participate as a holder of securities or in respect of any contract in which a Director is interested by virtue of his interest in securities in Prudential).

Prudential may by ordinary resolution suspend or relax these provisions to any extent or ratify any contract not properly authorised by reason of a contravention of these provisions contained in its Articles of Association.

In accordance with English company law, the Articles of Association allow the Board to authorise any matter which would otherwise involve a Director breaching his duty under the Companies Act to avoid conflicts of interest or potential conflicts of interest and the relevant Director is obliged to conduct himself or herself in accordance with any terms imposed by the Board in relation to such authorisation.

#### ***Directors' power to vote on own terms of appointment***

A Director shall not vote on or be counted in the quorum in relation to any resolution of the Board concerning his own appointment, or the settlement or variation of the terms or the termination of his own appointment, as the holder of any office or place of profit with Prudential or any other company in which Prudential is interested.

#### ***Directors' remuneration***

The remuneration of the executive Directors and the Chairman is determined by the Remuneration Committee, which consists of independent, non-executive Directors. The remuneration of the non-executive Directors is determined by the Board. For further details on the remuneration of Directors and details of compensation payable to Directors on loss of office, see the section entitled "*Payments to Directors for loss of office*" below, and paragraph 6 of this Part XIX.

#### ***Transactions with Directors***

Prudential may only grant a loan or quasi-loan, or provide security or other financial accommodation, to its Directors and their connected persons if approval has been obtained from shareholders at a general meeting.

#### ***Payments to Directors for loss of office***

In accordance with English company law, Prudential must obtain the approval of members in general meeting before making a payment in cash or non-cash benefits to a Director or past director or any connected person as compensation for loss of any office (including as a Director) or employment with Prudential or any of its subsidiary undertakings, and before making any payment in connection with his retirement. However, approval is not required for a payment made in good faith in discharge of an existing legal obligation, such as under an employment contract which has no connection with the event giving rise to the payment for loss of office.

#### ***Change of control***

There is no specific provision in the Articles of Association that would have an effect of delaying, deferring or preventing a change in control of Prudential and that would operate only with respect to a merger, acquisition or corporate restructuring involving Prudential, or any of its subsidiaries.

#### ***Exclusive jurisdiction***

Under the Articles of Association, any proceeding, suit or action between a shareholder and Prudential and/or its Directors arising out of or in connection with the Articles of Association or otherwise, between Prudential and any of its Directors (to the fullest extent permitted by law), between a shareholder and Prudential's professional service providers and/or between Prudential and its professional service providers (to the extent such proceeding, suit or action arises in connection with a proceeding, suit or action between a shareholder and such professional service provider) may only be brought in the courts of England and Wales.

#### ***Disclosure of interests***

There are no provisions in the Articles of Association that require persons acquiring, holding or disposing of a certain percentage of Prudential's shares to make disclosure of their ownership percentage. The basic disclosure requirement under Part 6 of the FSMA 2000 and Rule 5 of the Disclosure and Transparency Rules imposes a statutory obligation on a person to notify Prudential and the FSA of the percentage of the voting rights in Prudential he or she directly or indirectly holds or controls, or has rights over, through his or her direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

- reaches, exceeds or falls below 3% and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or
- reaches, exceeds or falls below any such threshold as a result of any change in the number of voting rights attached to shares in Prudential.

The Disclosure and Transparency Rules set out in detail the circumstances in which an obligation of disclosure will arise, as well as certain exemptions from those obligations for specified persons. Under section 793 of the Companies Act, Prudential may, by notice in writing, require a person that Prudential knows or has reasonable cause to believe is or was during the three years preceding the date of notice interested in Prudential shares, to indicate

whether or not that is the case and, if that person does or did hold an interest in Prudential's shares, to provide certain information as set out in the Companies Act.

Where a company serves notice under the provisions described above on a person who is or was interested in shares of the company and that person fails to give the company the information required by the notice within the time specified in the notice, the company may apply to an English court for an order directing that the shares in question be subject to restrictions prohibiting, among other things, any transfer of those shares, the exercise of voting rights in respect of those shares and, other than in liquidation, payments in respect of those shares.

In addition, under the Articles of Association, a shareholder may lose the right to vote his shares if he or any other person appearing to be interested in those shares fails to comply within a prescribed period of time with such a request to give the required information with respect to past or present ownership or interests in those shares, or makes a statement in response to such a request which is in the opinion of the directors false or misleading in any material manner. In the case of holders of 0.25% or more of the issued share capital of Prudential (or any class of the share capital), in addition to disenfranchisement, the sanctions that may be applied by Prudential under its Articles of Association include withholding the right to receive payment of dividends on those shares, and restrictions on transfers of those shares. In the case of holders of less than 0.25% of the issued share capital of Prudential, the sanction is disenfranchisement alone.

The Disclosure and Transparency Rules further deal with the disclosure by certain persons, including directors, of interests in shares of the listed companies of which they are directors, and in derivatives or other financial instruments relating to those shares. The City Code also imposes strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and also on their respective associates during the course of an offer period.

#### ***Mandatory bids and compulsory acquisition rules relating to Prudential Shares***

Other than as provided by the City Code and Chapter 28 of the Companies Act, there are no rules or provisions relating to mandatory bids and/or squeeze-out and sell-out rules relating to Prudential.

#### ***Mandatory bid***

The City Code applies to Prudential. Under the City Code, if an acquisition of interests in shares were to increase the aggregate holding of the acquirer and its concert parties to interests in shares carrying 30% or more of the voting rights in Prudential, the acquirer and, depending on circumstances, its concert parties would be required (except with the consent of the Panel on Takeovers and Mergers) to make a cash offer for the outstanding shares in Prudential at a price not less than the highest price paid for interests in shares by the acquirer or its concert parties during the previous 12 months. This requirement would also be triggered by any acquisition of interests in shares by a person holding (together with its concert parties) shares carrying between 30% and 50% of the voting rights in Prudential if the effect of such acquisition were to increase that person's percentage of the total voting rights in Prudential.

#### ***Squeeze-out***

Under the Companies Act if an offeror were to make an offer to acquire all of the shares in Prudential not already owned by it and were to acquire 90% of the shares to which such offer related, it could then compulsorily acquire the remaining 10%. The offeror would do so by sending a notice to outstanding members telling them that it will compulsorily acquire their shares and then, six weeks later, it would deliver a transfer of the outstanding shares in its favour to Prudential which would execute the transfers on behalf of the relevant members, and pay the consideration to Prudential which would hold the consideration on trust for outstanding members. The consideration offered to the members whose shares are compulsorily acquired under this procedure must, in general, be the same as the consideration that was available under the original offer unless a member can show that the offer value is unfair.

#### ***Sell-out***

The Companies Act also gives minority members a right to be bought out in certain circumstances by an offeror who has made a takeover offer. If a takeover offer related to all the shares in Prudential and, at any time before the end of the period within which the offer could be accepted, the offeror held or had agreed to acquire not less than 90% of the shares, any holder of shares to which the offer related who had not accepted the offer could by a written communication to the offeror require it to acquire those shares. The offeror would be required to give any member notice of his/her right to be bought out within one month of that right arising. The offeror may impose a time limit on the rights of minority members to be bought out, but that period cannot end less than three months after the end of the acceptance period or, if later, three months from the date on which notice is served on members notifying them of their sell-out rights. If a member exercises his/her rights, the offeror is entitled and bound to acquire those shares on the terms of the offer or on such other terms as may be agreed.

## 5. Directors

### 5.1 Other directorships

The following table sets forth positions held by the Directors in other members of the Prudential Group as at 14 May 2010:

<u>Director</u>	<u>Member of the Group</u>	<u>Positions held</u>
Cheick Tidjane Thiam	Prudential Capital Public Limited Company	Director
	Prudential Holdings Limited	Director
	The Prudential Assurance Company Limited	Director and Chairman
Nicolaos Andreas Nicandrou	Prudential Services Limited	Director
	The Prudential Assurance Company Limited	Director
Robert Alan Devey	Prudential Annuities Limited	Director
	Prudential Group Pensions Limited	Director
	Prudential Lalondes Limited	Director
	Prudential Property Services (Bristol) Limited	Director
	Prudential Property Services Limited	Director
	Prudential Retirement Income Limited	Director
	Scottish Amicable PEP and ISA Nominees Limited	Director
	The Prudential Assurance Company Limited	Director
Clark Preston Manning, Jr.	Brooke Holdings LLC	Director, President and CEO
	Brooke Life Insurance Company	Chairman, President and CEO
	Hermitage Management LLC	Manager, President and CEO
	Jackson National Life Insurance Company	Director, President and CEO
	Jackson National Life Insurance Company of New York	Director, President and CEO
	PPM America, Inc.	Director and Chairman
	PPM Finance, Inc.	Director and Chairman
	PPM Holdings, Inc.	Director and Chairman
Michael George Alexander McLintock	M&G Group Limited	Director and CEO
	M&G Limited	Director and CEO
	M&G Investment Management Limited	Director and Chairman
	PPM Capital (Holdings) Limited	Director and Chairman

<u>Director</u>	<u>Member of the Group</u>	<u>Positions held</u>
Barry Lee Stowe	Prudential Corporation Asia Limited	Director
	Prudential Holdings Limited	Director

Save as set out below, the Directors have not been members of the administrative, management or supervisory bodies or partners of any other companies or partnerships (other than companies or partnerships in the Prudential Group and companies or partnerships which are subsidiaries of companies or partnerships of which Directors are directors) at any time in the five years prior to the date of this prospectus:

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>	
Harvey Andrew McGrath	Director of Children and Families Across Borders	Director of Charity Technology Trust	
	Director of TheCityUK		
	Chairman of Eximware Inc	Director of E D & F Man Cocoa Investments Limited	
	Chairman of ICould Limited	Director of E D & F Man Finance Limited	
	Trustee of ISS	Director of E D & F Man Group Limited	
	Chairman of the London Development Agency	Director of E D & F Man Holco Limited	
	Deputy Chairman of the London Skills and Employment Board	Director of E D & F Man International Limited	
	Director of New Philanthropy Capital	Director of E D & F Man Investment Products Limited	
	Director of Prudential Group plc*	Director of E D & F Man Limited	
	Director of the Royal Anniversary Trust	Director of E D & F Man Nominees Limited	
	Member of International Advisory Board of the School of Oriental and African Studies	Director of E D & F Man Paris Consultants Limited	
	Chairman of The Prince's Teaching Institute		Director and Chairman of East London Business Alliance
			Director of East London Business Alliance Charity
			Director of East London Partnership (dissolved)
			Director of Faxcorner Limited
		Director of Invest in Thames Gateway London Limited	
	Director and Chairman of London First		
	Director of Man Financial Limited		
	Director of Man Financial Overseas Limited		
	Director of Man Group Finance Limited		
	Director of Man Group Holdings Limited		

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
		Director of Man Group Investments Limited
		Director of Man Group plc
		Director of Man Group Services Limited
		Director of Man Group UK Holdings Limited
		Director of Man Group UK Limited
		Director of Man Investments Finance Limited
		Director of Man Investments Holdings Limited
		Director of Man Securities Limited
		Director of Man Ultraviolet Limited
		Director of Metropolitan Venture Partners Limited (dissolved)
		Director of MF Global Holdings Europe Limited
		Director of MF Global Overseas Limited
		Director of Sugarquay Limited
		Director of Tower Hamlets College
Cheick Tidjane Thiam	Director of Prudential Group plc*	Director of Arkema S.A., France
		Director of Aviva France S.A., France
		Director of Aviva Group Holdings Limited
		Director of Aviva Insurance Limited
		Director of Aviva International Holdings Limited
		Director of Aviva International Insurance Limited
		Director of Aviva plc
		Director of Aviva Sigorta A.S., Turkey
		Director of General Accident plc
		Director of Hibernian Group plc, Ireland
		Director of Norwich Union Life Holdings Limited
		Director of Scottish Insurance Corporation Limited

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
Nicolaos Andreas Nicandrou	Director of Prudential Group plc*	<p>Director of The Northern Assurance Company Limited</p> <p>Director of Aviva Director Services Limited</p> <p>Director of Aviva Investors UK Funds Limited</p> <p>Director of Aviva Investors UK Fund Services Limited</p> <p>Director of CGNU Life Assurance Limited</p> <p>Director of Commercial Union Life Assurance Company Limited</p> <p>Director of Hamilton Life Assurance Company Limited</p> <p>Director of Lancashire &amp; Yorkshire Reversionary Interest Company</p> <p>Director of Lifetime Group Limited</p> <p>Director of Lifetime Marketing Services Limited</p> <p>Director of Lifetime Nominees Limited</p> <p>Director of National Westminster Life Assurance Limited</p> <p>Director of Norwich Union Annuity Limited</p> <p>Director of Norwich Union Central Services Limited</p> <p>Director of Norwich Union Commercial Finance Limited</p> <p>Director of Norwich Union Commercial Mortgages Limited</p> <p>Director of Norwich Union Equity Release Limited</p> <p>Director of Norwich Union Life &amp; Pensions Limited</p> <p>Director of Norwich Union Life Holdings Limited</p> <p>Director of Norwich Union Life (RBS) JV Limited</p> <p>Director of Norwich Union Life (RBS) Limited</p> <p>Director of Norwich Union Life Services Limited</p> <p>Director of Norwich Union Mortgage Finance Limited</p> <p>Director of Norwich Union Mortgages (Life) Limited</p>

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
		Director of Norwich Union Pension Trustees Limited
		Director of Norwich Union Personal Finance Limited
		Director of Norwich Union SIPP Limited
		Director of NULH2 Limited
		Director of RBS Collective Investment Funds Limited
		Director of RBS Life Investments Limited
		Director of RBSG Collective Investments Limited
		Director of Royal Scottish Assurance plc
		Director of RSA (Services) Limited
		Director of The General Practice Finance Corporation
		Director of Trinity Trustee Company Limited
		Director of Undershaft (No.9) Limited
Robert Alan Devey	Director of Lloyds TSB Foundation for England and Wales	Director of Albion Collections Limited
	Director of Prudential Group plc*	Director of Bank of Scotland Insurance Services Limited
		Director of Capital Bank Insurance Services Limited
		Director of Clerical Medical Financial Services Limited
		Director of Clerical Medical Forestry Limited
		Director of Clerical Medical Investment Fund Managers Limited
		Director of Clerical Medical Investment Group Limited
		Director of Clerical Medical Managed Funds Limited
		Director of Clerical Medical PEP Managers Limited
		Director of Clerical Medical Properties Limited
		Director of Equitable Services and Consultancy Limited
		Director of General Reversionary and Investment Company (The)

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
		Director of Halifax Financial Services (Holdings) Limited
		Director of Halifax General Insurance Services Limited
		Director of Halifax Jersey Holdings Limited
		Director of Halifax Life Limited
		Director of HBOS Financial Services Limited
		Director of HBOS General Insurance Services Limited
		Director of HBOS GI PLC
		Director of HBOS Investment Fund Managers Limited
		Director of HECM Customer Services Limited
		Director of J & J Collections Limited
		Director of Mentor Professional Services Limited
		Director of P.E.G. Investment Company Limited
		Director of St. Andrew's Group plc
		Director of St. Andrew's Insurance plc
		Director of St. Andrew's Life Assurance plc
		Director of St. Andrew's Shell Company Limited
		Director of Stams Limited
Clark Preston Manning, Jr.	Director of Prudential Group plc*	Director of Ele's Place
		Director, President and CEO of Holborn Delaware LLC
Michael George Alexander McLintock	Trustee of the Grosvenor Estate	Trustee of the Charibond Charities Fixed Interest Common Investment Fund
		Chief Executive of Charities Investment Management Limited
	Member of the MCC Finance Committee	Director of Close Brothers Group plc
	Director of Prudential Group plc*	Director of Deva Group Limited
	Director of Wheatsheaf Investments Limited	Director of Investment Management Association
	Member of the MCC Development Committee	Member of the Investment Advisory Council of the Kings Fund

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
Barry Lee Stowe	<p>Director of ICICI Prudential Asset Management Company Limited</p> <p>Director of ICICI Prudential Life Insurance Company Limited</p> <p>Director of Life Insurance Marketing Research Association (LIMRA)</p> <p>Director of Life Officer Management Association (LOMA)</p> <p>Member of the Board of Visitors, Lipscomb University College of Business</p> <p>Director of Prudential Group plc*</p>	<p>President, Accident &amp; Health Worldwide for AIG Life Companies</p>
Keki Bomi Dadiseth	<p>Adviser to Actis Advisers Pvt Limited, India</p> <p>Trustee of BAI Hirabai J.N. Tata Navsari Charitable Institution, India</p> <p>Trustee of Breach Candy Hospital Trust, India</p> <p>Director of Britannia Industries Limited, India</p> <p>Member of the International Advisory Board of Fleishman-Hillard Inc.</p> <p>Director of Godrej Properties Limited, India</p> <p>International Advisor of Goldman Sachs</p> <p>Director of ICICI Prudential Life Insurance Company Limited</p> <p>Director of ICICI Prudential Trust Limited</p> <p>Member of the Executive Board of the Indian School of Business, India</p> <p>Director of Prudential Group plc*</p> <p>Senior Advisor of Oliver Wyman Limited</p> <p>Chairman of Omnicom India Marketing Advisory Services Pvt Ltd.</p> <p>Member of the International Advisory Board of Marsh &amp; McLennan Companies Inc.</p> <p>Director of Piramal Healthcare Limited, India</p>	<p>Member of the International Advisory Board of DaimlerChrysler</p> <p>Director of Times Global Broadcasting Co. Ltd, India</p> <p>Director of Unilever N.V., Netherlands</p> <p>Director of Unilever plc</p>

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
	Non-executive director of Siemens Limited, India	
	Trustee of Sir Ratan Tata Trust, India	
	Chairman of Sony India Pvt. Limited	
	Director of The Indian Hotels Company Ltd (The Taj Group), India	
Michael William Oliver Garrett	Director of Bobst Group, Switzerland	Member of the Advisory Committee for an APEC (Asian-Pacific Economic Cooperation) Food System
	Chairman of Evian Group	Member of the Supervisory Board of Cereal Partners Worldwide
	Director of Gottex Fund Management Holdings Limited, Guernsey	Director of Food Specialities (Nepal) Pvt Ltd
	Director of Hasbro Inc, USA	Chairman of the Food Industry Council of Australia
	Director of Nestle India Limited	Member of the Industry Council of Australia
	Director of Prudential Group plc*	Member of the Advisory Committee of the Lausanne/Tokyo Business Leaders Club
	Member of Swaziland International Business Advisory Panel	Director of Nestle Asean (Malaysia) Sdn Bhd
	Member of the Development Committee of the International Business Leaders Forum	Director of Nestle Australia Ltd
		Director of Nestlé (China) Ltd
		Director of Nestle Cold Storage (Sabah) Sdn Bhd
		Director of Nestle Distributors Limited
		Director of Nestle Dongguan Limited
		Director of Nestle Foods (Malaysia) Sdn Bhd
		Director of Nestle Japan Holding Ltd
		Director of Nestle Japan Ltd
		Director of Nestle (Malaysia) Sdn Bhd
		Director of Nestle Manufacturing (Malaysia) Sdn Bhd
		Director of Nestle Milkpack Ltd, Pakistan

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
		Director of Nestle Nigeria PLC, Nigeria
		Director of Nestle Pakistan Ltd
		Director and Vice Chairman of Nestle Philippines Inc
		Director and Chairman of Nestle Products Limited
		Director of Nestle Products Sdn Bhd
		Director of Nestle Qingdao Limited
		Executive Vice President and member of the Executive Board of Nestle S.A., Switzerland
		Director of Nestle Shanghai Ltd
		Director of Nestle Shuangcheng Limited
		Director of Nestle Singapore (Pte) Limited
		Director of Nestle (South Africa) (Proprietary) Limited
		Director of Nestle Tianjin Ltd
		Member of the Supervisory Board and Chairman of P.T. Nestle Indonesia
		Director of Quality Coffee Products Limited
		Director of Shanghai Fuller Foods Co Ltd
		Director of SNF Sdn Bhd
		Member of the Turkish Prime Minister's Advisory Group
		Director of Uprona (Canada) Limited
		Member of the WTO Business Advisory Council in Switzerland
Ann Frances Godbehere	Director of Ariel Holdings Limited, Bermuda	Director of European Reinsurance Company of Zurich, Switzerland
	Director of Atrium Underwriters Limited	Director of GE Insurance Solutions and subsidiaries, USA
	Director of Atrium Underwriting Group Limited	Director of IMD (International Management Development business school), Switzerland
	Director of Prudential Group plc*	Company Secretary of KHN Consulting Limited (Dissolved)
	Director of Rio Tinto Limited, Australia	Director of Life Assurance Holding Corporation Limited

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
	Director of Rio Tinto plc	Director of The Mercantile & General Reinsurance Company Limited
	Director of UBS AG, Switzerland	Executive Director of Northern Rock plc Director of Reassure UK Life Assurance Company Limited Director of Swiss Re America Holdings and subsidiaries, USA Director of Swiss Re GB PLC Chief Financial Officer of Swiss Re Group Director of Swiss Re Life & Health Limited Director of Swiss Re Properties Limited Director of Swiss Reinsurance Company UK Limited Director of Windsor Life Assurance Company Limited Director of XSMA Limited
Bridget Ann Macaskill	Chief Executive Officer of First Eagle Investment Management, LLC, USA Director of MAC (Scotland) Limited Director of Prudential Group plc* Trustee of TIAA-CREF	Director of Federal National Mortgage Association (Fannie Mae), USA Director of J Sainsbury plc Director of Scottish and Newcastle PLC
Kathleen Anne O'Donovan	Director of ARM Holdings plc Director of Bird & Co Boardroom Mentoring Limited Co-Chair of International Rescue Committee U.K. Chairman of Invensys Pension Trustee Limited Director of Prudential Group plc* Director of Trinity Mirror plc	Non-executive director of the Court of the Bank of England Director of EMI Group plc Director of EMI Group Senior Executive Pension Scheme Trustee Limited Director of Great Portland Estates P.L.C. Director of O <sub>2</sub> plc
James Hood Ross	Member of the Conservative Science, Technology, Engineering and Mathematics Task Force Trustee Director of the Council for Industry and Higher Education Chairman of the Leadership Foundation for Higher Education	Director of Datacard Inc., USA Director of McGraw Hill Companies Inc., USA Trustee Director of the Sherborne School Foundation

<u>Director</u>	<u>Current directorships, offices and partnerships</u>	<u>Previous directorships, offices and partnerships</u>
	Director of the Liverpool Associates in Tropical Health Limited	
	Chairman of the Liverpool School of Tropical Medicine	
	Director of Prudential Group plc*	
	Director of Schneider Electric S.A., France	
Lord Turnbull	Chairman of BH Global Limited	Director of Arup Group Limited
	Director of The British Land Public Limited Company	Director of The National Institute of Economic and Social Research (Incorporated)
	Director of Frontier Economics Limited	Secretary of the Cabinet and Head of the Home Civil Service
	House of Lords—Life Peer	
	Senior Advisor to the London Partners of Booz & Company (U.K.) Ltd	
	Director of Prudential Group plc*	
	Trustee of The Global Warming Policy Foundation	
	Director of The Isle of Sheppey Academy	

\* Prudential Group plc will become the parent company of the Enlarged Group as at the Scheme Effective Date.

## 5.2 *Interests in Prudential Shares*

Set out below are the interests of the Directors in the issued share capital of Prudential including the interests of persons connected with the Directors for the purposes of DTR 3.1.2 of the Disclosure and Transparency Rules as at 14 May 2010 (being the last practicable date prior to the publication of this prospectus). The table is based on notifications made to Prudential pursuant to DTR 3.1.2.

	<u>As at 14 May 2010</u>	
	<u>Existing Shares</u>	<u>% of issued share capital</u>
Harvey McGrath . . . . .	297,574	0.012
Tidjane Thiam . . . . .	268,605	0.011
Nic Nicandrou <sup>(1)</sup> . . . . .	132,490	0.006
Rob Devey . . . . .	77,308	0.003
Clark Manning <sup>(2)</sup> . . . . .	456,821	0.018
Michael McLintock . . . . .	594,979	0.023
Barry Stowe <sup>(3)</sup> . . . . .	315,994	0.012
Keki Dadiseth . . . . .	28,339	0.001
Michael Garrett . . . . .	33,337	0.001
Ann Godbehere . . . . .	12,370	0.001
Bridget Macaskill . . . . .	39,944	0.002
Kathleen O'Donovan . . . . .	21,184	0.001
James Ross . . . . .	19,333	0.001
<u>Lord Turnbull</u> . . . . .	13,251	0.001

### Notes

- (1) The Prudential Shares in the table include Prudential Shares purchased under the Prudential Group Share Incentive Plan together with Matching Shares (on a 1:4 basis). The total Prudential Shares held in the Share Incentive Plan and included in the table will only be released if the employee remains in employment for three years. For Nic Nicandrou the total number of Matching Shares at 14 May 2010 is 22.
- (2) Part of Clark Manning's interests in Prudential Shares are made up of 29,896 ADRs (representing approximately 59,792 ordinary shares).
- (3) Part of Barry Stowe's interests in Prudential Shares are made up of 48,532 ADRs (representing approximately 97,064 ordinary shares). 8,513.73 of the ADRs are held within an investment account which secures premium financing for a life assurance policy.

The Directors intend to either take up all of their rights, or sell sufficient rights to fund the taking up of the Prudential Shares to which the balance of their rights entitles them. Those Directors who are ADR holders will have their rights automatically sold on their behalf. Directors who are ADR holders will use any funds (net of any tax which may be due) which are realised from the sale of those rights to purchase additional Prudential Shares or Prudential ADRs of the same value as soon as they are legally authorised to do so.

## Directors' outstanding long-term incentive awards

### Share-based long-term incentive awards

The section below sets out the outstanding share awards under the Restricted Share Plan (RSP), the Group Performance Share Plan (GPSP) and the Business Unit Performance Share Plan (BUPP).

<u>Plan name</u>	<u>Conditional share awards outstanding at 31 December 2009 (Number of shares)</u>	<u>Conditional share awards 14 May 2010</u>
<b>Rob Devey</b>		
GPSP 2009 . . . . .	120,898	120,898
BUPP 2009 . . . . .	120,897	120,897
GPSP 2010 . . . . .	0	104,089
BUPP 2010 . . . . .	0	104,089
Total . . . . .	241,795	449,973
<b>Clark Manning</b>		
GPSP 2007 . . . . .	191,140	0
BUPP 2007 . . . . .	95,570	0
GPSP 2008 . . . . .	182,262	182,262
BUPP 2008 . . . . .	91,131	91,131
GPSP 2009 . . . . .	468,476	468,476
BUPP 2009 . . . . .	468,476	468,476
GPSP 2010 . . . . .	0	302,442
BUPP 2010 . . . . .	0	302,442
Total . . . . .	1,497,055	1,815,229
<b>Michael McLintock</b>		
GPSP 2007 . . . . .	52,040	0
GPSP 2008 . . . . .	48,330	48,330
GPSP 2009 . . . . .	92,022	92,022
GPSP 2010 . . . . .	0	66,238
Total . . . . .	192,392	206,590
<b>Nic Nicandrou</b>		
GPSP 2009 . . . . .	316,328	316,328
GPSP 2010 . . . . .	0	208,179
Total . . . . .	316,328	524,507
<b>Nick Prettejohn</b>		
GPSP 2007 . . . . .	130,071	0
BUPP 2007 . . . . .	65,035	0
GPSP 2008 . . . . .	127,622	127,622
BUPP 2008 . . . . .	63,811	63,811
GPSP 2009 . . . . .	242,997	242,997
BUPP 2009 . . . . .	242,997	242,997
Total . . . . .	872,533	677,427

<u>Plan name</u>	<u>Conditional share awards outstanding at 31 December 2009 (Number of shares)</u>	<u>Conditional share awards 14 May 2010</u>
<b>Barry Stowe</b>		
GPSP 2007 .....	105,706	0
BUPP 2007 .....	52,853	0
GPSP 2008 .....	107,988	107,988
BUPP 2008 .....	53,994	53,994
GPSP 2009 .....	196,596	196,596
BUPP 2009 .....	196,596	196,596
GPSP 2010 .....	0	129,076
BUPP 2010 .....	0	129,076
Total .....	713,733	813,326
<b>Tidjane Thiam</b>		
GPSP 2008 .....	314,147	314,147
GPSP 2009 .....	299,074	299,074
GPSP 2010 .....	0	510,986
Total .....	613,221	1,124,207
<b>Mark Tucker</b>		
RSP 2005 .....	223,011	0
GPSP 2007 .....	295,067	0
GPSP 2008 .....	294,512	294,512
Total .....	812,590	294,512

#### Other share awards

The table below sets out the share awards that have been made to executive Directors under their appointment terms and those deferred from annual bonus plan payouts. The number of shares is calculated using the average share price over the three business days commencing on the day of the announcement of the Prudential Group's annual financial results for the relevant year. For the awards from the 2008 annual bonus, made in 2009, the average share price was 308.63 pence.

	<u>Conditional share awards outstanding at 31 December 2009 (Number of shares)</u>	<u>Conditional share awards outstanding at 14 May 2010</u>
<b>Rob Devey</b>		
Awards under appointment terms 2009 .....	50,575	50,575
Deferred 2009 annual bonus award .....	0	26,733
<b>Clark Manning</b>		
Deferred 2006 annual bonus award .....	10,064	0
Deferred 2007 annual bonus award .....	17,825	17,825
Deferred 2009 annual bonus award .....	0	59,792
<b>Michael McLintock</b>		
Deferred 2006 annual bonus award .....	90,092	0
Deferred 2007 annual bonus award .....	112,071	66,029
Deferred 2008 annual bonus award .....	217,410	128,093
Deferred 2009 annual bonus award .....	0	69,620
<b>Nic Nicandrou</b>		
Awards under appointment terms 2009 .....	10,616	0
	5,889	0
	13,898	13,898
	16,059	16,059
	68,191	68,191
Deferred 2009 annual bonus award .....	0	24,506

	<b>Conditional share awards outstanding at 31 December 2009 (Number of shares)</b>	<b>Conditional share awards outstanding at 14 May 2010</b>
<b>Barry Stowe</b>		
Awards under appointment terms 2006 . . . . .	7,088	0
	2,110	2,110
Deferred 2007 annual bonus award . . . . .	43,777	43,777
Deferred 2008 annual bonus award . . . . .	21,064	21,064
Deferred 2009 annual bonus award . . . . .	0	36,386
<b>Tidjane Thiam</b>		
Awards under appointment terms 2008 . . . . .	48,362	0
	41,135	0
	49,131	49,131
Deferred 2008 annual bonus award . . . . .	110,403	65,046
Deferred 2009 annual bonus award . . . . .	0	58,829

Notes

- (1) In order to secure the appointment of Rob Devey and to compensate him for the loss of outstanding long-term remuneration, Rob was awarded rights to Prudential Shares as set out in the table.
- (2) Under the terms agreed on his leaving Prudential, the outstanding deferred awards to Nick Prettejohn have been released to him.
- (3) In order to secure the appointment of Nic Nicandrou and to compensate him for the loss of outstanding long-term remuneration, Nic was awarded rights to Prudential Shares as set out in the table.
- (4) Under the terms agreed on his leaving Prudential, the outstanding deferred awards to Mark Tucker have been released to him.
- (5) In March 2010 a number of outstanding deferred share awards were reduced by settling tax liabilities.

**Outstanding share options**

Options outstanding under the SAYE scheme are set out below. The SAYE is open to all UK and certain overseas employees. Options under this scheme up to HMRC limits are granted at a 20% discount and cannot normally be exercised until a minimum of three years has elapsed. No payment has been made for the grant of any options. The price to be paid for exercise of these options is shown in the table below. No variations to any outstanding options have been made.

	<b>Options outstanding at 31 December 2009</b>	<b>Options outstanding at 14 May 2010</b>
Tidjane Thiam . . . . .	1,705	1,705

Gains of £0 were made by Directors in 2009 on the exercise of share options (2008: £15,420).

No price was paid for the award of any option.

The highest and lowest share prices during 2009 were 650.5 pence and 207 pence respectively.

**5.3 Conflicts of Interest**

The Directors may, from time to time, hold directorships or other significant interests with companies outside of the Prudential Group which may have business relationships with the Prudential Group. Following recent legislative changes in the UK which came into effect on 1 October 2008, and in accordance with the Articles of Association, the Board has powers to authorise any actual and potential conflict situations. The Board has introduced additional procedures to identify and manage any conflicts or potential conflicts of interest and, in relation to situations that may give rise to actual or potential conflicts of interest, to ensure where possible that no actual or potential conflicts of interest will arise. These procedures provide for the Board and the Nomination Committee to formally review and, where appropriate, authorise conflict situations and potential conflict situations raised by Directors. In considering and authorising conflicts or potential conflicts, the Board and Nomination Committee are empowered to impose conditions to any authorisations it grants.

Keki Dadiseth and Barry Stowe are both directors of ICICI Prudential Life Insurance Company Limited, a joint venture which is 26% owned by the Prudential Group. In addition, Barry Stowe is a director of ICICI Prudential Asset Management Company Limited, a joint venture which is 49% owned by the Prudential Group, and Keki Dadiseth is a director of ICICI Prudential Trust Limited, a joint venture which is 49% owned by the Prudential Group. These appointments have been authorised by the Board. The Board does not consider that these appointments in any way affect Keki Dadiseth's status as an independent Director.

None of the Directors have any actual or potential conflicts of interest between their duties to Prudential as directors of Prudential and their private interests and/or other duties.

#### **5.4 *Competing business interests***

The Hong Kong Listing Rules require Prudential to disclose any interest of a Director in any business which competes or is likely to compete with Prudential's business. One of the executive Directors, Michael McLintock, is a trustee of the Grosvenor Estate which invests in, among other things, real estate and may therefore compete to an immaterial extent with the Prudential Group in its investments in that sector. Procedures are implemented by the Board so that Prudential is capable of conducting its business independently of, and at arm's length from, the Grosvenor Estate. Other than Michael McLintock, none of the Directors is interested in any business apart from Prudential's business which competes or is likely to compete, either directly or indirectly, with Prudential's business.

None of the Directors or senior managers of Prudential are related.

#### **5.5 *Other***

Save as disclosed above, no Director has any interest in the share capital or loan capital of Prudential or any of its subsidiaries and nor does any person connected with the Directors (within the meaning of section 252 of the Companies Act) have any such interests, whether beneficial or non-beneficial.

Within the period of five years preceding the date of this document, none of the Directors:

- (A) has any convictions in relation to fraudulent offences;
- (B) has been a director or senior manager (who is relevant to establishing that a company has the appropriate expertise and management of that company) of any company at the time of any bankruptcy, receivership or liquidation of such company; or
- (C) has received any official public incrimination and/or sanction by any statutory or regulatory authorities (including designated professional bodies) or has been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of a company.

There are no loans made or guarantees granted or provided by any member of the Prudential Group to or for the benefit of any Director.

## 6. Remuneration of Directors and Senior Managers

The following tables show the remuneration paid and benefits in kind granted to Directors for FY 2007, 2008 and 2009.

### Directors' remuneration

	2007 £000					
	Salary/Fees	Bonus	Benefits(*)	Cash supplements for pension purposes(†)	Total Emoluments 2007	Value of anticipated releases from LTIPs in respect of performance periods ending 31 December 2007(§)
<b>Chairman</b>						
Sir David Clementi . . . . .	508	—	41	127	676	—
<b>Executive directors</b>						
Philip Broadley . . . . .	567	590	56	153	1,366	814
Clark Manning <sup>(notes i, ii)</sup> . . . . .	500	1,724	16	—	2,240	2,933
Michael McLintock <sup>(note iii)</sup> . . . . .	320	1,780	48	—	2,148	1,280
Mark Norbom (until 14 December 2006) <sup>(note iv)</sup> . . . . .	—	—	—	—	—	—
Nick Prettejohn <sup>(note v)</sup> . . . . .	615	615	54	80	1,364	—
Barry Stowe <sup>(notes vi, vii)</sup> . . . . .	500	500	140	125	1,265	—
Mark Tucker <sup>(note viii)</sup> . . . . .	907	1,134	59	227	2,327	1,588
Total executive directors . . . . .	<u>3,409</u>	<u>6,343</u>	<u>373</u>	<u>585</u>	<u>10,710</u>	<u>6,615</u>
<b>Non-executive directors</b>						
Sir Winfried Bischoff (from 2 August 2007) . . . . .	25	—	—	—	25	—
Keki Dadiseth <sup>(note ix)</sup> . . . . .	81	—	—	—	81	—
Michael Garrett . . . . .	66	—	—	—	66	—
Ann Godbehere (from 2 August 2007) . . . . .	29	—	—	—	29	—
Bridget Macaskill . . . . .	79	—	—	—	79	—
Roberto Mendoza (until 17 May 2007) . . . . .	24	—	—	—	24	—
Kathleen O'Donovan . . . . .	98	—	—	—	98	—
James Ross . . . . .	98	—	—	—	98	—
Lord Turnbull . . . . .	73	—	—	—	73	—
Total non-executive directors . . . . .	<u>573</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>573</u>	<u>—</u>
<b>Overall total</b> . . . . .	<u>4,490</u>	<u>6,343</u>	<u>414</u>	<u>712</u>	<u>11,959</u>	<u>6,615</u>

\* Benefits include, where provided, cash allowances for cars, the use of a car and driver, medical insurance, security arrangements, expatriate benefits.

† Pension supplements that are paid in cash as per pension policy are included in the table. The pension policy and pension arrangements for current executive directors are set out subsequently.

§ Value of anticipated LTIP releases is the total of cash paid plus, for shares released, the value of the released shares based on the share price at 31 December 2007. All executive directors participate in long-term incentive plans and the details of share releases from awards with a performance period ending 31 December 2007 are provided in the footnotes to the table on share awards. Executive directors' participation in all-employee plans are set out subsequently.

#### Notes

- i In 2007 it was assumed that for Clark Manning a deferred share award from the 2007 annual bonus valued at \$200,000 would be made. This is included in the 2007 bonus figure.
- ii Clark Manning's bonus figure excludes a contribution of £6,745, from a profit sharing plan, which has been made into a 401K retirement plan. This is included in the table on pension contributions in the section 'Directors' pensions and life assurances'.
- iii Michael McLintock's 2007 annual incentive contains a deferral element. As a result of a review of remuneration structures of Michael McLintock, an additional award was made under the current LTIP in 2007. Also, in 2007 it was assumed that a deferred share award from the 2007 annual bonus valued at £640,000 would be made. This is included in the 2007 bonus figure.
- iv Mark Norbom's directorship with Prudential plc ended on 14 December 2006 but he remained in employment until 31 January 2007. In connection with the termination of his employment he received a payment of £291,000 and nine successive monthly payments of £55,792.

He also received private medical and life cover, school fees and club memberships until 31 October 2007 and housing benefits until 5 May 2007.

- v In 2007 it was assumed that for Nick Prettejohn a deferred share award from the 2007 annual bonus valued at £307,625 would be made. This is included in the 2007 bonus figure.
- vi In 2007 it was assumed that for Barry Stowe a deferred share award from the 2007 annual bonus valued at £250,000 would be made. This is included in the 2007 bonus figure.
- vii Barry Stowe's benefits include those relating to his expatriate status, including costs of £88,288 related to housing.
- viii In 2007 it was assumed that for Mark Tucker a deferred share award from the 2007 annual bonus valued at £453,600 would be made. This is included in the 2007 bonus figure.
- ix Keki Dadiseth was paid allowances totalling £9,400 in 2007 in respect of his accommodation expenses in London whilst on Prudential's business, in lieu of reimbursing hotel costs as is the usual practice for directors who are not resident in the UK.
- x In aggregate, total fees paid to Directors amounted to £573,000 in 2007.

	<b>2008 £000</b>					
	<u>Salary/fees</u>	<u>Bonus</u>	<u>Benefits(*)</u>	<u>Cash supplements for pension purposes(†)</u>	<u>Total Emoluments 2008</u>	<u>Value of anticipated releases from LTIPs in respect of performance periods ending 31 December 2008(§)</u>
<b>Chairman</b>						
Sir David Clementi <sup>(note i)</sup> . . . . .	538	—	43	134	715	—
<b>Executive directors</b>						
Philip Broadley (until 15 May 2008) <sup>(note ii)</sup> . . . . .	236	118	22	64	440	655
Clark Manning <sup>(note iii)</sup> . . . . .	567	1,177	24	—	1,768	929
Michael McLintock <sup>(note iv)</sup> . . . . .	320	1,780	54	—	2,154	881
Nick Prettejohn <sup>(note v)</sup> . . . . .	650	650	59	85	1,444	577
Barry Stowe <sup>(notes vi, vii)</sup> . . . . .	550	337	182	138	1,207	—
Tidjane Thiam (from 25 March 2008) <sup>(notes viii, ix, x)</sup> . . . . .	505	650	59	30	1,244	—
Mark Tucker . . . . .	975	942	66	244	2,227	1,297
Total executive directors . . . . .	<u>3,803</u>	<u>5,654</u>	<u>466</u>	<u>561</u>	<u>10,484</u>	<u>4,339</u>
<b>Non-executive directors</b>						
Sir Winfried Bischoff . . . . .	63	—	—	—	63	—
Keki Dadiseth <sup>(note xi)</sup> . . . . .	73	—	—	—	73	—
Michael Garrett . . . . .	73	—	—	—	73	—
Ann Godbehere . . . . .	81	—	—	—	81	—
Bridget Macaskill . . . . .	86	—	—	—	86	—
Harvey McGrath (from 1 September 2008) <sup>(note xii)</sup> . . . . .	167	—	—	—	167	—
Kathleen O'Donovan . . . . .	108	—	—	—	108	—
James Ross . . . . .	101	—	—	—	101	—
Lord Turnbull . . . . .	81	—	—	—	81	—
Total non-executive directors . . . . .	<u>833</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>833</u>	<u>—</u>
<b>Overall total</b> . . . . .	<u>5,174</u>	<u>5,654</u>	<u>509</u>	<u>695</u>	<u>12,032</u>	<u>4,339</u>

\* Benefits include, where provided, cash allowances for cars, the use of a car and driver, medical insurance, security arrangements, expatriate benefits.

† Pension supplements that are paid in cash are included in the table. The pension policy and pension arrangements for current executive directors are set out subsequently.

§ Value of anticipated LTIP releases is the total of cash paid plus, for shares released, the value of the released shares based on the share price at 31 December 2008. All executive directors participate in long-term incentive plans and the details of share releases from awards with a performance period ending 31 December 2008 are provided in the footnotes to the table on share awards. Executive directors' participation in all-employee plans are set out subsequently.

**Notes**

- i Sir David Clementi was Chairman until 31 December 2008 and remained an employee until 31 January 2009.
- ii Philip Broadley resigned in 2007. In view of his flexibility in agreeing a leaving date after the 2008 Annual General Meeting and for his agreement to act as a consultant for six months post his date of leaving, he was provided with the following:
  - a total payment of £507,105 paid in two tranches in June and December 2008;
  - medical insurance and life assurance cover for six months after his leaving date; and
  - treatment as a "good leaver" in respect of his outstanding share awards. The deferred share awards under his 2006 and 2007 annual incentive plans were released on his leaving. His outstanding long-term incentive awards will vest according to the rules of the plans in the same way as other recipients of awards, but pro-rated where appropriate for the time worked during the performance period.

All of these payments after June 2008 were subject to his continuing to be available for consultancy for six months after his leaving date and subject to his compliance with non-solicitation and confidentiality conditions.

- iii Clark Manning's bonus figure excludes a contribution of US\$13,800 from a profit sharing plan, which has been made into a 401K retirement plan. This is included in the table on pension contributions in the section 'Directors' pensions and life assurances'.
- iv In 2008 it was assumed that for Michael McLintock a deferred share award from the 2008 annual bonus valued at £640,000 would be made. This is included in the 2008 bonus figure.
- v In 2008 it was assumed that for Nick Prettejohn a deferred share award from the 2008 annual bonus valued at £325,000 would be made. This is included in the 2008 bonus figure.
- vi In 2008 it was assumed that for Barry Stowe a deferred share award from the 2008 annual bonus valued at £62,013 would be made. This is included in the 2008 bonus figure.
- vii Barry Stowe's benefits primarily relate to his expatriate status including costs of £91,829 related to housing, £34,113 for children's education and £21,165 for home leave.
- viii On appointment, Tidjane Thiam was provided with a guarantee that his 2008 bonus would not be less than 100% of salary.
- ix In 2008 it was assumed that for Tidjane Thiam a deferred share award from the 2008 annual bonus valued at £325,000 would be made. This is included in the 2008 bonus figure.
- x In addition to the 2008 bonus disclosed in the table above, Tidjane Thiam received a payment of £650,631 to compensate for the loss of a 2007 bonus and in lieu of 2005 awards which were due to vest in March 2008.
- xi Keki Dadiseth was paid allowances totalling £12,063 in 2008 in respect of his accommodation expenses in London while on Prudential's business, in lieu of reimbursing hotel costs as is the usual practice for directors who are not resident in the UK.
- xii Harvey McGrath joined Prudential on 1 September 2008 and became Chairman on 1 January 2009.
- xiii In aggregate, total fees paid to Directors amounted to £833,000 in 2008.

	2009 £000						
	Salary/Fees	Bonus	Benefits(*)	Cash Supplements For Pension Purposes(†)	Other Cash Payments	Total Emoluments 2009	Value of anticipated releases from LTIPs in respect of performance periods ending 31 December 2009(§)
<b>Chairman</b>							
Harvey McGrath . . . . .	500	—	42	—	—	542	—
<b>Executive directors</b>							
Rob Devey (from 16 November 2009) <sup>(note i)</sup> . . . . .	69	600	138	1	—	808	—
Clark Manning <sup>(note ii)</sup> . . . . .	696	2,028	29	—	—	2,753	1,223
Michael McLintock <sup>(note iii)</sup> . . . . .	320	1,750	53	6	—	2,129	2,572
Nic Nicandrou (from 28 October 2009) <sup>(note iv)</sup> . . . . .	98	550	5	1	—	654	—
Nick Prettejohn <sup>(note v)</sup> . . . . .	488	505	40	63	607	1,703	763
Barry Stowe <sup>(note vi)</sup> . . . . .	646	618	262	162	—	1,688	1,098
Tidjane Thiam <sup>(note vii)</sup> . . . . .	763	1,056	49	87	—	1,955	—
Mark Tucker <sup>(note viii)</sup> . . . . .	731	841	99	183	308	2,162	1,731
Total executive directors . . . . .	<u>3,811</u>	<u>7,948</u>	<u>675</u>	<u>503</u>	<u>915</u>	<u>13,852</u>	<u>7,387</u>
<b>Non-executive directors</b>							
Sir Winfried Bischoff <sup>(note ix)</sup> . . . . .	47	—	—	—	—	47	—
Keki Dadiseth <sup>(note x)</sup> . . . . .	86	—	—	—	—	86	—
Michael Garrett . . . . .	77	—	—	—	—	77	—
Ann Godbehere . . . . .	94	—	—	—	—	94	—
Bridget Macaskill . . . . .	89	—	—	—	—	89	—
Kathleen O'Donovan . . . . .	109	—	—	—	—	109	—
James Ross . . . . .	107	—	—	—	—	107	—
Lord Turnbull . . . . .	87	—	—	—	—	87	—
Total non-executive directors . . . . .	<u>696</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>696</u>	<u>—</u>
<b>Overall total.</b> . . . . .	<u>5,007</u>	<u>7,948</u>	<u>717</u>	<u>503</u>	<u>915</u>	<u>15,090</u>	<u>7,387</u>

\* Benefits include where provided the use of a car and driver, medical insurance, security arrangements, and expatriate benefits.  
† Pension supplements that are paid in cash are included in the table.  
\*\*\* 2009 figures include deferred share awards made from 2009 annual incentive plans.  
§ Value of anticipated LTIP releases is the total of cash paid plus, for shares released, the value of the released shares based on the share price at 31 December 2009. All executive directors participate in long-term incentive plans.

**Notes**

- i As part of Rob Devey's appointment terms, it was agreed that any bonus award for Rob would be assessed as if he had been in employment for the whole of 2009. A deferred share award from the 2009 annual bonus valued at £240,000 has been made to Rob. This is included in the 2009 bonus figure. Actual costs reimbursed to Rob as part of his relocation arrangements are included in the benefits figure. It should be noted that Rob elected not to receive his cash supplement for pension purposes in full during 2009. It is anticipated that Prudential will make

a request to the Trustees of the Alternative Retirement Benefit Scheme during 2010 to accept a contribution for an amount equivalent to this supplement.

- ii Clark Manning's bonus figure excludes a contribution of US \$14,700 from a profit sharing plan which has been made into a 401K retirement plan. A deferred share award from the 2009 annual bonus valued at US\$476,250 has been made to Clark. This is included in the 2009 bonus figure.
- iii For Michael McLintock a deferred share award from the 2009 annual bonus valued at £625,000 has been made. This is included in the 2009 bonus figure.
- iv As part of Nic Nicandrou's appointment terms, it was agreed that any bonus award for Nic would be assessed as if Nic had been in employment for the whole of 2009. A deferred share award from the 2009 annual bonus valued at £220,000 has been made to Nic. This is included in the 2009 bonus figure. Nic has not yet been reimbursed for any relocation expenses. It should be noted that Nic elected not to receive his cash supplement for pension purposes in full during 2009. It is anticipated that Prudential will make a request to the Trustees of the Long Term Savings Plan during 2010 to accept a contribution for an amount equivalent to this supplement.
- v Nick Prettejohn's 2009 annual bonus payment has been prorated for length of service during the year and is based on performance outcomes achieved at the end of 2009. This bonus was fully paid in cash in March 2010. The figure in the Other Payments column is a termination payment that was agreed as part of his leaving arrangements which was paid in instalments on 13 October 2009 and 11 January 2010.
- vi For Barry Stowe a deferred share award from the 2009 annual bonus valued at HK\$2,248,852 has been made. This is included in the 2009 bonus figure. Barry's benefits primarily relate to his expatriate status including costs of £148,051 for housing, £41,528 for children's education and £32,607 for home leave.
- vii Tidjane Thiam's 2009 annual bonus outcome was determined taking into account the period of time he was remunerated as Chief Financial Officer and Group Chief Executive. For Tidjane a deferred share award from the 2009 annual bonus valued at £528,137 has been made. This is included in the 2009 bonus figure.
- viii As part of Mark Tucker's remuneration arrangements following his resignation from Prudential. It was agreed that his 2009 annual bonus payment would prorated based on length of service during the year and paid at a target level of performance. The figure in the Other Payments column is a termination payment that was agreed as part of his leaving arrangements as detailed on page 152 and paid on 11 January 2010.
- ix Sir Winfried Bischoff left Prudential on 15 September 2009.
- x Keki Dadiseth was paid allowances totalling £5,398 in 2009 in respect of his accommodation expenses in London whilst on Prudential's business, in lieu of reimbursing hotel costs as is the usual practice for directors who are not resident in the UK.
- xi In aggregate, total fees paid to Directors amounted to £696,000 in 2009.

No amounts (other than those set out in this section) were paid or received by the Directors for each of the three years immediately preceding the issue of this prospectus as an inducement to join or upon joining Prudential.

No compensation was paid or received by the Directors or past directors for each of the three years immediately preceding the issue of this prospectus for the loss of office in connection with the management of the affairs of any member of the Prudential Group.

There are no arrangements under which a Director has waived or agreed to waive any emoluments for each of the three financial years immediately preceding the issue of this prospectus.

Executive Directors have contracts that terminate on their normal retirement date. The normal retirement date for the executive Directors except Clark Manning and Barry Stowe is the date of their 65<sup>th</sup> birthday. The normal retirement date for Clark Manning and Barry Stowe is the date of their 60<sup>th</sup> birthday. The normal notice of termination Prudential is required to give executive Directors is 12 months. Accordingly, in normal circumstances the Director would be entitled to one year's salary and benefits in respect of the notice period on termination. Additionally, outstanding awards under annual and long-term incentive plans will vest depending on the circumstances and according to the rules of the plans.

When considering any termination of a service contract, the Remuneration Committee will have regard to the specific circumstances of each case, including a Director's obligation to mitigate his loss. Payments additionally would be phased over the notice period.

Service contracts of Directors do not include provision for specific payment in the event of early termination, nor do they provide for extended notice periods or compensation in the event of a change of control.

It is not currently proposed that the aggregate of the remuneration payable to and benefits in kind receivable by the Directors will be varied in consequence of the Acquisition.

## 7. Share plans

### (A) Existing Share Plans

#### *Prudential Group Performance Share Plan*

The Group Performance Share Plan (GPSP) is the incentive plan in which all executive directors and other senior executives within the Prudential Group may participate. This scheme was established as a replacement for the Restricted Share Plan (RSP) under which no further awards could be made after March 2006. Awards are granted either in the form of a nil cost option, conditional right over shares, or such other form that shall confer to the participant an equivalent economic benefit, with a vesting period of three years. The performance measure for the awards in 2007, 2008 and 2009 is that Prudential's Total Shareholder Return (TSR) outperforms an index comprising of peer companies. Vesting of the awards between each performance point is on a straight line sliding scale basis. Participants are entitled to the value of reinvested dividends that would have accrued on the shares that vest. The shares which vest are settled either by shares purchased in the open market by a trust for the benefit of qualifying employees or by new issue shares. Special rules apply on termination of employment and on a change of control.

#### *Prudential Business Unit Performance Plan (BUPP)*

The BUPP is an incentive plan created to provide a framework under which awards would be made to executive directors and other senior employees in the UK, Jackson and Asia. Awards under this plan in 2007, 2008 and 2009 were based on growth in shareholder capital value on the European embedded value (EEV) basis with performance measured over three years. For the UK, awards under this plan in 2010 are based on the Prudential Group TSR measure but for Jackson and Asia will continue to be based on growth in shareholder capital value on the EEV basis as noted above. Upon vesting, the 2007 award was released half as cash and half as shares. The 2008 award will also be released as half cash and half shares, from 2009 onwards the awards are released wholly in shares. The shares which vest are settled by either shares purchased in the open market by a trust for the benefit of qualifying employees or by new issue shares. Special rules apply on termination of employment and on a change of control. Participants are entitled to receive the value of reinvested dividends over the performance period for those shares that vest. The growth parameters for the awards are relevant to each region and vesting of the awards between each performance point is on a straight line sliding scale basis.

#### *Prudential Savings Related Share Option Scheme, Prudential 2003 Savings Related Share Option Scheme (SAYE Schemes)*

UK-based employees and executive directors are eligible to participate in the SAYE Schemes. The schemes allow employees to save towards the exercise of options over Prudential Shares, at an option price set at the beginning of the savings period at a discount of up to 20% to the market price. Savings contracts may be up to £250 per month for three or five years. On maturity at the end of the set term, participants may exercise their options within six months of the end of the savings period and purchase Prudential Shares. If an option is not exercised within six months, participants are entitled to a refund of their cash contributions plus interest if applicable under the rules. Shares are issued to satisfy options that are exercised. Special rules apply on termination of employment and on a change of control.

#### *Prudential International Assurance Sharesave Plan*

The Irish equivalent of the SAYE Schemes, as outlined above, for employees in the Republic of Ireland.

#### *Prudential International Savings Related Share Option Scheme*

The international equivalent of the Prudential Savings Related Share Option Scheme, as outlined above for the Asia based executive director and employees in Hong Kong, Singapore, Malaysia, Taiwan and India.

#### *Prudential International Savings Related Share Option Scheme (non-employees)*

The equivalent of the SAYE Schemes, as outlined above, for individuals who are not employees but who provide services to the Prudential Group such as insurance agents.

#### *Prudential Group Deferred Bonus Plan 2010 and the PruCap Deferred Bonus Plan*

These plans, which operate together with the relevant business unit annual bonus plans, require that a portion of a participant's annual bonus be paid in the form of a right to acquire Prudential Shares. The shares are released to the

participant at the end of the three year deferral period. Special rules apply on termination of employment and on a change of control.

*Prudential Services Limited Share Incentive Plan, Prudential Assurance Company Limited Share Incentive Plan, Prudential UK Services Limited Share Incentive Plan and Prudential Group Share Incentive Plan*

These HMRC approved Share Incentive Plans allow all employees based in the UK insurance business and Group Head Office to purchase Prudential Shares (partnership shares) on a monthly basis out of gross salary. For every four partnership shares bought, an additional matching share is awarded, purchased on the open market. Dividend shares accumulate while the employee participates in the plan. Partnership shares may be withdrawn from the plan at any time. If the employee withdraws from the plan within five years, the matching shares are forfeited and if within three years, dividend shares are forfeited.

*Prudential Europe Share Participation Plan*

The Prudential Europe Share Participation plan is an Irish Revenue approved plan and is open to certain employees of Prudential Europe Assurance Holdings, Prudential International Assurance and Prudential International Management Services. The plan gives participants the opportunity to have Prudential Shares purchased on their behalf and held by a trustee. The value of the shares purchased is limited; each participant's entitlement may be a fixed amount or a proportion of the participant's basic salary subject to a limit of 7 1/2% of the participant's basic salary or an amount determined by the Irish Revenue from time to time.

*Prudential-Jackson National Life US Performance Share Plan*

Jackson operates a performance-related share award which, subject to the prior approval of the Jackson Remuneration Committee, may grant share awards to eligible Jackson employees in the form of a contingent right to receive shares or a conditional allocation of shares. These share awards have vesting periods of four years and are at nil cost to the employee. Award holders do not have any right to dividends or voting rights attaching to the shares. The shares are held in the employees share trust in the form of American Depository Receipts which are tradable on the New York Stock Exchange. Special rules apply on termination of employment and on a change of control.

*Prudential Corporation Asia Long Term Incentive Plan*

This plan is an incentive plan for senior employees based in Asia. Awards under the plan vest after three years subject to the employee being in employment at the time of vesting without any performance conditions. Awards are discretionary and on a year by year basis determined by PCA's full year financial results and the employee's contribution to the business in each case for the immediately preceding financial year. All awards are in Prudential shares except for countries where share awards are not feasible due to securities and/or tax reasons, where awards are replaced by the cash value of the shares that would otherwise have been transferred.

*The Prudential Corporation Asia Deferred Bonus Plan*

Under this plan, a portion of a participant's annual bonus may be paid in the form of an award over Prudential Shares. Participants may also be given the opportunity to take all or part of their remaining bonus in the form of an award over Prudential Shares. Participants may also be granted matching awards over additional Prudential Shares. Awards may or may not be made subject to performance targets. Awards, which may take the form of nil-cost options or a conditional right over shares, normally vest after a three year deferral period subject to continued employment and, if applicable, satisfaction of performance targets. Special rules apply on termination of employment and on a change of control.

*The Momentum Retention Plan*

Employees who are participating in the Momentum development programme may receive an award in respect of Prudential Shares, half of which are released four years from the award date and the other half are released seven years from the award date. Special rules apply on termination of employment and on a change of control. Until the release date participants do not have any right to dividends or voting rights attaching to shares.

*Annual Incentive Plan (non-US tax payers) and Annual Incentive Plan (US tax payers) (the Annual Incentive Plans)*

Prudential operates two annual incentive plans, one for non-US tax payers and one for US tax payers. Senior executives may participate in the relevant Annual Incentive Plan which is based on the achievement of annual performance measures taken from Prudential's business plans and an individual's contribution. Certain senior employees have annual incentive plans with awards made partly in cash and partly in the form of shares, deferred for three years, with the release of shares subject to close periods. The shares are held in the employee share trust and shares equivalent to dividends otherwise payable will accumulate in the form of additional deferred shares for the benefit of award holders during the deferral period up to the release date.

*Prudential Restricted Share Plan*

The Restricted Share Plan is an incentive plan to encourage or facilitate the holding of shares in Prudential by or for the benefit of employees of Prudential and its Subsidiaries. There are only two employees within the Prudential Group with outstanding options in the plan which became exercisable when performance targets based on Prudential's Total Shareholder Return (TSR) were satisfied.

**(B) New Share Plans**

The following is a summary of the main provisions of the New Share Plans which, subject to the approval of the shareholders of Prudential, New Prudential will adopt to operate after the Scheme Effective Date. The operation of each share plan will be governed by the rules of that plan. In each case, the new plan is substantially identical to the corresponding Prudential Share Scheme. New Prudential will also adopt new plans to replace (or, where appropriate amend the existing plans) the remaining Prudential Share Schemes.

In addition (but subject to shareholders approval), New Prudential has passed a resolution which will allow it to establish additional share plans for the benefit of the New Prudential group's overseas employees provided that such plans operate within the equity dilution limits described below and (save to the extent necessary or desirable to take account of overseas tax, securities and exchange control laws) such plans do not confer upon participants benefits which are greater than those which could be obtained from the plans described below and that, once such plans have been established, they may not be amended without the approval of New Prudential in general meeting if such approval would be required to amend the corresponding provision of the plans described below.

**I New Prudential Group Performance Share Plan (Group PSP)**

*(i) Administration*

The Remuneration Committee of New Prudential or other duly authorised Board committee (the "Committee") is responsible for determining awards to, and administering the Group PSP.

*(ii) Eligibility*

All employees of the New Prudential group, as well as any executive directors who are required to devote substantially all of their time to the business of the New Prudential group, are eligible to participate in the Group PSP at the discretion of the Committee.

*(iii) Grant of awards*

Awards may be granted in the six weeks following the date on which the Group PSP is adopted by New Prudential. Thereafter, awards may normally only be granted in the six weeks following the announcement by New Prudential of its results for any period, or where there are circumstances considered by the Committee to be exceptional. Awards may also be granted outside these periods in connection with the commencement of an eligible employee's employment if this is appropriate. However, at all times, the grant of awards will be subject to the terms of the Model Code for transactions in securities by directors and New Prudential Share Dealing Rules.

No awards may be granted later than ten years after the approval of the Group PSP by the shareholders of Prudential.

Awards may take the form of:

- an option to acquire ordinary shares in New Prudential at nil or nominal cost;
- a conditional right over ordinary shares in New Prudential; or
- such other form that shall confer to the participant an equivalent economic benefit.

Awards may be granted over newly issued shares, treasury shares and shares purchased in the market and held by an employee benefit trust established by any member of the New Prudential group.

Awards granted under a nil or nominal cost option can be exercised no later than the tenth anniversary of the date of award (or such earlier date as determined by the Committee at the date of the award).

Awards under the Group PSP will not be pensionable. Awards are not transferable (other than on death) without the consent of the Committee. No payment will be required for the grant of an award.

*(iv) Performance conditions*

Awards will vest subject to the satisfaction of challenging conditions which will determine how much (if any) of the award will vest at the end of the performance period. The period over which performance will be measured shall not be less than three years (except as noted below).

The performance conditions will be designed to link reward to the achievement of stretching levels of performance and the creation of shareholder value. The performance period will normally start on the first date of the financial year in which the award is made.

Details of the performance conditions applied to awards made to executive directors will be set out in the Directors' Remuneration Report each year.

The performance conditions may be varied in certain circumstances following the grant of an award so as to achieve the original purpose but not so as to make the achievement of the performance conditions any more or less difficult to satisfy.

*(v) Individual limits*

For employees who are required to devote substantially all of their time to the business of the New Prudential group based in the US or such other jurisdictions as the Committee determines to be appropriate, the maximum award which may be granted under the Group PSP in respect of any financial year will be over shares worth 550% of basic salary. For all other employees the maximum will be 350% of basic salary. Awards granted under the New Prudential Business Unit Performance Plan in respect of the relevant financial year shall be included in these limits.

*(vi) Dilution limits*

The maximum number of new issue shares that may be allocated under the Group PSP must not exceed the following limits:

- a) in any 10-year period, the aggregate number of new issue shares allocated under the Group PSP, when added to the number of new issue shares allocated under all other employee share plans operated by Prudential or New Prudential must not exceed 10% of the issued ordinary share capital of New Prudential from time to time; and
- b) in any 10-year period, the aggregate number of new issue shares allocated under the Group PSP, when added to the number of new issue shares allocated under all other discretionary employee share plans operated by Prudential or New Prudential must not exceed 5% of the issued ordinary share capital of New Prudential from time to time.

While it remains best practice to do so, treasury shares will be treated as newly issued for the purposes of these limits.

Awards granted to participants under the Prudential Share Schemes in exchange for their awards under those plans will be treated as having been granted at the time when the awards which they replace were originally granted.

*(vii) Leaving employment*

A participant's awards will normally lapse unless he or she has remained in employment with the New Prudential group until after the end of the performance period.

The Committee may, however, allow exceptions where a participant leaves employment as a result of death, injury or disability, the company or business for which he or she works being sold out of the New Prudential group or for any other reason at the Committee's discretion.

If a participant leaves as a result of death, injury or disability before the end of the performance period, the Committee may, in its discretion, decide the extent to which an award will vest having regard to the performance condition at date of leaving and the period of time that has elapsed since the award was granted.

If a participant leaves as a result of the company or business for which he or she works being sold out of the New Prudential group, the Committee may, in its discretion, determine the extent to which awards vest or are carried forward in an appropriate form, taking account of the circumstances of the transaction, performance (of New Prudential and/or the performance condition) and the time elapsed.

In any other circumstances where the Committee decides to exercise its discretion on a participant leaving employment, the Committee may determine the timing of and extent to which an award may vest, normally having regard to the period of time that has elapsed since the award was granted and the performance condition measured from the start of the performance period to the date of departure or to the end of the 3-year performance period.

*(viii) Dividends*

Participants will normally be entitled to the value of reinvested dividends that would have accrued on their vested shares, unless at the time of an award the Committee determines otherwise.

*(ix) Change of control or reconstruction*

In the event of a change of control of New Prudential as a result of a takeover, reconstruction or winding up of New Prudential (not being an internal reorganisation), the Committee may require awards to be exchanged for new awards in the acquiring company on a comparable basis. Alternatively, the Committee may, at its discretion, determine the extent to which awards may vest and/or become exercisable taking into account the performance of New Prudential and the period of time which has elapsed since the date of the award having regard to the following table:

<u>Proportion of performance period that has elapsed at change of control</u>	<u>Proportion of award which is eligible for release subject to performance</u>
Less than 12 months . . . . .	33%
12 months — 24 months . . . . .	67%
More than 24 months. . . . .	100%

As an alternative to early release, the Committee may permit participants to exchange their awards for new awards of shares in the acquiring company on a comparable basis.

*(x) Adjustments*

Awards may be adjusted if there is a variation in the share capital of New Prudential such as a rights or bonus issue, or if New Prudential implements a demerger, or a special dividend, that would affect the value of awards.

*(xi) Rights attaching to shares*

Shares allotted or transferred under the Group PSP will rank equally with all other ordinary shares of New Prudential for the time being in issue (except for rights attaching to such shares by reference to a record date prior to the exercise of the award). New Prudential will apply for the listing of any new shares allotted under the Group PSP.

*(xii) Amendments*

The Group PSP may at any time be altered by the Committee in any respect. However, any alterations to the rules governing eligibility, limits on participation and the number of new shares available under the Group PSP, terms of vesting and adjustment of awards for variations in share capital, which are to the advantage of participants must be approved in advance by the shareholders of New Prudential in general meeting unless the alteration or addition is minor in nature and/or made to benefit the administration of the Group PSP, to comply with the provisions of any existing or proposed legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or New Prudential group companies.

The Committee shall not make any amendment that would materially prejudice the existing interest of a participants except with the prior consent of the participant.

## **II New Prudential Business Unit Performance Plans (BUPP)**

### *(i) Administration*

The Remuneration Committee of New Prudential or any other duly authorised committee (the “Committee”) is responsible for determining awards to, and administering the BUPP.

### *(ii) Eligibility*

All employees of the New Prudential group, as well as any executive directors who are required to devote substantially all of their time to the business of the New Prudential group, are eligible to participate in the BUPP at the discretion of the Committee.

### *(iii) Grant of awards*

Awards may be granted in the six weeks following the date on which the BUPP is adopted by New Prudential. Thereafter, awards may normally only be granted in the six weeks following the announcement by New Prudential of its results for any period, or where there are circumstances considered by the Committee to be exceptional. Awards may also be granted outside these periods in connection with the commencement of an eligible employee’s employment if this is appropriate. However, at all times, the grant of awards will be subject to the terms of the Model Code for transactions in securities by directors and New Prudential’s Share Dealing Rules.

No awards may be granted later than ten years after the approval of the BUPP by the shareholders of New Prudential.

Awards may take the form of a combination of cash and ordinary shares in New Prudential. For executive directors, 50% of the award will be denominated in ordinary shares, or such greater proportion as determined by the Committee.

The proportion of the award which is denominated in ordinary shares in New Prudential may take the form of:

- an option to acquire ordinary shares in New Prudential at nil or nominal cost;
- a conditional right over ordinary shares in New Prudential; or
- such other form (including a cash award) that shall confer to the participant an equivalent economic benefit.

The awards may be granted over newly issued shares, treasury shares and shares purchased in the market and held by an employee benefit trust established by New Prudential.

Awards granted under a nil or nominal cost option can be exercised no later than the tenth anniversary of the date of awards (or such earlier date as determined by the Committee at the date of the award).

Awards under the BUPP will not be pensionable. Awards are not transferable other than on death without the consent of the Committee. No payment will be required for the grant of an award.

### *(iv) Performance conditions*

Awards will vest subject to the satisfaction of challenging conditions which will determine how much (if any) of the award will vest at the end of the performance period. The period over which performance will be measured shall not be less than three years.

The performance conditions will be designed to link reward to the achievement of stretching levels of performance and the creation of shareholder value in each business unit. The performance period normally will start on the first day of the financial year in which the award is made.

Details of the performance conditions applied to awards made to the executive directors will be set out in the Directors’ Remuneration Report each year.

The performance conditions may be varied in certain circumstances following the grant of an award so as to achieve the original purpose but not so as to make the achievement of the performance conditions any more or less difficult to satisfy.

### *(v) Individual limits*

For employees who are required to devote substantially all of their time to the business of the New Prudential group based in the United States or such other jurisdictions as the Committee determines to be appropriate, the maximum award which may be granted under the BUPP in respect of any financial year will be 550% of basic salary.

For all other employees the maximum award will be 350% of basic salary. Awards granted under the Group Performance Share Plan in respect of the relevant financial year shall be included in these limits.

*(vi) Dilution limits*

The maximum number of new issue shares that may be allocated under the BUPP must not exceed the following limits:

- (a) in any 10-year period, the aggregate number of new issue shares allocated under the BUPP, when added to the number of new issue shares allocated under all other employee share plans operated by New Prudential or Prudential must not exceed ten % of the issued ordinary share capital of New Prudential from time to time; and
- (b) in any 10-year period, the aggregate number of new issue shares allocated under the BUPP, when added to the number of new issue shares allocated under all other discretionary employee share plans operated by New Prudential or Prudential must not exceed five % of the issued ordinary share capital of New Prudential from time to time.

While it remains best practice to do so, treasury shares will be treated as newly issued for the purposes of these limits.

Awards granted to participants under the Prudential Share Schemes in exchange for their awards under those plans will be treated as having been granted at the time when the awards which they replace were originally granted.

*(vii) Leaving employment*

A participant's award will normally lapse unless he or she has remained in employment with the New Prudential group until after the end of the performance period.

The Committee may, however, allow exceptions where a participant leaves employment as a result of death, injury or disability, the company or business for which he or she works being sold out of the New Prudential group or for any other reason at the Committee's discretion.

If a participant leaves for reason of death, injury or disability before the end of the performance period, the Committee may, in its discretion decide the extent to which an award will vest having regard to the performance condition at the date of leaving and the period of time that has elapsed since the award was granted.

If a participant leaves as a result of the company or business for which he or she works being sold out of the New Prudential group, the Committee may, in its discretion, determine the extent to which awards vest or are carried forward in an appropriate form taking account of the circumstances of the transaction, performance (of New Prudential and/or the performance condition) and the time elapsed.

In any other circumstance where the Committee decides to exercise its discretion on a participant leaving employment, the Committee may determine the timing of and extent to which an award may vest having regard to the period of time that has elapsed since the award was granted and the performance condition measured from the start of the performance period to the date of departure or to the end of the three-year performance period.

*(viii) Dividends*

Participants will normally be entitled to the value of reinvested dividends that would have accrued on their vested shares, unless at the time of an award the Committee determines otherwise.

*(ix) Change of control or reconstruction*

In the event of a change of control of New Prudential as a result of a takeover, reconstruction or winding-up of New Prudential (not being an internal reorganisation), the Committee may require awards to be exchanged for new awards in the acquiring company on a comparable basis. Alternatively, the Committee may, at its discretion, determine the extent to which awards may vest and/or become exercisable taking into account the performance of

New Prudential and the period of time which has elapsed since the date of the award having regard to the following table:

<u>Proportion of performance period that has elapsed at change of control</u>	<u>Proportion of award which is eligible for release subject to performance</u>
Less than 12 months . . . . .	33%
12 months — 24 months . . . . .	67%
More than 24 months . . . . .	100%

As an alternative to early release, the Committee may permit participants to exchange their awards for new awards of shares in the acquiring company on a comparable basis.

*(x) Adjustments*

Awards may be adjusted if there is a variation in the share capital of New Prudential such as a rights or bonus issue, or if New Prudential implements a demerger, or a special dividend, that would affect the value of awards.

*(xi) Rights attaching to shares*

Shares allotted or transferred under the BUPP will rank equally with all other ordinary shares of New Prudential for the time being in issue (except for rights attaching to such shares by reference to a record date prior to the exercise of the award). New Prudential will apply for the listing of any new shares allotted under the BUPP.

*(xii) Amendments*

The BUPP may at any time be altered by the Committee in any respect. However, any alterations to the rules governing eligibility, limits on participation and the number of new shares available under the BUPP, terms of vesting and adjustment of awards for variations in share capital, which are to the advantage of participants must be approved in advance by the shareholders of New Prudential in general meeting unless the alteration or addition is minor in nature and/or made to benefit the administration of the BUPP, to comply with the provisions of any existing or proposed legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or New Prudential group companies.

The Committee shall not make any amendment that would materially prejudice the existing interest of a participant except with the prior consent of the participant.

**III New Prudential UK Savings Related Share Option Scheme (the SAYE Scheme)**

*(i) Administration*

The directors of New Prudential, or a duly authorised committee thereof, (the “Committee”) are responsible for the operation and administration of the SAYE Scheme, which is designed to obtain HMRC approval under the Income Tax (Earnings and Pensions) Act 2003.

*(ii) Eligibility*

All UK resident employees (including directors) of New Prudential, or any subsidiary nominated to join in the SAYE Scheme, who have completed a specified minimum period of service, will be eligible to apply for options.

*(iii) Options*

Options will entitle the holder to acquire ordinary shares of New Prudential. Options may be satisfied by the issue of new shares, the transfer of shares held in treasury or the purchase of shares in the market.

Options will be personal to the participant and may not be transferred.

*(iv) Exercise price*

The exercise price may not be less than an amount equal to 80% of the average of the closing middle-market quotations of a New Prudential Share, as derived from the Daily Official List of the London Stock Exchange, for such three consecutive dealing days as the Committee may select in the 30-day period (or, if applications have to be scaled down, the 42-day period) prior to the date of grant.

(v) *Savings contract*

As a condition of the grant of an option, an eligible employee must agree to enter into a savings contract with a bank or building society approved by the Committee under which the employee agrees to pay monthly contributions over a 3 or 5-year period and on the maturity of which a tax-free bonus is payable.

(vi) *Individual limit*

The aggregate maximum monthly contribution payable by an employee under all savings contracts linked to the SAYE Scheme may not exceed such sum as the Committee may determine, being not more than the amount from time to time permitted by the Income Tax (Earnings and Pensions) Act 2003 (currently, £250).

An option will be over such number of ordinary shares in New Prudential as has a total exercise price as nearly as possible equal to, but not exceeding, the amount repayable under the relevant savings contract on its maturity.

(vii) *Dilution limits*

The maximum number of new issue shares that may be allocated under the SAYE Scheme in any 10-year period must not, when added to the number of new issue shares allocated under all other employee share plans operated by Prudential or New Prudential, exceed 10% of the issued ordinary share capital of New Prudential from time to time.

While it remains best practice to do so, treasury shares will be treated as newly issued for the purposes of these limits.

Awards granted to participants under the Prudential Share Schemes in exchange for their awards under those plans will be treated as having been granted at the time when the awards which they replace were originally granted.

(viii) *Exercise of options*

Options will normally be exercisable in whole or in part during the period of six months starting on the maturity date of the related savings contract. A participant may also exercise his options within six months of reaching age 65.

Whenever an option is exercised, it may only be exercised to the extent of the amounts then repayable under the related savings contract (including any interest or bonus).

(ix) *Leaving employment*

If the participant leaves as a result of death, his personal representatives may exercise his options in the 12 months following his death or, if earlier, the maturity date of the related savings contract. If a participant ceases to be employed within the New Prudential group for a permitted reason, the participant may exercise his options in the six months following the termination of his employment. A permitted reason is: injury; ill-health; disability; redundancy; retirement at age 65 or at the age at which he is bound to retire in accordance with his terms of employment; the sale of the company or business in which the participant works; and, in the case of any option which the participant has held for at least three years, on a mutual termination of employment. If a participant ceases to be employed in any other circumstances, his option will lapse.

(x) *Change of Control*

The exercise of options will also be permitted in the event of a change of control including a change of control resulting from a restructuring, a scheme of arrangement pursuant to Part 26 of the Companies Act 2006 or a takeover or a voluntary winding up of New Prudential.

In the event of a change of control, participants may surrender their options in return for substitute options over shares in the acquiring company or another company. If, immediately following the change of control, not less than 75% of the shareholders of the acquiring company are the same as the shareholders of New Prudential before the change of control and the participants are offered or granted substitute options, the Committee may deem that unvested options are exchanged, unless the participant objects.

(xi) *Adjustments*

Options may be adjusted if there is a variation in the share capital of New Prudential such as a rights or bonus issue, that would affect the value of awards.

*(xii) Rights attaching to shares*

Shares allotted or transferred under the SAYE Scheme will rank equally with all other New Prudential Shares for the time being in issue (except for rights attaching to such shares by reference to a record date prior to the exercise of the award). New Prudential will apply for the listing of any new shares allotted under the SAYE Scheme.

*(xiii) Amendments*

The SAYE Scheme may at any time be altered by the Committee in any respect. However, any alterations to the rules governing eligibility, limits on participation and the number of shares available under the SAYE Scheme, terms of vesting and adjustment of awards for variations in share capital, which are to the advantage of participants must be approved in advance by the shareholders of New Prudential in general meeting unless the alteration or addition is minor in nature and/or made to benefit the administration of the SAYE Scheme, to comply with the provisions of any existing or proposed legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or New Prudential group companies.

The Committee shall not make any amendment that would materially prejudice the existing interest of a participant except with the prior consent of the participant.

**IV New Prudential Irish SAYE Scheme**

This scheme will apply for the benefit of employees working in the Republic of Ireland. Its provisions are substantially similar to those of the SAYE Scheme.

**V New Prudential International (Employees) SAYE Scheme**

This scheme will apply for the benefit of employees working outside the UK and the Republic of Ireland. Its provisions are substantially similar to those of the SAYE Scheme.

**VI New Prudential International (Non-Employees) SAYE Scheme**

This scheme will apply to incentivise and retain individuals, such as insurance agents, who are not employees of the New Prudential group but who are closely connected with this group. Its provisions are substantially similar to those of the SAYE Scheme save that options lapse when the participant's contract for services ends unless the Committee in its absolute discretion decides otherwise, when the Board may decide the terms on which the options may be exercised.

**VII New Prudential Share Incentive Plan (SIP)**

*(i) Administration*

The Board or an authorised committee thereof, (the "Committee") is responsible for the operation and administration of the SIP.

*(ii) Eligibility*

All UK resident employees (including directors) of New Prudential, and any subsidiary nominated to participate in the SIP, who have completed a specified minimum period of service will be eligible to participate in the SIP. Other employees may be invited to participate in the SIP at the discretion of the directors of New Prudential or duly authorised committee thereof.

*(iii) Constitution*

The SIP will be constituted by a trust deed.

*(iv) Operation of the Plan*

On any occasion on which the Committee decides to operate the SIP, it may be operated on one or more of the following bases:

*(a) as a Free Plan;*

*(b) as a Partnership Plan; and*

*(c) as a Matching Plan.*

(v) *Free Plan*

The employing companies will provide the trustees with funds to enable them to subscribe for and/or purchase ordinary shares in New Prudential which will then be allocated to the eligible employees. The maximum individual allocation of Shares under the Free Plan (“**Free Shares**”) in any tax year will be the limit from time to time specified by the Income Tax (Earnings and Pensions) Act 2003 (currently, £3,000).

Any allocation of Free Shares must be made on similar terms; however, the allocation can be linked to remuneration, length of service, number of hours worked, or to such individual, team, divisional or corporate performance as the Committee may decide. The performance targets set for each unit must be broadly comparable and must not contain any features which have the effect of concentrating the awards on directors or higher-paid employees.

Free Shares must be held by the trustees for a minimum period of three years or for such longer period not exceeding five years as the Committee may decide. If a participant ceases to be employed within the New Prudential group, his Free Shares must be withdrawn from the trust. If the shares are withdrawn from the trust before the end of the 5-year period, the participant may incur an income tax and national insurance liability.

If the participant ceases to be employed within the minimum 3-year period (or within such shorter period as the Committee may decide) otherwise than in certain specified circumstances such as redundancy or disability, the Committee may provide that his Free Shares will be forfeited.

(vi) *Partnership Plan*

Under the Partnership Plan, an eligible employee may enter into an agreement with New Prudential to allocate part of his pre-tax salary each year to subscribe for and/or purchase Shares (“**Partnership Shares**”). The maximum allocation may not exceed that from time to time permitted by the Income Tax (Earnings and Pensions) Act 2003 (currently, £1,500). The agreement may provide for the Partnership Shares to be bought within 30 days of the day on which the deduction is made. Alternatively, the agreement may provide for the deductions to be accumulated for a period (not exceeding 12 months) and for the Partnership Shares to be bought within 30 days of the end of that period.

A participant may withdraw his Partnership Shares at any time and must do so on ceasing to be employed within the New Prudential group but, if he does so before the Partnership Shares have been held in the trust for five years, he may incur an income tax and national insurance liability.

(vii) *Matching Plan*

If the Committee decides to operate the Partnership Plan in any period, it may also decide to operate the Matching Plan in the same period. Under the Matching Plan, the employing companies will provide the trustees with funds to enable them to subscribe for and/or purchase Shares (“**Matching Shares**”) which will then be allocated to the eligible employees who have purchased Partnership Shares up to the maximum from time to time permitted by the Income Tax (Earnings and Pensions) Act 2003.

Matching Shares must be held by the trustees for a minimum period of three years or for such longer period not exceeding five years as the Committee may decide. If a participant ceases to be employed within the New Prudential group, his Matching Shares must be withdrawn from the trust. If the shares are withdrawn from the trust before the end of the 5-year period, the participant may incur an income tax liability and national insurance.

If the participant ceases to be employed within the minimum 3-year period (or within such shorter period as the Committee may decide) other than for a specified reason such as redundancy or disability or withdraws his Partnership Shares from the trust before the end of the minimum 3-year period, the Committee may provide that his Matching Shares will be forfeited.

(viii) *Subscription price*

The subscription price of any Free or Matching Shares issued will be the greater of the nominal value of the share on the date of subscription and the market value of a share. The subscription price for Partnership Shares will be the market value at the date of subscription or, if there is an accumulation period, the market value at the start of the period, if lower.

*(ix) Dilution limits*

The maximum number of new issue shares that may be allocated under the SIP in any 10-year period must not, when added to the number of new issue shares allocated under all other employee share plans operated by Prudential or New Prudential, exceed 10% of the issued ordinary share capital of New Prudential from time to time.

While it remains best practice to do so, treasury shares will be treated as newly issued for the purposes of these limits.

Awards granted to participants under the Prudential Share Schemes in exchange for their awards under those plans will be treated as having been granted at the time when the awards which they replace were originally granted.

*(x) Leaving employment*

If a participant ceases to be an eligible employee the trustees shall transfer to the participant any shares held by the trustee or if the participant so directs, dispose of the shares and account for proceeds of the sale to the participant.

*(xi) Dividends*

Any dividends paid on the Free, Partnership or Matching Shares will, subject to a specified limit, be paid or re-invested in the purchase of additional shares in New Prudential, unless otherwise directed by the Committee.

*(xii) Voting rights*

The trustees of the SIP will not exercise the voting rights attributable to the shares held in the trust except in accordance with the participant's instructions.

*(xiii) Change of Control*

In the event of a general offer being made to the shareholders of New Prudential or a rights or capitalisation issue, participants will be able to direct the trustees how to act on their behalf.

*(xiv) Listing*

New Prudential will apply for any shares issued pursuant to the SIP to be admitted to the Official List and for permission to trade in those shares. Shares issued under the SIP will rank equally in all respect with existing New Prudential Shares except for rights attaching to shares by reference to a record date prior to the date of allotment.

*(xv) Benefits non-pensionable*

Benefits under the SIP will not form part of a participant's remuneration for pension purposes.

*(xvi) Amendments*

The Committee may amend the SIP, or the terms of awards, to take account of changes to any applicable legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or for any company in the New Prudential group.

Except as described above no amendment which is to the advantage of employees or participants may be made, without the prior approval of the shareholders of New Prudential in general meeting, to those provisions dealing with eligibility, individual or eligible employees scheme limits, determination of price, rights attaching to shares acquired under the SIP, the rights of participants on winding up, the terms of awards, the adjustment of awards or the power of amendment.

**VIII M&G Executive Long Term Incentive Plan 2010 (the M&G 2010 LTIP)**

*(i) Administration*

The Remuneration Committee of New Prudential or any other duly authorised committee (the "Committee") is responsible for the operation and administration of the M&G 2010 LTIP.

*(ii) Eligibility*

All directors and employees of M&G or any member of the New Prudential group who are not under notice of termination of employment or directorship are eligible to participate in the M&G 2010 LTIP.

*(iii) Awards*

Awards of phantom shares are granted in the absolute discretion of the Committee. The amount of any payment due under any award will be determined by reference to M&G's operating profits and fund investment performance, over a performance period of three financial years, with usually a notional starting share price of £1.00 per phantom share.

Each year, the number of phantom shares to be awarded will depend on the performance of M&G in the financial year prior to the award being made and an assessment of each participant's contribution. Thus the award to be made in 2011 will be related to the business performance in 2010.

Awards will normally be paid out shortly after the announcement of results for the final year of the performance period. The amount of the payout is based on the sustained performance of M&G both in terms of appropriate levels of profitability and maintaining strong fund investment performance.

At the end of the three year performance period, the value of the phantom shares awarded is based on the IFRS profits achieved at the end of the 3-year period. The number of phantom shares subject to the award will be adjusted at the end of the performance period to take account of the performance of M&G both in terms of profitability and maintaining strong investment performance as follows:

*(iv) Profit growth*

- Awards will be scaled back based on profit performance achieved if profits in the third year are less than the average of the profits in the years prior to and over the performance period.
- The scaling back will be on a straight-line basis from zero % to 100% of the award between zero profit and the achievement of profits equal to the average.
- No award will vest in the event of a loss or zero profit, irrespective of fund performance.
- No adjustment will be made if the profits at the end of the third year are at least equal to the average of the profits in the years prior to and over the performance period.

*(v) Investment performance*

- Where investment performance over the three year performance period is in the top two quartiles the number of phantom shares vesting will be enhanced. A sliding scale will apply up to 200% of the annual award, which is awarded when top quartile performance is reached.
- Awards will be forfeited if investment performance is in the fourth quartile, irrespective of any performance growth.

No benefits under the plan are pensionable and awards cannot be transferred except on death.

*(vi) Adjustments*

The Committee may make adjustments to the terms of awards if there are changes in accounting policy, there is a merger or demerger or disposal of all or part of the M&G business, if anybody obtains control of M&G or New Prudential or following any other change in M&G's structure that has a material impact on the value of awards.

*(vii) Leaving employment*

If a participant leaves the New Prudential group, the award will normally be forfeited unless he or she leaves because of death, disability or for reasons attributable to a change of control (as defined below) within 12 months of the change of control. In these circumstances, the award would be paid out immediately but would be pro-rated based on the number of days the participant was employed compared with the total number of days in the performance period. The amount of the payment would be as described above but based on operating profits for complete financial years only and fund investment performance at the end of the previous financial year.

If a participant leaves for any other reasons, the Committee may, in its discretion decide that the award will be carried forward or paid out early. The Committee will determine the amount of any early payment taking account of the performance of M&G and the method which is used for determining payouts for other good leavers.

*(viii) Change of control*

In the event of a change of control of New Prudential, the award will normally remain in place and the payment at the end of the normal 3-year period will be underpinned by the payment which would have been made if operating profits had been as projected by the most recently adopted M&G business plan prior to the change of control. The Committee may determine in its absolute discretion that the award vests taking into account performance and prorating for time as appropriate.

For these purposes, a change of control also includes a sale of the participant's employer outside the New Prudential group.

*(ix) Amendments*

The plan may at any time be altered by the Committee in any respect. However, any alteration to the rules governing eligibility, limits on participation, the basis on which payouts are made and adjustments to awards which are to the advantage of participants must be approved in advance by the shareholders of New Prudential in general meeting unless the alteration or addition is minor in nature and/or is made to benefit the administration of the plan, to comply with the provisions of existing or proposed legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or members of the New Prudential group.

**IX New Prudential Europe Share Participation Plan (ESPP)**

*(i) Administration*

The Board, or a duly constituted committee thereof, (the "Committee") is responsible for the operation and administration of the ESPP.

*(ii) Eligibility*

All Irish resident employees, including full time directors of New Prudential and its participating subsidiaries who have not less than three months continuous service are eligible to participate in the ESPP in any year in which it is operated. Other employees may be eligible to participate in the ESPP at the Committee's discretion.

*(iii) Constitution*

The ESPP will be constituted by a trust deed.

*(iv) Limitations*

The maximum number of shares that may be allocated to any one participant in any year shall be determined by the relevant Irish legislation for the time being in-force.

*(v) Operation of the Plan*

On any occasion on which the Committee decides to operate the ESPP, it will decide the allocation basis, i.e; the manner in which eligible employees may participate, the amount of funds that may be made available to the ESPP by the participating employers, the basis on which those funds will be made available and the allocation amongst the participants of the ordinary shares of New Prudential acquired with the contributions.

The ESPP sets out different bases of allocations which can be used at the discretion of the Committee. In all cases the Taxes Consolidation Act 1997 provides that the basis of allocation must satisfy the requirements of the Irish Revenue Commissioners for similar terms treatment for all participants. Shares can be acquired from company contributions and from employees' salary foregone funds.

The trustees will apply the amounts received by them in acquiring ordinary shares in New Prudential for allocation amongst the participants. The trustees (as directed by the Committee) will acquire the shares.

Shares allocated to a participant will be held by the trustees for a minimum period of two years from the date of allocation or for such other period as specified by the Irish Taxes Consolidation Act 1997, during which period they may not be sold or dealt in except on the death of the participant, the attainment of pensionable age (as defined in section 2 of the Irish Social Welfare (Consolidation) Act 2005) or the termination of employment by reason of injury, disability or redundancy.

Shares must be held within the ESPP for three years, or for such other period as may be specified by the Irish Taxes Consolidation Act 1997, in order to be released to participants free of income tax.

(vi) *Dividends*

While a participant's shares remain held by the trustees, he will receive any dividends paid on those shares.

(vii) *Voting rights*

The participant may direct the trustees how to exercise the voting rights attaching to his shares while they are held in trust. The trustees will not exercise those voting rights except in accordance with the participant's instructions.

(viii) *Change of control, reorganisations etc*

In the event of a general offer being made to the shareowners or a rights or capitalisation issue, participants will be able to direct the trustees how to act on their behalf.

(ix) *Amendments*

The ESPP may at any time be altered by the Committee, provided that no amendment shall: alter to the disadvantage of a participant his rights in respect of shares under the ESPP; result in the ESPP ceasing to be approved by the Irish Revenue Commissioners; or take effect unless the prior written approval from the Irish Revenue Commissioners has been obtained.

## **X New Prudential Share Option Plan ("SOP")**

(i) *Administration*

Options under the SOP may be granted by the Board, or a duly authorised committee thereof (the "Committee") on behalf of New Prudential, the trustees of the plan or a Subsidiary. In the remainder of this summary, the term "the Grantor" will refer to the administering body that is responsible for the appropriate award. Where the Grantor is not the Committee the terms of any option must be approved in advance by the Committee.

(ii) *Eligibility*

Any employee of the New Prudential group will be eligible to participate in the plan at the discretion of the Committee.

(iii) *Grant of Options*

Options may be granted at any time after approval of the plan. However, at all times the grant of options will be subject to the terms of the Model Code for transactions in securities by directors and New Prudential's share dealing rules. No options may be granted later than 10 years after the adoption of the SOP. The option price may not be less than the closing price on the day preceding the date of grant taken from the Official List.

Options are non-transferable and will be not be pensionable. No payment will be required for the grant of an option.

(iv) *Performance Conditions*

The vesting of an option and the extent to which it vests may be subject to the satisfaction of any objective performance targets and any other conditions set by the Grantor at the time of the grant. The performance conditions may be varied (or waived) in certain circumstances following the grant of an option in a way which is intended to be reasonable in the circumstances and to produce a fairer measure of performance and is not materially more or less difficult to satisfy (except in the case of a waiver).

An option will generally vest no earlier than 3 years from the date of grant and must be exercised within 10 years (or such shorter period as the Committee may determine).

(v) *Individual Limits*

An option will not be granted to an individual if it will cause the aggregate market value of: the shares subject to that option, the shares which they may acquire on exercising other options and the shares which they may acquire on exercising options under any other HMRC approved discretionary scheme established by any member of the New Prudential group, to exceed the amount permitted by statute (currently £30,000).

(vi) *Dilution Limits*

The maximum number of new issue shares that may be allocated under the SOP must not exceed in any 10 year period when added to the number of new issue shares allocated under all other employee share plans operated by New Prudential or Prudential, 10% of the issued ordinary share capital of New Prudential from time to time.

While it remains best practice to do, treasury shares will be treated as newly issued for the purposes of these limits. Awards granted to participants under the Old Share Plans in exchange for their awards under those plans will be treated as having been granted at the time when the awards which they replaced were originally granted.

(vii) *Leaving Employment*

A participant's options will lapse if the optionholder ceases to be employed within the New Prudential group.

(viii) *Rights Attaching to Shares*

Shares issued or transferred under the SOP will rank equally with all other New Prudential Shares for the time being in issue (except for rights attaching to such shares by reference to a record date prior to the date of such issue or transfer). New Prudential will apply for the listing of any new shares allotted under the SOP, if and so long as New Prudential Shares are listed on the Official List and traded on the London Stock Exchange.

(ix) *Change of Control*

In the event of a change of control of New Prudential the options under the SOP may be exchanged for new options. If options are not exchanged then they will become exercisable to the extent that the relevant performance targets have been satisfied at the date of the change of control but only on a time pro rated basis (unless the Committee decides otherwise).

(x) *Variations in Share Capital*

Options may be adjusted if there is a variation in the share capital of New Prudential such as a capitalisation issue, a rights issue, a rights offer or bonus issue and a sub-division, consolidation or reduction in the capital of New Prudential.

(xi) *Amendments*

The plan rules may from time to time be amended by the Committee but any change to a key feature of the SOP will need to be approved by HMRC. The provisions relating to eligibility, limits on the number or amount of the shares subject to the scheme, the maximum entitlement for any one participant and the basis for determining a participant's entitlement to shares and for the adjustment of such entitlements if there is any variation in the share capital cannot be altered to the advantage of participants without the prior approval of shareholders in general meeting except for minor amendments to benefit the administration of the scheme, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or for any member of the New Prudential group.

## **XI Momentum Retention Plan**

(i) *Administration*

The plan will be operated and administrated by a committee (including Directors) or persons appointed for the purposes of administering the plan (the "**Committee**").

(ii) *Eligibility*

Employees who are participants in the Momentum development programme are eligible to participate in the plan.

(iii) *Grant of awards*

Participants in the plan may receive an award of deferred shares or phantom shares which will be settled in cash. For the deferred shares awards/phantom awards half of the shares will be released 4 years from the award date, and the other half will be released 7 years from the award date.

Awards are not pensionable and cannot be transferred except on death.

*(iv) Leaving employment*

A participant's awards will lapse if the participant leaves the New Prudential group before the shares are released or ceases to participate in the Momentum development programme. However, the Committee may decide that some or all of the award will continue or will be released after termination of the participant's employment or ceasing to participate in the programme (or vest on such event) in the following circumstances: illness, injury, the company or business in which the employee works being transferred out of the New Prudential group, disability and death.

*(v) Change of control or reconstruction*

In the event of a change of control of New Prudential as a result of a takeover, or a reconstruction or winding up of New Prudential, the awards will be exchanged for new awards in the acquiring Company on a comparable basis. Alternatively, the Committee may, at its discretion, determine the extent to which awards will be released.

*(vi) Adjustments*

Awards may be adjusted by the Committee if there is a variation in the share capital or reserves of New Prudential (such as a capitalisation or rights issue or any consolidation, sub-division or reduction), or the implementation by New Prudential of a demerger or a special dividend.

*(vii) Rights attaching to shares*

Until the release date a participant shall not have any beneficial ownership of shares which are subject to the award, and will not have any right to any dividends or voting rights attached to the shares.

*(viii) Dilution Limits*

The maximum number of new issue shares which may be allocated under the plan in any 10-year period must not when added to the number of new issue shares allocated under all other employee share plans operated by Prudential or New Prudential exceed 10% of the issued ordinary share capital of New Prudential from time to time.

While it remains best practice to do so, treasury shares will be treated as newly issued for the purposes of these limits. Awards granted to participants under the Old Share Plans in exchange for their awards under those terms will be treated as been granted at the time when the awards which they replaced were originally granted.

*(ix) Amendments*

The plan may be altered at any time in any respect. However, any alterations to the rules which govern eligibility, limits on participation and the number of shares available under the plan, the terms of vesting and adjustments of awards for variations in the share capital which are to the advantage of participants must be approved in advance by the shareholders of New Prudential in general meeting unless the alteration or addition is minor in nature and/or made to benefit the administration of the plan, to comply with the provisions of any existing or proposed legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or New Prudential group companies.

## **8. Pension plans**

The Prudential Group operates a number of pension schemes. The majority of these are defined contribution plans with a small number of defined benefit plans.

### ***Defined benefit plans***

The specific features of the defined benefit plans vary in accordance with the regulations of the country in which the plan operates. Three of the plans are based in the UK. These are, in general, funded wholly by the Prudential Group and based on a formula using years of service and salary earned in the last year or years of employment.

The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS), 86% (2008: 87%) of the underlying scheme liabilities of the Prudential Group defined benefit schemes are accounted for within PSPS.

The Prudential Group also operates two smaller defined benefit schemes for UK employees who were employed by the Scottish Amicable business prior to its acquisition by Prudential and for M&G employees who were employed by M&G prior to its acquisition by Prudential.

Defined benefit schemes in the UK are required to be subject to full actuarial valuation at least every three years in order to assess the appropriate level of funding for schemes in relation to their liabilities. These valuations include assessments of the likely rate of return on the assets held within the separate trustee administered funds. For all three schemes the projected unit method was used for the most recent full actuarial valuations.

PSPS was last actuarially valued as at 5 April 2008 by the external scheme actuary Towers Watson (previously known as Watson Wyatt). This valuation demonstrated the scheme to be 106% funded by reference to the Scheme Solvency Target that forms the basis of the scheme's statutory funding objective. Accordingly, the total contributions to be made by the Prudential Group into the scheme were reduced from the previous arrangement of £75 million per annum to £50 million per annum effective from July 2009. As the scheme was in a surplus position at the valuation date, no formal recovery plan was required.

The £50 million contribution is made up of £25 million per annum employer's contributions for ongoing service of current employees, and £25 million per annum to recognise that there had been significant deterioration in the value of the scheme assets between 5 April 2008 and 31 March 2009 the date of the finalisation of the valuation. Any contributions are subject to a reassessment when the next valuation (5 April 2011) is completed. The additional funding is akin to deficit funding. Deficit funding for PSPS is apportioned in the ratio of 70/30 between the PAC life fund and shareholder-backed operations following detailed consideration in 2005 of the sourcing of previous contributions. Employer contributions for ongoing service of current employees are apportioned in the ratio relevant to current activity. In 2009 total contributions for the year including expenses and augmentations were £67 million (2008: £79 million). The market value of scheme assets as at 5 April 2008 was £4,759 million. The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the purposes of valuation were as follows:

	<u>%</u>
Rate of increase in salaries . . . . .	Nil
Rate of inflation . . . . .	3.5
Rate of increase of pensions in payment for inflation:	
Guaranteed (maximum 5%) . . . . .	3.5
Guaranteed (maximum 2.5%)† . . . . .	2.5
Discretionary . . . . .	Nil
Expected returns on plan assets . . . . .	4.55

#### *Mortality assumptions*

The tables used for PSPS pensions in payment at 5 April 2008 were:  
Base post retirement mortality:

For current male (female) pensioners 108.6% (103.4%) of the mortality rates of the 2000 series mortality tables, published by the Continuous Mortality Investigation Bureau. For male (female) non-pensioners 113.4% (97.4%) of the 2000 series rates.

Allowance for future improvements to post retirement mortality:

For males (females) 100% (75%) of Medium Cohort subject to a minimum rate of improvement of 1.75% (1%) up to the age of 90, decreasing linearly to zero by age of 120.

The valuation of the Scottish Amicable Pension Scheme as at 31 March 2008 demonstrated the scheme to be 91% funded, with a shortfall of actuarially determined liabilities of 9%, representing a deficit of £38 million. This valuation was performed by the external actuaries Xafinity. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a 7 year period were made from July 2009 of £7.3 million per annum, which has been allocated 50% to the PAC with-profits fund and 50% to the PAC shareholders fund.

The valuation of the M&G Pension Scheme as at 31 December 2008 was finalised in January 2010. The valuation demonstrated the scheme to be 76% funded, with a shortfall of actuarially determined assets to liabilities of £51 million. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a 5 year period were made from January 2010 of £14.1 million per annum for the first two years and £9.3 million per annum for the subsequent three years.

All three UK defined benefit plans were closed to new members prior to or during 2003.

There is also a small defined benefit scheme in Taiwan, but as part of the sale of the Taiwan agency business completed in June 2009, the Prudential Group settled the majority of the obligations under the scheme as a significant number of employees transferred out of the scheme.

### Defined contribution plans

The Prudential Group operates a number of defined contribution schemes/pensions savings plans. These include schemes in the UK for employees employed after August 2003 (defined contribution section of the PSPS plan) and in Jackson and Asia. The cost of the Prudential Group's contributions for continuing operations to these schemes in 2009 was £38 million.

### Directors' pensions and life assurance

Prudential's current practice in respect of pension arrangements for the current executive Directors is set out below.

Michael McLintock participates in a contributory scheme that provides a target pension of 2/3rds of Final Pensionable Earnings on a retirement at age 60 for an employee with 30 years or more potential service, for which his contribution is 4% of basic salary. In both cases Final Pensionable Earnings are capped by a notional scheme earnings cap which replicates the HMRC earnings cap in-force before A-Day (6 April 2006). Michael McLintock is entitled to supplements based on the portion of his basic salary not covered for pension benefits under a HMRC approved scheme. He is also provided with life assurance cover of four times salary.

Clark Manning participates in a US tax-qualified defined contribution plan (a 401K plan). He is also provided with life assurance cover of two times salary. Company matching contributions of 6% of basic salary up to a maximum of \$14,700 were made in 2009. In addition, an annual profit sharing contribution of \$14,700 was made in 2009.

Rob Devey, Nic Nicandrou, Tidjane Thiam and Barry Stowe are entitled to a total salary supplement of 25% of basic salary. They are all provided with life assurance cover of four times salary. All these executive Directors, except Barry Stowe, were members of the staff defined contribution pension plan as at 31 December 2009.

Where supplements for long term saving and pension purposes are paid in cash, the amounts are included in the Directors' remuneration tables in section 6.

Details of Directors' pension entitlements under HMRC approved defined benefit schemes are set out in the following table.

	Age at 31 Dec 2009	Years of pensionable service at 31 Dec 2009	Accrued benefit at 31 Dec 2009	Additional pension earned during year ended 31 Dec 2009		Transfer value of accrued benefit at 31 Dec <sup>(3)</sup>		Amount of (B - A) less contributions made by directors during 2009	Contributions to pension and life assurance arrangements <sup>(4)</sup>
				£000	£000	2009	2008		
Michael McLintock . . . . .	48	17	47	5	5	755	426	329 (note 5)	89

1. As required by the Listing Rules.
2. As required by the Companies Act remuneration regulations.
3. The transfer value equivalent has been calculated in accordance with Actuarial Guidance Note GN11.
4. Supplements in the form of cash are included in the Directors' remuneration table in section 6.
5. A number of factors operating together have resulted in the increase in transfer value over the year. This includes increases due to changes in market conditions from inflation rates rising and interest rates falling, an extra year of service accruing, an increase in the HMRC earnings cap and Michael drawing one year closer to retirement.

No enhancements to the retirement benefits paid to or receivable by Directors or former Directors other than the discretionary pension increases awarded to all pensioners have been made during the year.

Total contributions to Directors' pension arrangements including cash supplements for pension purposes were £876,466 (2008: £1,027,267) of which £298,586 (2008: £268,668) related to money purchase schemes.

## 9. Interests of persons involved

Ann Godbehere is a non-executive director of UBS AG, the parent company of the UBS Group. UBS Limited is a member of the underwriting syndicate formed by the Underwriters in respect of the Rights Issue.

Save as disclosed in this section and otherwise in this document, no person involved in the Rights Issue had an interest which was material to the Rights Issue.

## 10. Principal subsidiaries and associated undertakings

### Prior to the Acquisition and Scheme — Prudential

Prudential is the holding company of all the companies in the Prudential Group and its assets substantially comprise shares in and loans to such companies. It does not conduct any other business and is accordingly dependent on the other members of the Prudential Group and revenues received from them. The following table shows the principal operating subsidiaries of Prudential, being those which are considered by Prudential to be most likely to have a significant effect on the assessment of the assets and liabilities, financial position or profits and losses of Prudential:

	<u>Date of Incorporation</u>	<u>Country of incorporation</u>	<u>Principal Activity</u>	<u>Issued Share Capital</u>	<u>Proportionate Holding</u>
The Prudential Assurance Company Limited . . . . .	1 June 1881	England and Wales	Insurance	970,468,254 ordinary shares of 25p 347,600,000 B preference share of 25p 1,000,000 A preference shares of £1	100%
Prudential Annuities Limited* . . . . .	1 November 1990	England and Wales	Insurance	550,000,000 ordinary shares of £1	100%
Prudential Retirement Income Limited (PRIL)* . . . . .	17 August 1970	Scotland	Insurance	837,700,000 ordinary shares of £1 20,000,000 preference shares of £1	100%
M&G Investment Management Limited* . . . . .	5 August 1968	England and Wales	Asset management	9,350,000 ordinary shares of £1	100%
Jackson National Life Insurance Company* . . . . .	19 June 1961	US	Insurance	12,000,000 common stock of US\$1.15	100%
Prudential Assurance Company Singapore* (Pte) Limited . . . . .	24 May 1990	Singapore	Insurance	34,644,000 ordinary shares of SGD1	100%

\* Owned by a subsidiary undertaking of Prudential

Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation, except for PRIL which operates mainly in England and Wales.

The following table shows the principal operating subsidiaries of AIA, being those which are considered by Prudential to be most likely to have a significant effect on the assessment of the assets and liabilities, financial position or profits and losses of AIA, prior to the Acquisition.

	<u>Country of Incorporation</u>	<u>Principal Activity</u>	<u>Proportionate Holding</u>
AIA Co . . . . .	Hong Kong	Insurance	100%
American International Assurance Company (Bermuda) Limited . . . . .	Bermuda	Insurance	100%
American International Assurance Company (Australia) Limited . . . . .	Australia	Insurance	100%
AIA Pension and Trustee Company Limited . . . . .	British Virgin Islands	Trusteeship	100%
American International Assurance Berhad . . . . .	Malaysia	Insurance	100%
PT AIA Financial . . . . .	Indonesia	Insurance	100%
PT Asuransi AIA Indonesia <sup>(1)</sup> . . . . .	Indonesia	Insurance	100%
The Philippine American Life & General Insurance Company . . . . .	Philippines	Insurance	99.78%
AIG Life Insurance (Vietnam) Company Limited . . . . .	Vietnam	Insurance	100%
Grand Design Development Limited . . . . .	British Virgin Islands	Investment holding company	100%
Bayshore Development Group Limited . . . . .	British Virgin Islands	Investment holding company	90%
BPI-Philam Life Assurance Corporation (formerly known as Ayala Life Assurance Inc.) . . . . .	Philippines	Insurance	51%

(1) Disposed of during 2009

### *After Acquisition and Scheme:*

Upon the completion of the Acquisition and the Scheme becoming effective, New Prudential will become the parent company of the Enlarged Group. Companies which will be New Prudential's principal subsidiaries and associated undertakings are those which are considered by Prudential to be most likely to have a significant effect on the assessment of the assets and liabilities, financial position or profits and losses of New Prudential:

	<u>Country of Incorporation</u>	<u>Principal Activity</u>	<u>Proportionate Holding</u>
Prudential . . . . .	England and Wales	Holding Company	100%
AIA . . . . .	Hong Kong	Holding Company	100%

These subsidiaries will be directly held by New Prudential. All other subsidiaries of Prudential and AIA listed above will be held indirectly.

### **11. Effects of the Scheme on debt financing**

Following the Scheme, under certain capital securities and subordinated debt, some adjustments to the alternative coupon satisfaction mechanism ("ACSM") will be required in order to provide for the payment of deferred interest to the holders of the capital securities or subordinated debt in amounts not less than the holders would have received had the Scheme not taken place.

### **12. Related party transactions**

Related party transactions of the Prudential Group during the last three financial years are as disclosed in accordance with IFRS in note I6 to the Prudential consolidated financial information contained in Part XIV of this prospectus. The nature of the related party transactions of the Prudential Group has not changed since 31 December 2009 up to the date of this prospectus from those described in the aforementioned note I6. There have been no other related party transactions requiring disclosure under IFRS since 31 December 2009 up to the date of this prospectus.

Related party transactions of the AIA Group during the last three financial years are as disclosed in accordance with IFRS in Note 41 to the AIA historical financial information contained in this prospectus. Save as described at section 12 of Part VII of this prospectus, the nature of the related party transactions of the AIA Group has not changed since 30 November 2009 up to the date of this prospectus from those described in the aforementioned note 41 and there have been no other related party transaction requiring disclosure under IFRS since 30 November 2009 up to the date of this prospectus.

### **13. Major shareholders**

As far as is known to Prudential by virtue of the notifications made pursuant to the Disclosure and Transparency Rules, the only substantial holders of Prudential, who, directly or indirectly, were interested in 3% or more of Prudential's ordinary share capital as at 14 May 2010 (the latest practicable date prior to the publication of this prospectus, were:

<u>Shareholder</u>	<u>Interest</u>
Norges Bank . . . . .	3.08%
Legal and General Group Plc . . . . .	4.03%
BlackRock, Inc. . . . .	6.39%
Capital Research and Management Company . . . . .	12.04%

Following completion of the Transactions, it is expected that AIA Aurora will hold approximately 10.9% of New Prudential Shares (subject to adjustments for, inter alia, further issues of Prudential Shares or New Prudential Shares in the period prior to completion of the Acquisition) as described in Part V of this prospectus.

Save as disclosed above, as at 14 May 2010 (being the latest practicable date prior to the publication of this prospectus), Prudential is not aware of any person who is, or will be, immediately following the Rights Issue, directly or indirectly, interested in 3% or more of Prudential.

As at 14 May 2010, being the latest practicable date prior to the publication of this prospectus, Prudential is not aware of any person who, as at the date of this prospectus, directly or indirectly, acting jointly or with others or acting alone, could exercise control over Prudential. None of the major shareholders has different voting rights from Prudential's ordinary shareholders.

## 14. Property, plant and equipment

### *Description of Property — Corporate Property*

As at 31 December, 2009, Prudential's UK headquartered businesses occupied approximately 35 properties in the United Kingdom, Europe, India, South Africa and Namibia. These properties are primarily offices with some ancillary storage and warehouse facilities. Prudential's global headquarters are located in London. Of the remainder, the most significant are offices in London and Reading in England, Stirling in Scotland and Mumbai in India. The property in Stirling is held on a freehold basis, and is leased by the business from PAC's long-term fund. The rest of the properties occupied by Prudential's UK based businesses, in the UK, India, South Africa and Namibia, are held leasehold. In Europe, five of the properties are occupied leasehold and the rest (3) are short term serviced offices. The leasehold properties range in size from 500 to 160,000 sq ft Overall, the UK, Europe, Mumbai, South Africa and Namibia occupied property portfolio totals approximately 650,000 sq ft.

In addition to these properties, the Prudential Group owns the freehold of a sports facility in Reading for the benefit of staff.

The Prudential Group also holds approximately 74 other leasehold properties in the United Kingdom, spread geographically throughout the country. There are also 3 in Dublin, Ireland. This surplus accommodation totals approximately 740,000 sq ft.

In the United States, the Prudential Group owns Jackson National Life's executive and principal administrative office located in Michigan. The Prudential Group owns a total of six facilities in Lansing, Michigan, which total 550,842 sq ft. The Prudential Group also leases premises in Michigan, Colorado, California, Illinois, New York, New Jersey, Georgia, Florida, Wisconsin, Massachusetts, Connecticut, New Hampshire, Pennsylvania, Virginia, Indiana and North Dakota for certain of its operations. The Prudential Group holds 30 operating leases with respect to office space, throughout the United States. The leasehold properties range in size from 500 — 180,000 sq ft. In the United States, the Prudential Group owns and leases a total of approximately 872,584 sq ft of property. In addition to the owned and leased properties, the Prudential Group also owns a total of 238 acres of surplus land. This property is all located in Lansing, Michigan.

In Asia, the Prudential Group owns or leases properties principally in Hong Kong, Singapore, Malaysia, Indonesia, Thailand, Philippines, China (JV), Taiwan, Japan, Vietnam, India (JV) and Korea. Within these countries, the Prudential Group owns 24 property assets, ranging from office space, warehouse storage units to land holdings. The breakdown of these owned assets by country is as follows:

Malaysia: six owned assets — All office space totalling 12,315 sq ft

Philippines: two owned assets — All office space totalling 4,278 sq ft

Singapore: one owned asset — All office space totalling 11,883 sq ft

Thailand: 11 owned assets — All land holdings totalling 73,832 sq ft

Taiwan: four owned assets — All office space totalling 12,989 sq ft

The Prudential Group also has (excluding India), a total of 539 operating leases, (expense and intercompany leases), totalling approximately 4.8 million sq ft of property.

In India, the Prudential Group holds a minority stake in a joint venture with ICICI who hold the property interests. The property is occupied by the ICICIPruLife and ICICIPru AMC businesses. The holding comprises approximately 2,450 properties, totalling approximately 3.5 million sq ft. There is one owned and occupied asset comprising approximately 30,000 sq ft in Mumbai. Prudential Corporation Asia's real estate strategy moving forward involves consolidation of its existing property portfolio to take advantage of the downturn in regional and global markets securing cost savings to the business while maintaining competitive advantage.

The total value of the Prudential Group's owner occupied properties, discussed in the narrative above and as reported in the financial information, is £153 million as at 31 December 2009. This represents less than 0.1% of the Prudential Group's total assets.

Post 31 December 2009, the following two agreements have been approved and either have been or are expected to be completed in due course. The first agreement covers the lease of a property in Tennessee in the United States, which is required to provide additional space to accommodate expansion and an Eastern region sales desk. The initial lease will run for a period of 10 years and 6 months, commencing in January 2011, based on an initial occupancy of 90,000 sq ft. This occupancy will be increased to 150,000 sq ft in a phased approach as headcount increases. The second agreement is in respect of the lease of a property in Singapore, with the purpose of allowing the relocation of six other separate office functions to a single location. The leased office space consists of 37,000 sq ft with the lease commencing in 2011 and having an initial 9 year term.

The characteristics of the agreements mean that both of these leases will be accounted for as operating leases.

There have been no other property transactions subsequent to 31 December 2009 which would have a material impact on the financial position of the Prudential Group.

Prudential believes that its facilities are adequate for its present needs in all material respects. Prudential confirms that the Prudential Group's owner occupied properties and leased properties are individually and collectively not crucial and material to its operations, and that the Prudential Group's operating leases have no material commercial value.

As set out above, the Prudential Group owns 31 properties which the Prudential Group also occupies, which are accounted for as owner occupied property. These properties are comprised of 24 in Asia, 1 in the UK and 6 in the US. The total value of the Prudential Group's owner occupied properties at 31 December 2009 was £153 million. This represents less than 0.1% of the Prudential Group total assets.

The Prudential Group also holds interests in properties within its investment portfolios accounted for as investment property. At 31 December 2009 the total value of investment property was £10,905 million and was comprised 592 properties held by the UK, 6 held by the US and 5 held by the Asia business. In total they comprise 4.8% of the Prudential Group's total assets. The UK business' holdings account for over 98% by value of the total investment property.

The Prudential Group is the lessee under 600 operating leases used as office accommodation, comprised of 539 leases held by the Asia, 30 leases held by the US and 31 leases held by the UK business. In the UK, the Prudential Group holds 3 short-term serviced offices and a further 77 leases that are not occupied and represent surplus accommodation.

## 15. Intellectual property

The Prudential Group conducts business under the "Prudential", "Jackson" and "M&G" brand names and logos. It is also the registered owner of over 1,000 domain names, including "www.prudential.co.uk", "www.prudential-corporation-asia.com", "www.jackson.com", "www.mandg.co.uk" and "www.pru.co.uk".

The Prudential Group does not operate in the United States under the Prudential name and there have been long-standing arrangements between it and Prudential Financial, Inc. and its subsidiary, the Prudential Insurance Company of America, relating to their respective uses of the Prudential name. Under these arrangements Prudential Financial, Inc. has the right to use the Prudential name in the Americas and certain parts of the Caribbean, Japan, Korea and Taiwan and the Prudential Group has the right to use the name everywhere else in the world although third parties have rights to the name in certain countries.

As at 14 May 2010 (being the latest practicable date prior to the publication of this prospectus), the Prudential Group was not aware of any material incidence of intellectual property rights infringement claims or litigation initiated by others and vice versa for the three years ended 31 December 2009.

### *Trade marks*

As at 14 May 2010, being the latest practicable date prior to the publication of this prospectus, the key trade marks in relation to the business of the Prudential Group as a whole are:

<u>Trade mark</u>	<u>Registered Owner</u>
Prudential face logo . . . . .	The Prudential Assurance Company Limited
Prudential name . . . . .	The Prudential Assurance Company Limited
M&G name and logo . . . . .	M&G Limited
Jackson name and logo . . . . .	Jackson National Life Company
Prudential face logo, UK Prudential Assurance in Chinese	
Character series . . . . .	Prudential IP Services Limited

Prudential has approximately 736 trade mark registrations for, and approximately 134 applications for registrations relating to, the Prudential, M&G and/or Jackson name and/or their respective logos in countries throughout the world including in all countries in which the Prudential Group currently operates. Of these trade marks, as at the 14 May 2010, members of the Prudential Group have 34 trade marks registered in Hong Kong and 6 applications for registrations in Hong Kong.

As at 14 May 2010, being the latest practicable date prior to publication of their prospectus, the key trade marks in relation to the business of the AIA Group as a whole are:

the new AIA logo;

the POWER OF WE logo;

Yao Bang in Chinese characters; and

Philam Life logo.

The AIA Group has approximately 300 trade mark applications and registrations relating to the AIA, The Power of We, Yao Bang and/or Philam Life name, and/or their respective logos, and/or other names/or logos of the AIA Group in the relevant countries in which the AIA Group currently operates. These trademarks are currently registered, or have been applied for, in the name of companies of the AIA Group or have been assigned from the AIG Group to the AIA Group.

As at 14 May 2010, being the latest practicable date prior to publication of this prospectus, the following are the key domain name registrations of the AIA Group:

www.aia.com

www.agentsaia.com

www.aia-pt.com.hk

www.philamlife.com

www.aiafh.com

www.aiafinancialhealthcheck.com

www.aiaprovidentfunds.com

www.mpf-aijf.com

www.simplylifedirect.com

The AIA Group also has over 300 domain names registered in countries throughout the world including in all countries in which the AIA Group operates.

## **16. Material contracts of the Prudential Group**

Set out below is a summary of (a) each material contract (other than contracts entered into in the ordinary course of business) to which Prudential or any member of the Prudential Group is a party which has been entered into within the two years immediately preceding the date of this prospectus; and (b) any other contract (not being a contract entered into in the ordinary course of business) entered into by Prudential or any member of the Prudential Group which contains a provision under which Prudential or any member of the Prudential Group has any obligation or entitlement which is material to the Prudential Group as at the date of this prospectus:

### **16.1 Acquisition Agreement**

Please refer to the summary of the Acquisition Agreement at Part V of this prospectus.

### **16.2 Underwriting Agreement**

Pursuant to an Underwriting Agreement dated 17 May 2010 between Prudential, the Joint Sponsors, the Joint Global Co-ordinators, the Joint Bookrunners, the Joint Lead Managers, the Co-Lead Managers, the Co-Managers and the Underwriters, the Joint Global Co-ordinators have agreed severally to use reasonable endeavours to procure acquirers for, or failing which, the Underwriters shall acquire in their Underwriting Proportions, up to 13,964,557,750 Rights Issue Shares to the extent not taken up under the Rights Issue, in each case at the Issue Price.

In consideration of their agreement to underwrite the Rights Issue Shares, and subject to their obligations under the Underwriting Agreement having become unconditional and the Underwriting Agreement not having been terminated, Prudential shall pay: (a) to the Underwriters, a commission of 2.50% on the aggregate proceeds of the Rights Issue Shares, to be shared between the Underwriters in proportion to their Underwriting Proportions (b) to the Joint Global Co-ordinators, a commission of 0.25% on the aggregate proceeds of the Rights Issue (c) to the Joint Global Co-ordinators, in Prudential's absolute discretion, a discretionary fee of up to 0.25% on the aggregate proceeds of the Rights Issue, and (d) to the Underwriters, a further discretionary fee of up to 0.25% on the aggregate

proceeds of the Rights Issue, to be shared among the Underwriters at the sole discretion of Prudential. Out of such fees (to the extent received by the Joint Global Co-ordinators) they will pay any sub-underwriting commission (to the extent sub-underwriters are or have been procured).

Prudential shall pay (whether or not the obligations under the Underwriting Agreement of Joint Bookrunners, the Joint Global Co-ordinators, the Joint Lead Managers, the Co-Lead Managers, the Co-Managers and the Underwriters become unconditional) all costs and expenses of, or in connection with, the Acquisition, the Rights Issue, the introductions on the Hong Kong Stock Exchange and the SGX-ST, the General Meeting, UK Admission, HK Admission, Singapore Admission and the Underwriting Agreement and related agreements.

The obligations of the Joint Bookrunners, the Joint Global Co-ordinators, the Joint Lead Managers, the Co-Lead Managers, the Co-Managers and the Underwriters under the Underwriting Agreement are subject to certain conditions including, among others:

- (A) the passing, without material amendment, of the Rights Issue Resolution (which itself is conditional upon the passing of the Scheme Resolutions) at the General Meeting on the date of the General Meeting specified in the General Meeting Notice;
- (B) the Acquisition Agreement remaining in full force and effect, not having lapsed and not having been terminated in accordance with its terms prior to UK Admission, and no condition to which the Acquisition Agreement is subject having become incapable of satisfaction and, if capable of waiver, not having been waived prior to UK Admission;
- (C) nothing occurring prior to UK Admission which, in accordance with the terms of the Bridge Facility, prevents or would prevent the drawdown of funds under the Bridge Facility, save to the extent that replacement financing is made available as envisaged by the terms of the Bridge Facility;
- (D) UK Admission becoming effective by not later than 8.00 a.m. (London time) on Tuesday 8 June 2010 (or such later time and date as Prudential and the Joint Global Co-ordinators may agree);
- (E) each condition to enable the Nil Paid Rights and the Fully Paid Rights to be admitted as a participating security in CREST (other than UK Admission) being satisfied on or before Tuesday 8 June 2010;
- (F) each condition to enable the Nil Paid Rights to be admitted as eligible securities for deposit, clearance and settlement in CCASS (other than HK Admission) being satisfied on or before the date of the General Meeting;
- (G) at the time of UK Admission, either HK Admission having occurred or there being no indication that the Listing Committee of the Hong Kong Stock Exchange will not grant listing of and permission to deal in the Rights Issue Shares, nil paid and fully paid; and
- (H) the fulfilment in all material respects by Prudential of its obligations under a number of provisions of the Underwriting Agreement by the times specified therein.

Certain of the conditions may be waived by the Joint Global Co-ordinators in their discretion.

If, at any time before UK Admission, any of the conditions has not been satisfied by the required time, or has become incapable of being satisfied and has not been waived, or it becomes, or is reasonably believed by the Joint Global Co-ordinators to have become, unlawful in the United Kingdom, Hong Kong, Singapore or the United States for any of the parties to the Underwriting Agreement (other than Prudential) to perform any of its material obligations under the agreement, the Joint Global Co-ordinators may terminate the Underwriting Agreement. None of the Underwriters are entitled to terminate the Underwriting Agreement after UK Admission.

The Joint Global Co-ordinators can adjust the Issue Price (but not terminate the Underwriting Agreement) if any of the following occurs before UK Admission:

- (A) Prudential issues a supplementary prospectus; or
- (B) there is (a) a suspension in trading in Prudential securities on the London Stock Exchange or on the Hong Kong Stock Exchange or in trading generally on the New York Stock Exchange, the Hong Kong Stock Exchange or the London Stock Exchange or (b) the fixing of minimum or maximum pricing of securities by any of those exchanges or (c) a material disruption in commercial banking or securities settlement services in the US, Hong Kong or the UK; or
- (C) a banking moratorium in the US, Hong Kong or the UK is declared.

Such an adjustment to the Issue Price will not change the total proceeds of the Rights Issue. The Issue Price cannot be reduced below 5 pence.

Since Prudential is a regulated entity in a number of jurisdictions, the Underwriting Agreement contains provisions which delay the confirmation of allotment of Rights Issue Shares to any of the Underwriters (but does not delay their obligation to pay for those Rights Issue Shares) until such time as any regulatory approvals are obtained (which can be no longer than 12 months). This mechanism does not render the underwriting conditional after UK Admission. Where allotment of Rights Issue Shares is deferred as referred to in this paragraph, the Underwriters are entitled, subject to certain conditions, to place such Rights Issue Shares in the market.

Pursuant to the Underwriting Agreement, the parties to the Underwriting Agreement have agreed that if a supplementary prospectus is issued by Prudential two business days or fewer prior to the date specified as the latest date for acceptance and payment in full, such date shall be extended to the date which is three dealing days after the date of issue of the supplementary prospectus.

Prudential has given certain warranties and indemnities to the Underwriters. The liabilities of Prudential are unlimited as to time (subject to statutory limitations) and amount.

The Underwriters have agreed that neither they nor any person acting on their behalf will procure acquirers for any of the Rights Issue Shares, the Nil Paid Rights and the Fully Paid Rights other than in accordance with certain selling restrictions.

### ***16.3 Standby Equity Financing Letter***

On 1 March 2010, the Joint Global Co-ordinators entered into a standby equity financing letter (the “**Standby Equity Financing Letter**”) with Prudential pursuant to which the Joint Global Co-ordinators agreed to arrange and underwrite the Rights Issue for Prudential in order to raise a sterling amount equivalent to approximately US\$21 billion (before costs, fees and expenses) (the “**Committed Equity Amount**”).

In consideration of the Joint Global Co-ordinators’ commitment to Prudential to underwrite the Rights Issue pursuant to the terms of the Standby Equity Financing Letter, Prudential paid the Joint Global Co-ordinators a fee of 0.25% of the Committed Equity Amount in respect of the period from 1 March 2010 to 30 April 2010. Additional weekly fees of 0.025% of the Committed Equity Amount in respect of the period from 1 May 2010 to 7 May 2010 and 0.05% of the Committed Equity Amount in respect of the period from 8 May 2010 until the date of publication of this document are also payable.

Subject to certain provisions continuing in full force and effect, the Standby Equity Financing Letter automatically lapsed and terminated upon the Underwriting Agreement being entered into. Under the Standby Equity Financing Letter, Prudential gave limited warranties to the Joint Global Co-ordinators (primarily with respect to information provided to the Joint Global Co-ordinators), and customary indemnities to the Joint Global Co-ordinators which survive termination of the Standby Equity Financing Letter.

### ***16.4 Option Deed and Subscription and Transfer Agreement***

In connection with the Rights Issue, Prudential, Credit Suisse and Prudential Rights (Jersey) Limited have entered into agreements, each dated 17 May 2010, in relation to the subscription and transfer of ordinary shares and redeemable preference shares in Prudential Rights (Jersey) Limited. Under the terms of these agreements:

- (A) Prudential and Credit Suisse agreed to take up ordinary shares in Prudential Rights (Jersey) Limited and enter into put and call options in respect of the ordinary shares in Prudential Rights subscribed for by Credit Suisse that are exercisable if the Rights Issue does not proceed;
- (B) Credit Suisse will apply the proceeds of the Rights Issue, including amounts received from acquirers procured by the Underwriters in subscribing for redeemable preference shares in Prudential Rights (Jersey) Limited to an aggregate value equal to such proceeds; and
- (C) Prudential will allot and issue the Rights Issue Shares to those persons entitled thereto in consideration of Credit Suisse’s undertaking to transfer its holding of redeemable preference shares and ordinary shares in Prudential Rights (Jersey) Limited to Prudential.

Accordingly, instead of receiving cash as consideration for the issue of the Rights Issue Shares, at the conclusion of the Rights Issue, Prudential will own the entire issued ordinary share capital and entire preference share capital of Prudential Rights (Jersey) Limited whose only assets will be its cash reserves, which will represent an amount equal to the proceeds of the Rights Issue. Prudential will be able to use this amount (including to pay the costs and expenses of the Rights Issue) on redemption of the redeemable preference shares it will hold in Prudential Rights (Jersey) Limited and, during any interim period prior to redemption, by procuring that Prudential Rights lends the amount to Prudential (or one of Prudential’s subsidiaries).

### **16.5 Hybrid Capital Facility**

On 16 May 2010 Prudential entered into a hybrid capital facility pursuant to which the Joint Lead Arrangers will provide up to US\$5,400,000,000 of Upper Tier 2 and Lower Tier 2 capital (the “**Hybrid Capital Facility**”).

The Hybrid Capital Facility will comprise two facilities, with a facility of up to US\$2,400,000,000 (or the currency equivalent) available for drawdown as Lower Tier 2 capital in one or more tranches either in the form of Lower Tier 2 notes or Lower Tier 2 term loans or a mixture of both. The other facility will provide up to US\$3,000,000,000 (or the currency equivalent) available for drawdown as Upper Tier 2 capital in one or more tranches either in the form of Upper Tier 2 notes or Upper Tier 2 term loans or a mixture of both.

The Hybrid Capital Facility will be available for drawing until the earlier of, the completion of the Acquisition or 1 March 2011. Drawings in the form of loans or notes will be used towards funding the purchase of AIA and the net proceeds of the loan or notes will reduce the available commitment under the Bridge Facility by the amount of such proceeds.

Notes issued under the Hybrid Capital Facility will be listed and it is expected that they will be issued pursuant to Prudential’s MTN Programme, provided that any notes issued and/or loans drawn may be converted into marketable securities to be issued by Prudential (with the same or more better regulatory capital treatment, pursuant to the GENPRU rules) at the option of each Joint Lead Manager. The margin will be no greater than the prevailing market rate.

The obligations of the Joint Lead Arrangers to subscribe for notes will be subject to customary conditions precedent (save that market and issuer adverse change conditions are excluded) for the issue of notes under Prudential’s MTN Programme and any amounts drawn in the form of term loans will be subject to the same conditions to drawdown as are provided for under the Bridge Facility.

The commitments under the Hybrid Capital Facility in respect of the Lower Tier 2 notes and loans will be mandatorily cancelled by an amount equal to the net proceeds of any notes and loans issued pursuant to the Bond Offerings which qualify on issue as Lower Tier 2 capital and the commitments under the Hybrid Capital Facility in respect of the Upper Tier 2 notes and loans will be mandatorily cancelled by an amount equal to the net proceeds of any notes and loans issued pursuant to the Bond Offerings which qualify on issue as Upper Tier 2 or Tier 1 capital.

### **16.6 Bridge Facility**

On 1 March 2010 Prudential entered into a committed bridge facility between, *inter alia*, Credit Suisse AG, London Branch, HSBC and J.P. Morgan plc (in their capacity as mandated lead arrangers), Credit Suisse, HSBC and JPMorgan Chase Bank, N.A. (in their capacity as original lenders) and HSBC (in its capacity as agent) (the “**Bridge Facility**”).

The Bridge Facility is intended to provide capital in the event that Prudential does not raise all or part of US\$5,400,000,000 (net of costs, fees and expenses) through the Bond Offerings or as drawings under the Hybrid Capital Facility or subscription under the Subordinated Note Commitment Letter. In such circumstances, Prudential may choose to fund any shortfall by drawing down such amount as may be required under the Bridge Facility, (taking into account the net proceeds of any notes issued pursuant to the Bond Offerings and under the Subordinated Note Commitment Letter and any drawings under the Hybrid Capital Facility). Borrowings under the Bridge Facility will bear interest at a variable annual rate, based on LIBOR, plus an applicable margin based on the credit rating at that time for Prudential’s long term senior or unsubordinated indebtedness.

Pursuant to the Bridge Facility, the lenders have agreed to provide a US\$5,400,000,000 senior unsecured facility for the purposes of the Acquisition. The lenders are obliged to provide funds, up to the total committed amount, provided that there are no non-payment events of default, insolvency or insolvency proceedings and provided that Prudential has not breached certain undertakings relating to, *inter alia*, disposals, and Class 1 or Class 2 acquisitions and the negative pledge. In addition, Prudential may not amend, vary, novate, supplement, supersede, waive or terminate any term of the Acquisition Agreement or enter into any agreement with AIG in a way which materially or adversely affects the interests of the lenders.

The certain funds period under the Bridge Facility runs from 1 March 2010 to the earlier of (a) 1 March 2011; (b) the date the Acquisition Agreement is terminated; and (c) the completion date of the Acquisition. During this time, Prudential will be able to draw up to US\$5,400,000,000 of funds under the Bridge Facility to fund a portion of the Acquisition consideration, net of any funds raised from the Bond Offerings. Once drawn, Prudential has an option to extend the maturity of the Bridge Facility to 1 March 2012.

The termination and default provisions of the Bridge Facility are on normal commercial terms.

### **16.7 Subordinated Note Commitment Letter**

In connection with the Bond Offerings, on 16 May 2010 Prudential, AIG and AIA Aurora entered into the Subordinated Note Commitment Letter under which, to the extent that the Joint Lead Arrangers are unable to procure subscriptions in full for the Bond Offerings for an aggregate amount equal to US\$5.4 billion by the Determination Date (being the date on which the last of certain conditions in the Acquisition Agreement have been satisfied or waived), AIA Aurora has agreed to subscribe for Lower Tier 2 capital notes and Upper Tier 2 capital notes on completion of the Acquisition in an aggregate amount equal to the lesser of: (i) US\$1.875 billion; and (ii) the amount required to make the aggregate amount of Lower Tier 2 capital notes and Upper Tier 2 capital notes subscribed for by investors under the Bond Offerings and AIA Aurora under the Subordinated Note Commitment Letter equal to US\$5.4 billion. The effectiveness of the Subordinated Note Commitment Letter is conditional on the consent of the Joint Lead Arrangers being obtained; at the date of this prospectus such consent has not been obtained and there can be no assurance that such consent will be obtained or as to the terms on which it may be obtained.

If and to the extent that AIA Aurora is obliged to subscribe for any Lower Tier 2 capital notes and Upper Tier 2 capital notes pursuant to the Subordinated Note Commitment Letter, subject to the paragraph immediately below, such notes shall be allocated between Lower Tier 2 capital notes and Upper Tier 2 capital notes in such proportion necessary to cause the Lower Tier 2 capital notes and Upper Tier 2 capital notes so subscribed for, together with Lower Tier 2 capital notes and Upper Tier 2 capital notes subscribed for by investors under the Bond Offerings, any subordinated debt securities to be subscribed for by the Joint Lead Arrangers pursuant to the Hybrid Capital Facility and any Lower Tier 2 capital notes and Upper Tier 2 capital notes to be subscribed for pursuant to AIA Aurora's optional further subscription described further below, to be in a ratio of five Upper Tier 2 capital notes to four Lower Tier 2 capital notes. If the Joint Lead Arrangers subscribe for any subordinated debt securities pursuant to the Hybrid Capital Facility, then the Lower Tier 2 capital notes, on the one hand, and the Upper Tier 2 capital notes, on the other hand, subscribed for by AIA Aurora pursuant to the Subordinated Note Commitment Letter and by the Joint Lead Arrangers shall be allocated on a proportionate basis as among AIA Aurora and the Joint Lead Arrangers.

To the extent that the aggregate nominal value of the Lower Tier 2 capital notes subscribed for by investors under the Bond Offerings and the Lower Tier 2 capital notes which AIA Aurora would otherwise be required to subscribe pursuant to the Subordinated Note Commitment Letter is equal to or in excess of US\$2.4 billion, the Lower Tier 2 capital notes and Upper Tier 2 capital notes to be subscribed for by AIA Aurora in excess of US\$2.4 billion shall be eligible as Upper Tier 2 capital notes.

If and to the extent that the aggregate of the amount of the Lower Tier 2 capital notes and Upper Tier 2 capital notes to be subscribed by AIA Aurora pursuant to the Subordinated Note Commitment Letter and the amount of Lower Tier 2 capital notes and Upper Tier 2 capital notes subscribed for by investors under the Bond Offerings is less than US\$5.4 billion, calculated as at the Determination Date, AIA Aurora has the option to subscribe for additional Lower Tier 2 capital notes and Upper Tier 2 capital notes, such notes to be on the terms set forth in the Hybrid Capital Facility.

Lower Tier 2 capital notes and Upper Tier 2 capital notes subscribed for by AIA Aurora under the Subordinated Note Commitment Letter will be listed and such Lower Tier 2 capital notes and Upper Tier 2 capital notes will be issued pursuant to Prudential's MTN Programme. The obligations of AIA Aurora to subscribe for Lower Tier 2 capital notes and Upper Tier 2 capital notes will be subject to customary conditions precedent (save that market and issuer adverse change conditions are excluded) for the issue of Lower Tier 2 capital notes and Upper Tier 2 capital notes under Prudential's MTN Programme.

AIA Aurora is subject to a lock-up in respect of the Lower Tier 2 capital notes and/or Upper Tier 2 capital notes subscribed for under the Subordinated Note Commitment Letter for a period of 12 months from the date of issue of such notes, subject to customary exceptions.

### **16.8 Subordinated debt financing facility**

On 16 May 2010 Prudential has entered into a contingent subordinated debt financing facility with the Joint Lead Arrangers, pursuant to which the Joint Lead Managers have agreed to provide up to £1,000,000,000 of subordinated capital (the "**Subordinated Debt Financing Facility**").

The Subordinated Debt Financing Facility would only be available to be drawn during the period of twelve months following the completion of the Acquisition, (with the ability to extend this period by a further 12 months at the option of Prudential) on the occurrence of certain stresses on Prudential's IGD capital. The amount drawn will replenish the IGD capital to the amount referred to under 'FSA Suspension Arrangements for the Enlarged Group' in Part X of this prospectus. The Subordinated Debt Financing Facility will provide for Lower Tier 2 loans with a term of six years and there will be limited conditions to drawdown (which will include, *inter alia*, completion of the Acquisition). The margin will be at a rate that is calculated by a formula that approximates the prevailing market

rate at the time the Subordinated Debt Financing Facility is drawn. The annual pre-tax financing cost of drawing the whole amount available under the Subordinated Debt Financing Facility is estimated to be £110 million (based on prevailing market rates at the date of this prospectus).

If drawn, the Joint Lead Arrangers will have the right to exchange the loans under the Subordinated Debt Financing Facility for Lower Tier 2 notes and/ or Upper Tier 2 notes. Drawings under the Subordinated Debt Financing Facility will be used first to prepay any amounts outstanding under the Bridge Facility and then for general corporate purposes.

The commitments under the Subordinated Debt Financing Facility will be mandatorily cancelled, and, subject to FSA approval, any drawings under the facility will be mandatorily prepaid, by an amount equal to the capital benefit arising from (a) any disposals by the Enlarged Group and (b) any capital release from any member of the Enlarged Group, in each case which are counted towards Prudential's IGD capital ratios. The commitments under the Subordinated Debt Financing Facility will also be mandatorily cancelled by an amount equal to the proceeds of any other issuance of regulatory capital by Prudential (except where such issuance is used to refinance or replace any existing regulatory capital instruments).

Whilst the Subordinated Debt Financing Facility is in place, Prudential will be subject to restrictions on making acquisitions and on issuing dividends which are not consistent with the group dividend policy as described in Part VI of this prospectus.

## **17. Material contracts of the AIA Group**

Set out below is a summary of (a) each material contract (other than contracts entered into in the ordinary course of business) to which AIA or any member of the AIA Group is a party which has been entered into within the two years immediately preceding the date of this prospectus and (b) any other contract (not being a contract entered into in the ordinary course of business) entered into by AIA or any member of the AIA Group which contains a provision under which AIA or any member of the AIA Group has any obligation or entitlement which is material to the AIA Group as at the date of this prospectus:

- (A) a letter of indemnity from American International Assurance Company (Bermuda) Limited dated 21 May 2008, pursuant to which American International Assurance Company (Bermuda) Limited indemnified the American International Assurance Company (Bermuda) Limited New Zealand branch for the total amount of any actuarial deficits;
- (B) a subordinated loan agreement between PT AIG Life and American International Assurance Company (Bermuda) Limited effective 14 July 2008, pursuant to which American International Assurance Company (Bermuda) Limited made a loan of US\$50,000,000 to PT AIG Life;
- (C) an agreement to sell and purchase certain freehold lands between American International Assurance Company Limited, Metrostar Property Public Company Limited and Mr. Veera Burapachaisri dated 1 July 2008, as supplemented on 23 July 2008, pursuant to which American International Assurance Company, Limited acquired real properties in Bangkok, Thailand;
- (D) a subordinated loan agreement between American International Assurance Company (Australia) Limited and American International Assurance Company, Limited dated 18 August 2008, pursuant to which American International Assurance Company, Limited made a loan to American International Assurance Company (Australia) Limited;
- (E) a supplemental agreement between American International Assurance Company (Australia) Limited and AIA Financial Services Limited dated 22 July 2008, pursuant to which the terms of a previous agreement between the parties dated 20 March 2007, under which American International Assurance Company (Australia) Limited agreed to assume certain liabilities of AIA Financial Services Limited, were amended;
- (F) an interim services agreement between AIG Global Services — Malaysia and American International Assurance Company Limited (Singapore branch) dated 8 January 2009, pursuant to which AIG Global Services — Malaysia, agreed to provide certain shared services to American International Assurance Company, Limited (Singapore branch) during the pilot stage;
- (G) a deed of termination and release between American International Assurance Company (Australia) Limited, Westpac Financial Services Group Limited, St. George Bank Limited and St. George Life Limited dated 9 April 2009, pursuant to which the parties cancelled and terminated the Alliance Services Agreement, Insurance Alliance Agreement and Reinsurance Agreements previously entered into on 31 July 2008, 31 July 2008 (as amended on 27 August 2008) and 19 December 2008, respectively;
- (H) an indemnity between American International Assurance Company, Limited and American International Assurance Company (Australia) Limited dated 28 February 2009, pursuant to which American International

- Assurance Company, Limited assumed certain indemnification obligations benefiting American International Assurance Company (Australia) Limited;
- (I) an investment management agreement between AIA Takaful International BHD. and Asian Islamic Investment Management SDN BHD dated 21 April 2009, pursuant to which Asian Islamic Investment Management SDN BHD. undertakes to act as investment manager for the benefit of AIA Takaful International BHD.;
  - (J) a deed of novation between AIG Global Services (Malaysia) SDN. BHD., AIA Shared Services SDN. BHD. and American International Assurance Company, Limited (Singapore Branch) dated 1 August 2009, pursuant to which AIA Shared Services SDN. BHD. assumed responsibility for the shared services previously provided by AIG Global Services (Malaysia) SDN. BHD. to American International Assurance Company, Limited (Singapore Branch);
  - (K) a share purchase agreement entered into between American International Assurance Company, Limited, American Life Insurance Company and American International Group, Inc. on 24 August 2009 pursuant to which American International Assurance Company, Limited acquired 99.78% of the issued share capital of The Philippine American Life and General Insurance Company from American Life Insurance Company for a total consideration of 27,962,420,342.60 Philippine Pesos;
  - (L) a promissory note of a principal amount of 27,962,420,342.60 Philippine Pesos issued by American International Assurance Company, Limited on 3 November 2009 to American Life Insurance Company as consideration for the acquisition by American International Assurance Company, Limited of 99.78% of the issued share capital of The Philippine American Life and General Insurance Company from American Life Insurance Company;
  - (M) a deed of absolute sale between American International Assurance Company, Limited and American Life Insurance Company dated 3 November 2009, pursuant to which American Life Insurance Company sold 199,560,522 issued and outstanding common shares in The Philippine American Life and General Insurance Company to American International Assurance Company, Limited for a total consideration of 27,962,420,342.60 Philippine Pesos;
  - (N) a voting trust agreement between American International Assurance Company, Limited and American Life Insurance Company dated 3 November 2009 in favour of American International Assurance Company, Limited in relation to the voting and economic rights attached to 99.78% of the issued share capital of The Philippine American Life and General Insurance Company;
  - (O) an assignment agreement between American International Assurance Company, Limited and American International Group, Inc. dated 3 November 2009, pursuant to which American International Group, Inc. assigned all rights, title and interest attached to 99.78% of the issued share capital of The Philippine American Life and General Insurance Company to American International Assurance Company, Limited;
  - (P) an assignment agreement between American Life Insurance Company and American International Group, Inc. dated 3 November 2009, pursuant to which all right, title, benefit and interest to, in and under a promissory note of a principal amount of 27,962,420,342.60 Philippine Pesos issued by American International Assurance Company, Limited to American Life Insurance Company on 3 November 2009 was assigned to American International Group, Inc.;
  - (Q) an assignment agreement between American International Group, Inc. and AIG Life Holdings (International) LLC dated 3 November 2009, pursuant to which all right, title, benefit and interest to, in and under a promissory note of a principal amount of 27,962,420,342.60 Philippine Pesos was assigned from American International Group, Inc. to AIG Life Holdings (International) LLC on 3 November 2009;
  - (R) an assignment agreement between AIG Life Holdings (International) LLC and American International Reinsurance Company, Limited dated 3 November 2009, pursuant to which all right, title, benefit and interest to, in and under a promissory note of a principal amount of 27,962,420,342.60 Philippine Pesos was assigned from AIG Life Holdings (International) LLC to American International Reinsurance Company, Limited on 3 November 2009;
  - (S) a deed of release between American International Reinsurance Company, Limited and American International Assurance Company, Limited dated 3 November 2009, pursuant to which American International Assurance Company, Limited was released and discharged from all liabilities and obligations under a promissory note of 27,962,420,342.60 Philippine Pesos. issued by American International Assurance Company, Limited on 3 November 2009;

- (T) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Cesar A. Buenaventura in favour of American International Assurance Company, Limited;
- (U) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Reynaldo C. Centeno in favour of American International Assurance Company, Limited;
- (V) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Omar T. Cruz in favour of American International Assurance Company, Limited;
- (W) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Jose L. Cuisia, Jr in favour of American International Assurance Company, Limited;
- (X) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Francis G. Estrada in favour of American International Assurance Company, Limited;
- (Y) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Ricardo J. Romulo in favour of American International Assurance Company, Limited;
- (Z) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Washington Z. Sycip in favour of American International Assurance Company, Limited;
- (AA) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Edmund Sze Wing Tse in favour of American International Assurance Company, Limited;
- (BB) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Mark Wilson in favour of American International Assurance Company, Limited;
- (CC) a declaration of trust and indemnity undertaking dated 3 November 2009 between American International Assurance Company, Limited and Trevor Bull in favour of American International Assurance Company, Limited;
- (DD) a share purchase agreement entered into between American International Group, Inc., American International Reinsurance Company, Limited and AIA Group Limited dated 24 November 2009 pursuant to which AIA Group Limited acquired the entire issued share capital in American International Assurance Company, Limited from American International Reinsurance Company, Limited for a total consideration of US\$13,963,972,653;
- (EE) a promissory note of a principal amount of US\$13,963,972,653 issued by the Company to American International Reinsurance Company, Limited on 30 November 2009 as consideration for the acquisition by AIA Group Limited of the entire issued share capital of American International Assurance Company, Limited;
- (FF) a promissory note of a principal amount of US\$50,000,000 issued by AIA Group Limited to AIA Aurora LLC on 30 November 2009;
- (GG) a subscription agreement entered into between AIA Group Limited and AIA Aurora LLC dated 30 November 2009, pursuant to which AIA Aurora LLC agreed to subscribe for, and AIA Group Limited agreed to issue and allot to AIA Aurora LLC, 12,000,000,000 shares in the share capital of AIA Group Limited;
- (HH) a deed of assignment entered into between AIA Aurora LLC and American International Reinsurance Company, Limited dated 30 November 2009, pursuant to which a promissory note of US\$13,963,972,653 issued by AIA Group Limited to American International Reinsurance Company, Limited on 30 November 2009 was assigned to AIA Aurora LLC;
- (II) a deed of release entered into between AIA Group Limited and AIA Aurora LLC dated 30 November 2009, pursuant to which AIA Group Limited was released and discharged from all liabilities and obligations under

a promissory note of US\$13,963,972,653 issued by AIA Group Limited to American International Reinsurance Company, Limited on 30 November 2009;

- (JJ) a separation letter agreement between American International Group, Inc. and AIA Group Limited dated 30 November 2009, pursuant to which it was agreed that all contracts, agreements and other arrangements between American International Group, Inc. and AIA Group Limited be made on arm-length terms;
- (KK) a trade mark and domain name assignment agreement entered into between American International Group, Inc. and American International Assurance Company, Limited dated 30 November 2009, pursuant to which American International Group, Inc. assigned certain trademarks and domain names to American International Assurance Company, Limited and American International Assurance Company, Limited assigned certain domain names to American International Group, Inc.
- (LL) an intellectual property agreement entered into between American International Group, Inc., and American International Assurance Company, Limited dated 30 November 2009, pursuant to which certain intellectual property rights were licensed to American International Assurance Company, Limited and AIA Group Limited and their affiliates from American International Group, Inc. and certain intellectual property rights were licensed to American International Group, Inc. and its affiliates from American International Assurance Company, Limited; and
- (MM) a trade mark and corporate name license agreement entered into between American International Group, Inc., and American International Assurance Company, Limited dated 30 November 2009, pursuant to which American International Group, Inc. granted American International Assurance Company, Limited a transitional license to use certain AIG trade marks.

## **18. Litigation and arbitration proceedings**

### ***Litigation***

Other than as set out in this section 18, neither Prudential nor any member of the Prudential Group is or has been engaged in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which Prudential is aware) during the period covering at least the previous 12 months which may have, or have had in the recent past, significant effects on Prudential and/or the Prudential Group's financial position or profitability.

At 31 December 2007, 2008 and 2009, respectively, the legal provisions made in the Prudential Group's audited accounts for the years ending on those dates of £19 million, £23 million and £15 million relate predominantly to Jackson. Jackson is involved as a defendant in class action and other litigation substantially similar to class action and other litigation pending against many life insurance companies that allege misconduct in the sale and administration of insurance products. Jackson generally accrues a liability for legal contingencies with respect to pending litigation once management determines that the contingency is probable and estimable. During 2007, 2008 and 2009, respectively, £nil, £2 million and £9 million was paid. This provision has been calculated to reflect Jackson's estimate of claims likely to settle. However, it is not possible to meaningfully quantify the potential claim amount.

In addition to the legal proceedings relating to Jackson mentioned above, members of the Prudential Group are involved in other litigation and regulatory issues. While the outcome of such matters cannot be predicted with certainty, Prudential believes that the ultimate outcome of such litigation and regulatory issues will not have a significant effect on Prudential and/or the Prudential Group's financial position or profitability.

Neither AIA nor any member of the AIA Group is or has been engaged in any governmental, legal or arbitration proceeding (including any such proceedings which are pending or threatened of which Prudential is aware) during the period covering at least the previous 12 months which may have, or have had in the recent past, significant effects on AIA and/or the AIA Group's financial position or profitability.

### ***Pension mis-selling***

In 1988, the UK government introduced new pensions legislation intended to encourage more individuals to make their own arrangements for their pensions. During the period from April 1988 to June 1994, many individuals were advised by insurance companies, Independent Financial Advisers and other intermediaries not to join, to transfer from or to opt out of their occupational pension schemes in favour of private pension products introduced under the UK Income and Corporation Taxes Act 1988. The UK insurance regulator (previously the Personal Investment Authority, now the FSA), subsequently determined that many individuals were incorrectly advised and would have

been better off not purchasing the private pension products sold to them. Industry participants are responsible for compensating the persons to whom private pensions were mis-sold.

As a result, the FSA required that all UK life insurance companies review their potential cases of pension mis-selling and pay compensation to policyholders where necessary and, as a consequence, record a provision for the estimated costs. The Prudential Group met the requirement of the FSA to issue offers to all cases by 30 June 2002.

The table below summarises the change in the pension mis-selling provision for the years ended 31 December 2007, 2008 and 2009. The change in the provision is included in benefits and claims in the income statement and the movement in unallocated surplus of with-profits funds has been determined accordingly.

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Balance at beginning of period . . . . .	401	448	345
Changes to actuarial assumptions and method of calculation . . . . .	71	(75)	20
Discount unwind . . . . .	22	20	3
Redress to policyholders . . . . .	(41)	(46)	(44)
Payment of administrative costs . . . . .	<u>(5)</u>	<u>(2)</u>	<u>(2)</u>
Balance at end of period . . . . .	<u>448</u>	<u>345</u>	<u>322</u>

The pension mis-selling provision is included within the liabilities in respect of investment contracts with discretionary participation features under IFRS 4.

The pension mis-selling provision at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, set out above of £448 million, £345 million and £322 million is stochastically determined on a discounted basis. The average discount rate implied in the movement in 2007, 2008 and 2009 respectively, is 4.6%, 4.0% and 4.6%. The undiscounted amounts at 31 December 2007, 31 December 2008 and 31 December 2009 respectively, expected to be paid in the 5-year periods subsequent to each of the years ending 31 December are presented below, with amounts expected to be paid beyond the 5-year period shown in aggregate:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
	£m	£m	£m
Year ended 31 December			
2008 . . . . .	51	—	—
2009 . . . . .	15	17	—
2010 . . . . .	15	8	29
2011 . . . . .	15	9	8
2012 . . . . .	22	13	11
2013 . . . . .	—	12	12
2014 . . . . .	—	—	15
Thereafter . . . . .	<u>707</u>	<u>572</u>	<u>513</u>
Total undiscounted amount . . . . .	825	631	588
Aggregate discount . . . . .	<u>(377)</u>	<u>(286)</u>	<u>(266)</u>
Discounted pension mis-selling provision at 31 December 2007, 31 December 2008 and 31 December 2009, respectively . . . . .	<u>448</u>	<u>345</u>	<u>322</u>

The liability accounting for the contracts which are the subject of the mis-selling provision is reflected in two elements, namely the core policyholder liability determined on the basis applied for other contract liabilities and the mis-selling provision. The overall liability for these contracts remains appropriate in the context of the accounting for policyholder liabilities that determines the calculation of both elements. However, the constituent elements are reallocated and remeasured for the changes arising from the application of the realistic Peak 2 basis of liabilities for the core policyholder liability, as reflected in the IFRS policy improvement to apply the UK GAAP standard FRS 27.

The Financial Ombudsman Service periodically updates the actuarial assumptions to be used in calculating the provision, including interest rates and mortality assumptions. The pension mis-selling provision represents the discounted value of future expected payments, including benefit payments and all internal and external legal and administrative costs of adjudicating, processing and settling those claims. To the extent that amounts have not been paid, the provision increases each year reflecting the shorter period of discount.

Prudential believes that, based on current information, the provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling as well as the costs and expenses of the Prudential Group's pension review unit established to identify and settle such cases. Such provision

represents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The costs associated with the pension mis-selling review have been met from the inherited estate (see below). Accordingly, these costs have not been charged to the asset shares used in the determination of policyholder bonus rates. Hence policyholders' pay-out values have been unaffected by pension mis-selling.

In 1998, Prudential stated that deducting mis-selling costs from the inherited estate would not impact its bonus or investment policy and it gave an assurance that if this unlikely event were to occur, it would make available support to the fund from shareholder resources for as long as the situation continued, so as to ensure that policyholders were not disadvantaged. The assurance was designed to protect both existing policyholders at the date it was announced, and policyholders who subsequently purchased policies while the pension mis-selling review was continuing. This review was completed on 30 June 2002. The assurance will continue to apply to any policy in-force at 31 December 2003, both for premiums paid before 1 January 2004, and for subsequent regular premiums (including future fixed, RPI or salary-related increases and Department of Work and Pensions rebate business). The assurance has not applied to new business since 1 January 2004. New business in this context consists of new policies, new members to existing pension schemes plus regular and single premium top-ups, transfers and switches to existing arrangements. The maximum amount of capital support available under the terms of the assurance will reduce over time.

The bonus and investment policy for each type of with-profits policy is the same irrespective of whether or not the assurance applies and this is expected to continue for the foreseeable future. Hence removal of the assurance for new business has had no impact on policyholder returns.

### *Mortgage endowment products*

In common with several other UK insurance companies, the Prudential Group used to sell low-cost endowment products related to repayment of residential mortgages. At sale, the initial sum assured is set at a level such that the projected benefits, including an estimate of the annual bonus receivable over the life of the policy, will equal or exceed the mortgage debt. Because of a decrease in expected future investment returns since these products were sold, the FSA is concerned that the maturity value of some of these products will be less than the mortgage debt. The FSA has worked with insurance companies to devise a programme whereby the companies write to customers indicating whether they may have a possible shortfall and outline the actions that the customers can take to prevent this possibility.

The Prudential Group is exposed to mortgage endowment products in respect of policies issued by Scottish Amicable Life plc ("SAL") and policies issued by Scottish Amicable Life Assurance Society ("SALAS") which were transferred into the Scottish Amicable Insurance Fund ("SAIF"). At 31 December, 2007, 2008 and 2009, respectively, provisions of £5 million, £5 million and £4 million in SAL and £43 million, £40 million and £35 million in SAIF were held with policyholder liabilities to cover potential compensation in respect of mortgage endowment product mis-selling claims. As SAIF is a separate sub-fund of the PAC long-term business fund, this provision has no impact on shareholders.

In addition, in the years ended 31 December 2007, 2008 and 2009, respectively, PAC's main with-profits fund paid compensation of £5 million, £1 million and £2 million in respect of mortgage endowment products mis-selling claims and at 31 December 2007, 2008 and 2009, respectively, held a provision of £55 million, £54 million and £47 million in respect of further compensation. The movement in this provision has no impact on the Prudential Group's profit before tax.

In May 2006, the Prudential Group introduced a deadline for both Prudential and Scottish Amicable mortgage endowment complaints. Impacted customers have three years to lodge a mis-selling complaint in line with the time limit prescribed by the FSA and the Association of British Insurers.

The provision for mortgage endowment claims is based on the Prudential Group's expectations of amounts that it might have to pay if there is a shortfall of the final maturity value of the policy as compared to the mortgage amount repayable. It is not based on explicit claims but on the Prudential Group's expectation of what might be claimed in the future. It is based on the following factors:

- the expected number of future claims (based on a proportion of the number of non-timebarred red letters);
- an expected proportion of claims submitted that are expected to be successful;
- an expected cost per successful claim; and
- an estimate of the expenses associated with dealing and settling any claims that may arise in the future

where all these factors are set according to recent experience, with margins for prudence as appropriate.

#### *Discussions with tax authorities*

As is common for many large business, members of the Prudential Group from time to time hold discussions with relevant tax authorities as part of agreeing their tax computations for each accounting period. Some of these discussions may be contentious in nature and a small number of the matters under discussion are (or may become) the subject of litigation. The Directors believe that appropriate and adequate provisions have been made in the Prudential Group accounts to cover any amounts that may be payable once such outstanding matters have been resolved.

#### **19. Working capital statement**

Prudential is of the opinion that, after taking into account the bank and other facilities available to the Prudential Group, as well as the net proceeds of the Rights Issue, the working capital available to the Prudential Group is sufficient for its present requirements, that is, for at least the next 12 months from the date of this prospectus.

For the avoidance of doubt, in the event that the Acquisition does not complete, Prudential is of the opinion that, after taking into account the bank and other facilities available to the Prudential Group, and excluding the net proceeds of the Rights Issue, the working capital available to the Prudential Group is sufficient for its present requirements, that is, for at least the next 12 months from the date of this prospectus.

Prudential is of the opinion that, after taking into account the bank and other facilities available to the Enlarged Group, as well as the net proceeds of the Rights Issue, the working capital available to the Enlarged Group is sufficient for its present requirements, that is, for at least the next 12 months from the date of this prospectus.

#### **20. Significant change**

There has been no significant change in the financial or trading position of the Prudential Group since 31 December 2009, the date to which Prudential's financial information included in Part XIV of this prospectus was prepared.

There has been no significant change in the financial or trading position of the AIA Group since 30 November 2009, the date to which AIA's financial information included in Part XV of this prospectus was prepared.

#### **21. No material adverse change**

There has been no material adverse change in the trading or financial position of the Prudential Group since 31 December 2009, the date to which Prudential's financial information is included in Part XIV of this prospectus.

#### **22. Consents**

KPMG Audit Plc has given and has not withdrawn its written consent to the inclusion of its Accountants' Report on Historical Financial Information in Section A of Part XIV and its Accountants' Reports on pro forma financial information in Section B and Section D of Part XVI of this document in the form and context in which they appear for the purposes of Rule 5.5.3.2(f) of the Prospectus Rules.

KPMG Audit Plc and KPMG have given and have not withdrawn their consent to the inclusion in this prospectus of their report in Section B of Part XVI of this prospectus and the references to their names herein in the form and context in which it appears and have authorised the contents of that report for the purposes of paragraph 5(2) of Appendix 1, Part B to the Hong Kong Listing Rules.

KPMG LLP has given and has not withdrawn its written consent to the inclusion of its Consulting Actuary's Report in Section C of Part XV of this document in the form and context in which it appears and has authorised the contents of that report for the purposes of Rule 5.5.3.2(f) of the Prospectus Rules and paragraph 5(2) of Appendix 1, Part B to the Hong Kong Listing Rules.

PricewaterhouseCoopers has given and has not withdrawn its written consent to the inclusion of its accountants' report in Part XV of this document in the form and context in which it appears and has authorised the contents of that part of this document which comprises that report for the purposes of Rule 5.5.3.2(f) of the Prospectus Rules and paragraph 5(2) of Appendix 1, Part B to the Hong Kong Listing Rules.

Written consents provided by PricewaterhouseCoopers are different from a consent filed with the SEC under Section 7 of the Securities Act, which is applicable to transactions involving securities registered under the Securities Act. PricewaterhouseCoopers has not filed a consent under Section 7 of the Securities Act.

### **23. Sources of information**

Unless otherwise indicated, the financial data relating to the Prudential Group in this prospectus has been extracted without material adjustment from the historical financial information for the Prudential Group as reported on by KPMG Audit Plc set out at Part XIV (*Historical Financial Information for Prudential Group*) of this prospectus or from the Prudential Group's unaudited accounting records, operating systems and other information prepared by Prudential.

Unless otherwise indicated, the financial data relating to the AIA Group in this prospectus has been extracted without material adjustment from the historical financial information for AIA as reported on by PricewaterhouseCoopers set out at Part XV (*Historical Financial Information for AIA Group*) of this prospectus or from the AIA Group's unaudited accounting records, operating systems and other information prepared by AIA or Prudential.

Investors should ensure that they read the whole of this prospectus and not only rely on key or summarised information.

Where third party information is used in this prospectus, the source of such information has been given. Prudential confirms that the information provided by such third parties has been accurately reproduced. So far as Prudential is aware and has been able to ascertain from information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading.

### **24. No incorporation of website information**

The contents of the Prudential Group's and AIA Group's websites do not form part of this prospectus.

### **25. Miscellaneous**

No funds have been raised by Prudential through the issue of equity securities in the 12 months immediately preceding the announcement of the Rights Issue.

The total costs and expenses payable by the Prudential Group in connection with the negotiation, preparation and implementation of the Transactions, including the issue of this prospectus and the Circular but excluding any costs associated with hedging the consideration amount are estimated to amount to approximately £850 million.

Prudential has budgeted £500 million for costs associated with hedging. The actual impact of the hedging arrangements on the acquisition price and the income statement will depend on the evolution of the sterling/dollar exchange rate through to completion of the Acquisition.

The financial information in this prospectus relating to Prudential or the Prudential Group does not comprise statutory accounts within the meaning of section 434(3) of the Companies Act 2006. Statutory accounts for each of FY 2007, FY 2008 and FY 2009 for the Prudential Group have been delivered to the Registrar of Companies.

KPMG LLP, whose address is 8 Salisbury Square, London EC4Y 8BB, has issued the Consulting Actuary's Report. The Consulting Actuary's Report has been signed by Trevor Jones and Nick Dexter in their capacity as partners of KPMG LLP. Mr. Jones and Mr. Dexter are both Fellows of the Institute of Actuaries.

Prudential will make appropriate announcements to a Regulatory Information Service giving details of the results of the Rights Issue and details of the Rights Issue Shares not taken up by Qualifying Shareholders on or about 15 June 2010.

It is not currently proposed that the aggregate of the remuneration payable to and benefits in kind receivable by the directors of AIA will be varied in consequence of the Acquisition.

Save as disclosed in this prospectus and as at the latest practicable date prior to the publication of this prospectus:

- (a) none of the Directors nor any of the experts was interested, directly or indirectly, in any assets other than investment or insurance products marketed, sold or managed by the Prudential Group on substantially the same terms as those prevailing at the time of the transaction for other comparable customers which have, within the two years immediately preceding the issue of this prospectus, been acquired or disposed of by or leased to the Enlarged Group, or are proposed to be acquired or disposed of by or leased to the Enlarged Group;
- (b) none of the Directors was materially interested in any contract or arrangement subsisting at the date of this prospectus which is significant in relation to the Enlarged Group's business;
- (c) within the two years preceding the date of this prospectus, no capital of the principal subsidiaries of the Prudential Group or any subsidiaries of the AIA Group is under option or is agreed conditionally or unconditionally to be put under option; and
- (d) within the two years immediately preceding the date of this prospectus, no commissions, discounts, brokerage or other special terms have been granted in connection with the issue or sale of any capital of the principal subsidiaries of the Group and any subsidiaries of the AIA Group.

None of KPMG Audit Plc, KPMG or KPMG LLP has any shareholding interests in Prudential or any of its subsidiaries or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in Prudential or any of its subsidiaries.

PricewaterhouseCoopers has no shareholding interests in AIA or any of its subsidiaries or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in AIA or any of its subsidiaries.

The Directors have been advised that as at 14 May 2010, being the latest practicable date prior to publication of this prospectus, no liability for estate duty in Hong Kong is likely to fall on Prudential or any of its subsidiaries.

## **26. Documents available for inspection**

Copies of the following documents will be available for inspection during usual business hours on Monday to Friday of each week (public holidays excepted) from 17 May 2010 at the offices of Slaughter and May, One Bunhill Row London EC1Y 8YY and Slaughter and May, 47th Floor, Jardine House, One Connaught Place, Central, Hong Kong until 23 June 2010 and will also be available for inspection for 15 minutes before and during the Court Meeting and General Meeting:

- (A) the current memorandum and articles of association of Prudential;
- (B) the memorandum and articles of association of New Prudential;
- (C) the report on historical financial information for the Prudential Group prepared by KPMG Audit Plc as set out in Part XIV of this prospectus;
- (D) the independent auditor's report to Prudential plc on the European Embedded Value (EEV) basis supplementary information prepared by KPMG Audit Plc as set out in Part XIV of this prospectus;
- (E) the report on historical financial information for AIA Group prepared by PricewaterhouseCoopers as set out in Part XV of this prospectus;
- (F) the consulting actuaries report on AIA EEV information by KPMG LLP as set out in Part XV of this prospectus;
- (G) the report on pro forma income statement and pro forma net asset statement (UK purposes) by KPMG Audit Plc as set out in part XVI of this prospectus and the report on pro forma income statement and pro forma net asset tangible statement (Hong Kong purposes) by KPMG Audit Plc and KPMG as set out in Part XVI of this prospectus;
- (H) the report on pro forma net worth and value-in-force on a European Embedded Value Basis by KPMG Audit Plc as set out in Part XVI of this prospectus;
- (I) the service agreements and letters of appointment of the Directors referred to in paragraph 6 of this Part XIX;
- (J) the written consents referred to in paragraph 22 of this Part XIX;
- (K) the Circular;
- (L) a copy of this prospectus;
- (M) a copy of the New Prudential Prospectus; and
- (N) the material contracts set out in paragraphs 16 and 17 of this Part XIX (available in Hong Kong only).

## **27. Hong Kong Stock Exchange waivers**

In connection with its listing application to the Hong Kong Stock Exchange, Prudential has applied for certain waivers from the Hong Kong Stock Exchange from strict compliance with certain requirements of the Hong Kong Listing Rules:

- the requirements of paragraphs 34 and 38 of Appendix 1B of the Hong Kong Listing Rules to impose duties of disclosure of interest in Prudential Shares on the condition that this prospectus will contain such interests as are notified to Prudential under the Disclosure and Transparency Rules in lieu of information disclosed pursuant to Part XV of the Securities and Futures Ordinance;
- the requirement to contain a summary of the Prudential's regulatory provisions of the jurisdiction in which Prudential is incorporated pursuant to Rule 19.10(3) of the Hong Kong Listing Rules in all subsequent listing documents of Prudential following the introduction of the Prudential Shares to the Hong Kong Stock Exchange;

- the requirements to disclose the details of share option schemes pursuant to paragraph 25 of Appendix 1B of the Hong Kong Listing Rules in all subsequent listing documents of Prudential following the introduction of the Prudential Shares to the Hong Kong Stock Exchange; and
- Rule 2.07C(1)(b)(ii) of the Hong Kong Listing Rules requires a company to publish its prospectus on the same day as it is despatched to shareholders. In connection with the Rights Issue, the Hong Kong Stock Exchange has permitted Prudential to publish this prospectus on 17 May 2010 and despatch it to its shareholders on 8 June 2010 on the grounds that it would be unduly burdensome and the non-compliance with this rule will not otherwise prejudice the interest of the investing public.

## **28. Registration and removal of Prudential Shares between Registers**

### **28.1 Registration**

In accordance with English law, the principal register of members of Prudential is kept in the UK, and is maintained by the Registrar. In connection with the introduction of the Prudential Shares to the Hong Kong Stock Exchange, Prudential will establish an overseas branch register of members in Hong Kong (the “HK Register”), which will be maintained by the HK Registrar. The HK Register may, in accordance with English law, only include members who are resident in Hong Kong.

Shareholders (including nominee companies or others who hold as nominees) who have registered addresses in Hong Kong will be issued with Prudential Shares which will be registered on the HK Register. All other shareholders will be issued with Prudential Shares which will be registered on the UK Register.

Certificates in respect of Prudential Shares registered on the HK Register will indicate that the Prudential Shares are registered on the HK Register.

Prudential will keep a duplicate of the HK Register updated from time to time at the place in England where the UK Register is kept available for inspection. Prudential will also keep in Hong Kong a duplicate of the UK Register updated from time to time. It will be available for inspection on a similar basis as the HK Register will be available for inspection in the UK, and in the same manner as the HK Register is available for inspection in Hong Kong.

Certificates in respect of Prudential Shares registered on the HK Register will be issued, unless otherwise requested, in one share certificate to each shareholder recorded on the HK Register to represent the entire holding of that shareholder recorded on the HK Register.

### **28.2 Removals of Prudential Shares between registers**

#### *Voluntary removals of Prudential Shares between registers*

Any shareholder whose Prudential Shares are registered on the UK Register may at any time obtain a form of request from the Registrar to remove Prudential Shares to the HK Register. A form of request for removal when completed should be returned together with the corresponding share certificates (unless the Prudential Shares are held in CREST and the shareholder has made a stock withdrawal instruction through CREST on the same day as described below) and cheque for the relevant charges to the Registrar who will arrange for the removal of such Prudential Shares to the HK Register, provided that the shareholder concerned provides a registered address in Hong Kong.

Prudential Shares held in CREST must be withdrawn from CREST in order to be removed to the HK Register. Accordingly, in addition to submitting a removal request, any shareholder holding Prudential Shares through CREST should arrange for a stock withdrawal instruction to be sent through the CREST system specifying the number of Prudential Shares to be withdrawn from CREST and the name and address for registration of such Prudential Shares on the UK Register prior to removal to the HK Register.

Similarly, any shareholder whose Prudential Shares are registered on the HK Register can at any time obtain a form of request from the HK Registrar to remove shares to the UK Register. On the return of such form, duly completed, together with the corresponding share certificates and payment for the relevant charges, the HK Registrar will arrange for the removal of such Prudential Shares to the UK Register.

Prudential Shares held in CCASS must be withdrawn from CCASS in accordance with the rules of CCASS and registered onto the HK Register before they can be removed to the UK Register.

For shareholders who wish to be registered on the HK Register by 25 May 2010, when it is expected that the introduction of the Prudential Shares to the Hong Kong Stock Exchange will become effective, a batch removal process will be available as disclosed below. From 20 May 2010 until 28 June 2010, removals between registers will be performed using an expedited removal process as disclosed below.

### *Compulsory removal from the HK Register*

Any transfer of Prudential Shares registered on the HK Register to a shareholder with a registered address outside Hong Kong will automatically result in the compulsory removal of such Prudential Shares from the HK Register to the UK Register. Such a shareholder will be informed that his Prudential Shares will be placed on the UK Register and he will receive new share certificates from the Registrar.

Similarly, if a shareholder on the HK Register ceases to have a registered address in Hong Kong following a change of address, his Prudential Shares will be automatically removed from the HK Register to the UK Register. In such circumstances, the shareholder is requested to return all relevant share certificates to the HK Registrar for cancellation and the Registrar will be instructed to issue new share certificates.

### **28.3 Removal charges and Prudential Share removal times from 29 June 2010**

The following table sets forth two levels of Prudential Share removal services offered by the Registrar and the HK Registrar from 29 June 2010:

<u>Category</u>	<u>Registrar</u>	<u>Standard</u>	<u>Express</u>										
Hong Kong to UK	HK Registrar	HK\$25.00 base + HK\$2.50 per certificate cancelled	0.05% of market value of shares removed										
	Registrar	No fee	Charges based on the value of the transaction:- <table><thead><tr><th><u>Value</u></th><th><u>Charge</u></th></tr></thead><tbody><tr><td>Up to £500,000</td><td>£110 + VAT</td></tr><tr><td>£500,001 to £1,000,000</td><td>£220 + VAT</td></tr><tr><td>£1,000,001 to £2,000,000</td><td>£330 + VAT</td></tr><tr><td>Over £2,000,000</td><td>£400 + VAT</td></tr></tbody></table>	<u>Value</u>	<u>Charge</u>	Up to £500,000	£110 + VAT	£500,001 to £1,000,000	£220 + VAT	£1,000,001 to £2,000,000	£330 + VAT	Over £2,000,000	£400 + VAT
<u>Value</u>	<u>Charge</u>												
Up to £500,000	£110 + VAT												
£500,001 to £1,000,000	£220 + VAT												
£1,000,001 to £2,000,000	£330 + VAT												
Over £2,000,000	£400 + VAT												
UK to Hong Kong	Registrar	£15.00 + VAT	Charges based on the value of the transaction:- <table><thead><tr><th><u>Value</u></th><th><u>Charge</u></th></tr></thead><tbody><tr><td>Up to £500,000</td><td>£110 + VAT</td></tr><tr><td>£500,001 to £1,000,000</td><td>£220 + VAT</td></tr><tr><td>£1,000,001 to £2,000,000</td><td>£330 + VAT</td></tr><tr><td>Over £2,000,000</td><td>£400 + VAT</td></tr></tbody></table>	<u>Value</u>	<u>Charge</u>	Up to £500,000	£110 + VAT	£500,001 to £1,000,000	£220 + VAT	£1,000,001 to £2,000,000	£330 + VAT	Over £2,000,000	£400 + VAT
	<u>Value</u>	<u>Charge</u>											
Up to £500,000	£110 + VAT												
£500,001 to £1,000,000	£220 + VAT												
£1,000,001 to £2,000,000	£330 + VAT												
Over £2,000,000	£400 + VAT												
	HK Registrar	HK\$25.00 base fee + HK\$2.50 per certificate issued	0.05% of market value of shares removed										

The Registrar and the HK Registrar aim to complete a standard removal of Prudential Shares (whether UK to Hong Kong or Hong Kong to UK) within six HK Business Days plus five UK business days. The Registrar and the HK Registrar aim to complete an express removal of Prudential Shares (Hong Kong to UK) within two HK Business Days plus one UK business day and an express removal of Prudential Shares (UK to Hong Kong) within two HK Business Days plus up to two UK business days. These time periods assume that the name and address of the shareholder which will appear on the UK Register and the HK Register are the same. Where a removal of Prudential Shares from the HK Register to the UK Register also involves the re-registration of the shares in a different name and/or address, then an additional re-registration fee of HK\$20.00 is payable to the HK Registrar for each certificate to be cancelled. In addition, the HK Registrar may require up to four additional HK Business Days to complete a standard removal of Prudential Shares if re-registration is required, and up to one additional HK Business Day to complete an express removal of Prudential Shares if re-registration is required.

Once a Prudential Share has been removed to the UK Register, it may be deposited into CREST in accordance with the rules of CREST. Similarly, once a Prudential Share has been removed to the HK Register, it may be deposited in CCASS in accordance with the rules of CCASS.

### **28.4 Special arrangements to facilitate removals of Prudential Shares to the HK Register prior to and during the initial period after the introduction of the Prudential Shares to the Hong Kong Stock Exchange.**

Special arrangements have been made to facilitate removals of Prudential Shares from the UK Register to the HK Register prior to and during the initial period after the introduction of the Prudential Shares to the Hong Kong Stock

Exchange, expected to be effective 25 May 2010, (“Introduction”) by way of a batch removal process (the “Batch Removal” process) and an expedited removal process (the “Expedited Removal Process”). Further details regarding these processes are set out below.

### **28.5 Batch Removal process**

For shareholders who wish to be registered on the HK Register by 25 May 2010, when it is expected that the introduction of the Prudential Shares to the Hong Kong Stock Exchange will become effective, the Registrar and the HK Registrar will arrange for the removal of Prudential Shares to the HK Register in a single batch as described below. Shareholders who wish to remove their Prudential Shares from the UK Register to the HK Register using this process will need to complete a request for removal of securities form. The form, which contains details of how it should be returned, is available from Prudential’s website at [www.prudential.co.uk/transaction](http://www.prudential.co.uk/transaction). For Prudential Shares to be registered on the HK Register by 25 May 2010, when it is expected that the introduction of the Prudential Shares to the Hong Kong Stock Exchange will become effective, the request for removal of securities forms must be received by the Registrar by no later than 5.00 p.m. (London time) on 19 May 2010. Except in circumstances where the Prudential Shares are held in CREST and the shareholder has made a stock withdrawal instruction through the CREST system on the same day as described below, the corresponding share certificates must be sent to the Registrar together with the request for removal of securities form.

Prudential Shares held in CREST must be withdrawn from CREST in order to be removed to the HK Register. Accordingly, in addition to submitting a request for removal of securities form, shareholders holding their Prudential Shares through CREST should arrange for a stock withdrawal instruction to be sent through the CREST system specifying the number of Prudential Shares to be withdrawn from CREST and the name and address for registration of such Prudential Shares on the UK Register prior to removal to the HK Register. This stock withdrawal instruction must settle by 3.00 p.m. (London time) on 19 May 2010, taking into account standard settlement times within the CREST system. In order to facilitate the removal of the Prudential Shares to the HK Register, this should be the name and address which will be registered on the HK Register. This must be a registered address in Hong Kong to be eligible for entry on the HK Register. The same name should appear on the request for removal of securities form. In order to facilitate deposit of the Prudential Shares into CCASS following their removal to the HK Register, the name and address specified upon withdrawal from CREST should where possible be that of the CCASS participant or person holding an account with a CCASS participant who will hold the Prudential Shares in CCASS.

The request for removal of securities form will set out the terms and conditions relating to the Batch Removal process. In particular, in signing a request for removal of securities form a shareholder agrees that, in the event the Introduction does not proceed, Prudential is authorised to arrange for its Prudential Shares to be removed back to the UK Register.

If a duly completed request for removal of securities form is received by the Registrar by 5.00 p.m. (London time) on 19 May 2010 together with the corresponding share certificates, or, if the Prudential Shares are held in CREST, settlement of a stock withdrawal instruction, (which instructions must be settled by 3.00 p.m. (London time) on (19 May 2010), subject to the granting of admission of, and permission to deal in, the Prudential Shares on the main board of the Hong Kong Stock Exchange by the listing committee of the Hong Kong Stock Exchange, it is expected that the relevant Prudential Shares will be registered on the HK Register by 24 May 2010 and that the corresponding share certificates will be despatched to the address of the shareholder specified on the HK Register or be available for collection from the offices of the HK Registrar at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong. In order for a shareholder or its specified nominee to arrange collection of its share certificates it should, following the return of its request for removal of securities form to the Registrar, notify the HK Registrar in writing to the address set out above, by email to [hkinfo@computershare.com.hk](mailto:hkinfo@computershare.com.hk) or by fax to (852) 2865 0990, before 24 May 2010.

Once any Prudential Shares have been removed to the HK Register, they may be deposited in CCASS in accordance with the rules of CCASS. Whether such Prudential Shares will be immediately credited to the stock account of the CCASS participant for electronic book-entry settlement in CCASS will also be subject to the rules of CCASS. As such, any person who would want to take advantage of the expedited procedure for removals to settle Prudential Share transactions in Hong Kong through CCASS should consult their CCASS participant ahead of time.

There are no fees payable in respect of such removals of Prudential Shares under the Batch Removal process.

### **28.6 Expedited removal process**

From 20 May 2010 until 28 June 2010 (subject to the suspension described below), shareholders will be able to obtain a request for removal of securities form from the Registrar and Prudential’s website at [www.prudential.co.uk/](http://www.prudential.co.uk/)

transaction. On the return of such form to the Registrar, duly completed, the Registrar will arrange for the removal of such Prudential Shares to the HK Register, as long as the shareholder concerned provides a registered address in Hong Kong. Except in circumstances where the Prudential Shares are held in CREST and the shareholder has made a stock withdrawal instruction through the CREST system on the same day as described below, the corresponding share certificates must be sent to the Registrar together with the request for removal of securities form. This service will be available without charge to the shareholder concerned.

If a duly completed request for removal of securities form and the corresponding share certificates, or, if the Prudential Shares are held in CREST, settlement of a stock withdrawal instruction, are received by the Registrar prior to 3.00 p.m. (London time) on a UK business day, the share registrars aim to complete an expedited removal of Prudential Shares from the UK Register to the HK Register within a period of one UK business day plus one HK Business Day (provided that, in the case of shareholders who hold their Prudential Shares in CREST, the stock withdrawal instruction has settled through CREST by 3.00 p.m. (London time) on the day that the request is received by the Registrar). Under such circumstances, it is therefore expected that the Prudential Shares would be registered on the HK Register, and the corresponding share certificates would be despatched to the address of the shareholder specified on the HK Register or be available for collection from the offices of the HK Registrar at the address set out above, by 9.00 a.m. (Hong Kong time) on the date falling one UK business day plus one HK Business Day after the date of receipt by the Registrar of the request for removal of securities form. In order for a shareholder or its specified nominee to arrange collection of its share certificates it should, following the return of its request for removal of securities form to the Registrar, notify the HK Registrar in writing to the address set out above, by email to [hkinfo@computershare.com.hk](mailto:hkinfo@computershare.com.hk) or by fax to (852) 2865 0990, before 9.00 a.m. (Hong Kong time) on the date falling one UK business day plus one HK Business Day after the date of receipt by the Registrar of the request for removal of securities form.

Prudential Shares held in CREST must be withdrawn from CREST in order to be removed to the HK Register. Accordingly, in addition to submitting a request for removal of securities form, shareholders holding their Prudential Shares through CREST should arrange for a stock withdrawal instruction to be sent through the CREST system specifying the number of Prudential Shares to be withdrawn from CREST and the name and address for registration of such Prudential Shares on the UK Register prior to removal to the HK Register. In order to facilitate the removal of the Prudential Shares to the HK Register, this should be the name and address which will be registered on the HK Register. This must be a registered address in Hong Kong to be eligible for entry on the HK Register. The same name should appear on the request for removal of securities form. In order to facilitate deposit of the Prudential Shares into CCASS following their removal to the HK Register, the name and address specified upon withdrawal from CREST should where possible be that of the CCASS participant or person holding an account with a CCASS participant who will hold the Prudential Shares in CCASS.

Once a Prudential Share has been removed to the HK Register, it may be deposited in CCASS in accordance with the rules of CCASS. Whether such Prudential Shares will be immediately credited to the stock account of the CCASS participant for electronic book-entry settlement in CCASS will also be subject to the rules of CCASS. As such, any person who would want to take advantage of the expedited procedure for removals to settle Prudential Share transactions in Hong Kong through CCASS should consult their CCASS participant ahead of time.

In signing and lodging a request for the removal of securities form before the Introduction becomes effective a shareholder agrees that, in the event the Introduction does not proceed, Prudential is authorised to arrange for its Prudential Shares to be removed back to the UK Register.

Any shareholder whose Prudential Shares are registered on the HK Register will be able to obtain a request for removal of securities form from the HK Registrar for a removal to the UK Register from 25 May 2010. On the return of such form to the HK Registrar, duly completed, together with the corresponding share certificates and payment for the relevant charges, the HK Registrar will arrange for the removal of such Prudential Shares to the UK Register. Prudential Shares held in CCASS must be withdrawn from CCASS in accordance with the rules of CCASS and registered onto the HK Register before they can be removed to the UK Register.

Where a duly completed request for removal of securities form is received by the HK Registrar together with the corresponding share certificate prior to 5.00 p.m. (Hong Kong time) on a HK Business Day, the Registrars aim to complete an expedited removal of Prudential Shares from the HK Register to the UK Register within a period of one HK Business Day plus one UK business day. This service will be available without charge to the shareholder concerned.

Once a Prudential Share has been removed to the UK Register, it may be deposited into CREST in accordance with the rules of CREST.

## ***28.7 Suspension of removals between registers in relation to the Rights Issue***

Removals between the UK Register and the HK Register will be suspended for a period in connection with the Rights Issue. The suspension period will be from 3.00 p.m. (London time) on 1 June 2010 to 8.00 a.m. (London time) on 8 June 2010 in the UK and from 4.30 p.m. (Hong Kong time) on 1 June 2010 to 9.30 a.m. on 8 June 2010 (Hong Kong time) in Hong Kong.

## **29. Liquidity Arrangements**

### ***29.1 Intended liquidity arrangements during the Designated Period***

Prior to and upon the Introduction, the Designated Dealers will seek to undertake stock borrowing and other trading activities in the circumstances described below.

Certain trades envisaged to be carried out by the Designated Dealers during the Designated Period would technically constitute covered short-selling under applicable Hong Kong laws and regulations. In this regard, Credit Suisse (Hong Kong) Limited has applied for on behalf of the Designated Dealers and has obtained an exemption from the Hong Kong Stock Exchange in order to permit the Designated Dealers to conduct the proposed short sale arrangements during the Continuous Trading Period in circumstances where the Prudential Shares are not “Designated Securities”, as defined in the Rules of the Hong Kong Stock Exchange and in order to ensure compliance with the Rules of the Hong Kong Stock Exchange which restrict short sales to only Designated Securities. In addition, the Hong Kong Stock Exchange has waived the restriction on short selling during the Pre-opening Session (from 9.30 a.m. to the commencement of the morning trading session at 10.00 a.m.) to allow the Designated Dealers to effect covered short-sale trades in the Prudential Shares during the daily Pre-opening Session for the duration of the Designated Period in order to enable the Designated Dealers to sell borrowed Prudential Shares during the Pre-opening Session. Credit Suisse (Hong Kong) Limited has also applied for on behalf of the Designated Dealers and has obtained from the Hong Kong Stock Exchange an exemption from the regulation that a short sale shall not be made on the Hong Kong Stock Exchange below the best current ask price except where the Designated Security is an Exchange Traded Fund traded under the Pilot Program or is an Exchange Traded Fund approved by the SFC to be excluded from the application of this regulation. The above exemptions granted are collectively referred to as the “Exemptions”.

No persons other than the Designated Dealers are permitted to enter into short sales of Prudential Shares on the Hong Kong Stock Exchange during the Designated Period or thereafter unless the Prudential Shares are designated for short selling by the Hong Kong Stock Exchange. Upon expiry of the Designated Period, the Designated Dealers will not be able to engage in further covered short sales on the Hong Kong Stock Exchange unless the Prudential Shares are designated for short selling by the Hong Kong Stock Exchange.

Such activities and Exemptions will facilitate the Designated Dealers in conducting stock trading activities on the Hong Kong Stock Exchange during the Designated Period with a view to seeking to provide liquidity to meet demand for Prudential Shares upon and in the period immediately following the Introduction:

1. The Designated Dealers will enter into stock borrowing arrangements with existing shareholders and remove borrowed Prudential Shares from the UK Register to the HK Register. Upon the Introduction and during the Designated Period, the Designated Dealers will seek to make Prudential Shares from such inventory and any additional Prudential Shares which they may borrow or purchase during the Designated Period available for sale to the Hong Kong market to meet demand if supply from other market sources proves to be insufficient to maintain an orderly market. These arrangements will terminate and cease upon the expiry of the Designated Period.
2. To seek to ensure that they will have ready access to appropriate quantities of Prudential Shares for settlement purposes upon the Introduction and during the Designated Period, the Designated Dealers have entered or will enter into stock borrowing and lending agreements with existing shareholders under arm’s length stock borrowing terms. Pursuant to the stock borrowing arrangements, such shareholders have made or will make available to the Designated Dealers lending facilities. Such Prudential Shares will be used principally to settle trades carried out by the Designated Dealers in Hong Kong. These Prudential Shares will have been registered on the HK Register prior to the Introduction.
3. To close out their borrowed positions, the Designated Dealers may purchase Prudential Shares or nil paid rights in the London market or in the Hong Kong market or remove back to the UK any unutilised Prudential Shares and transfer such Prudential Shares to the lending shareholders. If necessary, the Designated Dealers may repeat the process or alternatively may purchase Prudential Shares in the UK market or the Hong Kong market in order to provide additional liquidity to meet demand for Prudential Shares in the Hong Kong market during the Designated Period.

4. The Designated Dealers will set up designated broker identity numbers solely for the purposes of carrying out covered short-sale and other trades (including purchases and sales of Prudential Shares) in Hong Kong pursuant to those arrangements, in order to assist in identification and thereby seek to enhance the transparency of such trades on the Hong Kong market. Once the respective designated broker identity numbers are available and in any event not later than the HK Business Day before the first day of the Introduction, the Designated Dealers will notify Prudential of their designated broker identity numbers. Such information will then be posted on the website of Prudential, and disclosed by way of an announcement on the Hong Kong Stock Exchange. It is expected that this announcement will be made on or around 19 May 2010. Any change in such designated broker identity numbers will be disclosed as soon as practicable using the same channels as described above.

5. The Designated Dealers have entered and will enter into such arrangements (including the covered short-sale trading activities and any purchases and sales of Prudential Shares) on a voluntary basis in good faith and on arm's length terms with a view to contributing towards liquidity to meet demand for Prudential Shares in Hong Kong.

6. During the suspension period as described in section 28.7 of this Part XIX, the Designated Dealers intend to build an inventory prior to the commencement of the suspension through a combination of borrowing and purchases of Prudential Shares in either London or Hong Kong. These shares will then be made available to meet demand if supply from other market sources proves to be insufficient. The Designated Dealers will use their expertise and judgment to assess, based on the level of market demand during the suspension period, whether and in what number any additional stock borrowing or purchase arrangements are needed during the suspension period to provide liquidity in that period.

It is emphasised that other existing shareholders who may have removed part or all of their Prudential Shares from the UK Register to the HK Register prior to or upon the commencement of trading (or thereafter) can also carry out arbitrage trades in the Prudential Shares. Such activities will depend on, amongst other things, the extent of price differentials between the two stock exchanges, and the number of market participants who elect to enter into such arbitrage arrangements.

The stock borrowing and trading activities of the Designated Dealers and any persons acting for them will be entered into in accordance with all applicable laws, rules and regulations. The liquidity arrangements being implemented in connection with the Introduction are not equivalent to the price stabilisation activities which may be undertaken in connection with an initial public offering. In addition, the Designated Dealers are not acting as Market Makers or Security Market Makers (as those terms are defined in the Rules of the Hong Kong Stock Exchange). In particular, the Designated Dealers do not intend to seek to use buying of Prudential Shares in Hong Kong to meet excess supply in the market.

It should be noted that the Designated Dealers and any persons acting for them may, in connection with the proposed liquidity activities, maintain a long position in the Prudential Shares. There is no certainty regarding the extent or time or the period for which the Designated Dealers and any persons acting for them may maintain such a long position in the Prudential Shares. The liquidation of any such long position by the Designated Dealers or any person acting for them may have an adverse impact on the market price of the Prudential Shares.

## ***29.2 Spread of Shareholdings***

It is expected that the following measures and factors will assist in creating and/or improving the spread of holdings of the Prudential Shares available for trading on the Hong Kong Stock Exchange following the Introduction:

- As the Prudential Shares are of one and the same class, shareholders may at their discretion remove Prudential Shares from the UK to Hong Kong upon or after the Introduction, as described in section 28.2 of this Part XIX. Special arrangements have been made to facilitate removals of Prudential Shares, and to incentivise existing shareholders to remove their Prudential Shares to Hong Kong prior to and during the initial period after the Introduction under the Batch Removal process and the Expedited Removal Process at a fully subsidised cost. Details of such arrangements are set out above in the sections 28.5 and 28.6 of this Part XIX. To the extent that existing shareholders elect to remove Prudential Shares to Hong Kong before or shortly after the Introduction, such Prudential Shares may help contribute to the general liquidity of the Prudential Shares on the Hong Kong market.
- As indicated in section 29.1 of this Part XIX above, it is expected that existing shareholders will lend and make available to the Designated Dealers Prudential Shares and the Designated Dealers and/or persons acting for them may also purchase Prudential Shares in either the UK market or the Hong Kong market which, in each case, will be used principally to settle trades carried out by the Designated Dealers in Hong Kong.

- In conducting stock borrowing and trading activities in circumstances as described above in section 29.1 of this Part XIX, the Designated Dealers are effectively acting as a conduit to transfer some of the trading liquidity of the Prudential Shares in the UK market to the Hong Kong market.

### ***29.3 Benefits of the liquidity arrangements***

It is believed that the liquidity arrangements will benefit the Introduction in the following ways:

- by having a mechanism in place to promote and facilitate liquidity to meet demand for Prudential Shares on the Hong Kong market upon and during the initial period after the Introduction. During the Designated Period, the Designated Dealers will, at their discretion and to the extent they consider appropriate, seek to make Prudential Shares available for sale to the Hong Kong market, to try to meet demand if supply from other market sources proves to be insufficient to maintain an orderly market; and
- by seeking to minimise the risk of a disorderly market developing from significant demand for Prudential Shares not fulfilled in Hong Kong upon and during the initial period after the Introduction.

### ***29.4 Disclosure of the liquidity arrangements***

In order to enhance transparency of the activities carried out under the liquidity arrangements described above, various measures to provide information to the market and potential investors will be undertaken as described in section 30 of this Part XIX below.

Further, Prudential will, as soon as practicable and in any event before the opening of Hong Kong trading hours on the business day immediately before the first day of the Introduction, release an announcement on the Hong Kong Stock Exchange to inform the investing public of the following information as at the latest practicable date prior to such announcement:

- the number of Prudential Shares in respect of which the Registrar has received instructions from shareholders for the removal of such Prudential Shares to the HK Register under the Batch Removal process; and
- the total number of Prudential Shares which have been registered on the HK Register.

It should be noted that Prudential Shares removed from the UK Register to the HK Register in the Batch Removal (as set out in section 28.5 of this Part XIX) may include Prudential Shares which shareholders intend at that time or subsequently to move to CDP. Accordingly, it is possible that not all of the Prudential Shares removed from the UK Register to the HK Register in the Batch Removal will necessarily be available for trading in Hong Kong.

In respect of the trades (including covered short-sales and purchases or sales of Prudential Shares) to be carried out by the Designated Dealers on the Hong Kong Stock Exchange, the Designated Dealers will set up designated broker identity numbers solely for the purposes of carrying out such trades in Hong Kong, in order to assist in identification and thereby enhance transparency of the trades on the Hong Kong market. Information relating to such designated broker identity numbers will be disclosed as set out in section 29.1 of this Part XIX.

## **30. Investor awareness**

### ***30.1 Arrangements involving Prudential and the Designated Dealers***

Prior to the Introduction, Prudential and the Designated Dealers have been cooperating to inform the investor community in the UK and Hong Kong of the processes for removing Prudential Shares to the HK Register and to inform the investor community in Hong Kong of the liquidity arrangements as disclosed in this prospectus, and any developments or changes thereto. After the Introduction has taken place, Prudential and the Designated Dealers may continue to take measures to educate the public. The following measures will be taken to enhance the transparency of Prudential, the Batch Removal process, Expedited Removal Process and the liquidity arrangements:

- there will be media briefings and press interviews to inform investors of the arrangements;
- briefings will be conducted to local brokerage houses in Hong Kong;
- briefings in relation to the liquidity arrangements will be conducted for, amongst others, private bank divisions, a syndicate of brokerage houses and other institutional investors;
- a public announcement on the share migration procedures as summarised in sections 28 and 29 respectively above of this Part XIX has been posted on the Prudential website;
- Information, including Prudential's previous day closing price, trading volume and other relevant historical data will be disclosed on the Prudential website. Furthermore, during a period of three business days up to the

commencement of dealings in the Prudential Shares on the Hong Kong Stock Exchange, a daily announcement will be released on the Hong Kong Stock Exchange, disclosing the previous day's closing price of the Prudential Shares on the London Stock Exchange, as well as any relevant developments and updates with regard to the liquidity arrangements; and

- Electronic copies of this prospectus will be disseminated through the website of Prudential and the website of the Hong Kong Stock Exchange. In addition, following the Introduction and before despatch of the Provisional Allotment Letters to the HK Shareholders physical copies of this prospectus will be made available to HK Shareholders for collection upon request made to the HK Registrar.

### **30.2 Other sources of information**

Real-time trading information in respect of the Prudential Shares can be obtained from the following sources:

- the website of London Stock Exchange at <http://www.londonstockexchange.com/information-providers/market-data/market-data.htm>, at no cost; or
- through service providers that provide such facilities at investors' own expense. Such service will be provided on and subject to the terms and conditions of the relevant service provider.

## **31. Trading and Settlement of the Prudential Shares on the SGX-ST**

### **31.1 Information on Singapore Introduction**

A letter of eligibility to list has been obtained from the SGX-ST for the secondary listing and quotation of the Prudential Shares currently in issue. For the purposes of trading on the Main Board of the SGX-ST, each board lot of Prudential Shares will comprise 500 Prudential Shares, and the Prudential Shares will be quoted and traded on the SGX-ST in US dollars.

Upon admission to the Singapore Official List, Prudential will have a dual primary listing on both the London Stock Exchange and the Hong Kong Stock Exchange, and a secondary listing on the SGX-ST. The Prudential Shares are also traded in the form of American depository shares in US dollars on the New York Stock Exchange through Prudential's ADR facility. The Prudential Shares are quoted in pounds sterling on the London Stock Exchange, in HK dollars on the Hong Kong Stock Exchange and in US dollars on the SGX-ST.

### **31.2 Trading and Settlement of the Prudential Shares on the SGX-ST**

Pursuant to the listing and quotation of the Prudential Shares on the Main Board of the SGX-ST, all dealings in and transactions of the Prudential Shares executed on the SGX-ST will be cleared and settled under the electronic book-entry clearance and settlement system of CDP, and effected in accordance with CDP's terms and conditions for the operation of securities accounts, as amended from time to time.

CDP, a wholly-owned subsidiary of Singapore Exchange Limited, is incorporated under the laws of Singapore and acts as a depository and clearing organisation. CDP holds securities for its accountholders and facilitates the clearance and settlement of securities transactions between accountholders through electronic book-entry changes in the securities accounts maintained by such accountholders with CDP. An investor may open a direct account with CDP or a sub-account with any CDP depository agent. A CDP depository agent may be a member company of the SGX-ST, bank, merchant bank or trust company.

CDP has in turn appointed a nominee to hold the Prudential Shares deposited with CDP in CCASS. Citibank, N.A., Singapore ("Citibank Singapore") has been appointed by CDP as its global custodian to hold its Prudential Shares through a CCASS Participant, Citibank, N.A., Hong Kong ("Citibank HK"), in the CCASS system.

Through the movement mechanisms discussed below, it is possible for investors to purchase Prudential Shares on the SGX-ST and sell them on the Hong Kong Stock Exchange and *vice versa*. All of the linked movements between CDP and CCASS are effected only on a Free-of-Payment basis (that is, there is no related cash movement parallel to the securities movement, and any related cash transfers may only be effected outside CDP and CCASS directly between the buyer and seller through their own arrangements).

Investors should be aware that while there is no time difference between the Singapore and Hong Kong markets, the Hong Kong Stock Exchange has shorter trading hours than the SGX-ST. The trading hours on the SGX-ST are from 9.00 a.m. to 12.30 p.m. and 2.00 p.m. to 5.00 p.m., and the trading hours on the Hong Kong Stock Exchange are from 10.00 a.m. to 12.30 p.m. and 2.30 p.m. to 4.00 p.m. Due to this difference in trading hours, trading in the Prudential Shares between the two markets may only simultaneously occur during the period in which the trading hours of the two exchanges overlap.

Dealings in the Prudential Shares will be carried out in US dollars and will be effected for settlement in CDP on a scripless basis. Settlement of trades on a normal “ready” basis on the SGX-ST generally takes place on the third Singapore Business Day following the transaction date. Accordingly, investors should ensure that Prudential Shares sold on the SGX-ST are available for settlement in their CDP account no later than the third Singapore Business Day following the transaction date. A transaction will fail if the Prudential Shares are not in an investor’s CDP account for settlement by 12:00 p.m. (Singapore time) on such day, and will be subject to the buy-in cycle at 3:00 p.m. (Singapore time) on the third Singapore Business Day following the transaction date.

A clearing fee for the trading of Prudential Shares on the SGX-ST is payable at the rate of 0.04% of the transaction value, subject to a maximum of S\$600.00 per transaction. The clearing fee, instruments of transfer deposit fees and share withdrawal fee are subject to goods and services tax (“GST”) at the prevailing standard-rate (currently 7%) if the services are provided to a holder of Prudential Shares belonging in Singapore. However, such fees could be zero-rated when provided to a holder of Prudential Shares belonging outside Singapore provided certain conditions are met. For a holder of Prudential Shares belonging in Singapore who is registered for GST, the GST incurred is generally not recoverable as input tax credit from the Inland Revenue Authority of Singapore unless certain conditions are satisfied. These GST-registered holders of Prudential Shares should seek the advice of their tax advisors on these conditions.

As no share certificates will be issued to CDP in respect of the Prudential Shares held by shareholders through CDP, no physical share certificates may be withdrawn from CDP by these shareholders. In addition, shareholders holding Prudential Shares through CDP are required to comply with any requests by Prudential and/or relevant authorities to disclose information relating to the beneficial owners of the Prudential Shares.

In the absence of unforeseen circumstances, the movement of Prudential Shares into and out of CDP will take a minimum of one Singapore Business Day after the duly completed documentation has been submitted to CDP for processing, assuming that the shareholder has given proper instructions to Citibank HK or his CCASS Participant.

**Instructions and forms received by CDP after 10:00 a.m., Singapore time, on a given Singapore Business Day will be treated as being received on the next Singapore Business Day and, as such, will be processed on the next Singapore Business Day. Shareholders are responsible for ensuring the Prudential Shares are credited into their direct securities account maintained with CDP or securities sub-account with a depository agent, as the case may be, in time for the settlement of trades on the SGX-ST, as buying in may be instituted against shareholders if they are unable to deliver the Prudential Shares for settlement pursuant to their trades.**

### ***31.3 Movement of Prudential Shares from CCASS or the HK Register to CDP***

A shareholder who holds his Prudential Shares through CCASS and wishes to move his Prudential Shares to CDP can do so in the following manner:

- (i) the shareholder must have either a direct securities account maintained with CDP or securities sub-account with a depository agent;
- (ii) the following to be submitted to CDP by the shareholder (where the shareholder holds a direct securities account with CDP) or his depository agent (where the shareholder holds a securities sub-account with a depository agent):
  - (a) a duly executed CDP transfer form; and
  - (b) payment of the applicable CDP transfer charges (currently comprising the transfer fee of a minimum of S\$30.00 and a maximum of S\$100.00 and all applicable conversion and correspondent bank charges), together with the applicable GST (currently at 7%), UK stamp duty reserve tax of 1.5% of the market value of the moved Prudential Shares (unless otherwise directed or notified by CDP), and all other charges as may be prescribed by CDP in its sole discretion;
- (iii) the shareholder must simultaneously instruct his CCASS Participant to move such Prudential Shares to Citibank HK for the account of CDP by the applicable deadline;
- (iv) upon receipt of the duly completed CDP transfer form, CDP will advise Citibank HK (via Citibank Singapore) to expect receipt of such Prudential Shares for the account of CDP and to match the relevant movement;

- (v) upon notification by Citibank Singapore to CDP of the receipt of the Prudential Shares, CDP will credit the shareholder's direct securities account maintained with CDP or securities sub-account with a depository agent, as the case may be, with the relevant number of Prudential Shares; and
- (vi) CDP will send a confirmation of the credit to the shareholder.

Shareholders are responsible for ensuring that the Prudential Shares are credited into the relevant CDP securities account and in time for settlement of their trades on the SGX-ST.

A shareholder who holds Prudential Shares in certificated form on the HK Register and who wishes to move them to CDP must first deposit the Prudential Shares in CCASS and thereafter follow the procedures set out above.

#### ***31.4 Movement of Prudential Shares from CDP to CCASS***

A shareholder who holds his Prudential Shares through CDP and wishes to move his Prudential Shares from CDP to CCASS can do so in the following manner:

- (i) the shareholder or his CCASS Participant must have a securities account in the CCASS system;
- (ii) the following to be submitted to CDP by the shareholder (where the shareholder holds a direct securities account with CDP) or his depository agent (where the shareholder holds a securities sub-account with a depository agent):
  - (a) a duly executed CDP transfer form; and
  - (b) payment of the applicable CDP transfer charges (currently comprising the transfer fee of a minimum of S\$30.00 and a maximum of S\$100.00 and all applicable conversion and correspondent bank charges), together with the applicable GST (currently at 7%), and all other charges as may be prescribed by CDP in its sole discretion;
- (iii) the shareholder must simultaneously instruct Citibank HK to expect receipt of such Prudential Shares from CDP and to match the relevant movement;
- (iv) upon receipt of the duly completed CDP transfer form, CDP will debit the relevant number of Prudential Shares from the shareholder's securities account with CDP and thereafter instruct Citibank HK (via Citibank Singapore) to move such Prudential Shares to the CCASS account as specified by the shareholder; and
- (v) CDP will send a confirmation of the debit to the shareholder.

Shareholders are responsible for ensuring that the Prudential Shares are credited into the relevant CCASS account and in time for settlement of their trades on the Hong Kong Stock Exchange.

#### ***31.5 Suspension of movements of Prudential Shares into and out of CDP in relation to the Rights Issue***

Movements of Prudential Shares into and out of CDP's account in CCASS held by Citibank HK will be suspended for a period in connection with the Rights Issue. The suspension period will be from 5.00 p.m. (Singapore time) on 1 June 2010 to 9.00 a.m. (Singapore time) on 8 June 2010 in Singapore and from 4.30 p.m. (Hong Kong time) on 1 June 2010 to 9.30 a.m. (Hong Kong time) on 8 June 2010 in Hong Kong.

#### ***31.6 Movement of Prudential Shares between CDP and the UK Register***

A shareholder who holds his Prudential Shares through CREST or in certificated form on the UK Register and who wishes to move his Prudential shares to CDP must first remove the Prudential Shares to the HK Register in the manner described above in section 28.2 of this Part XIX. After the Prudential Shares have been registered on the HK Register, they may be deposited into CCASS and thereafter moved to CDP by following the procedures described in "Movement of Prudential Shares from CCASS or the HK Register to CDP" above.

A shareholder who holds his Prudential Shares through CDP and who wishes to move his Prudential Shares to the UK Register should first move the Prudential Shares from CDP to CCASS by following the procedures described in "Movement of Prudential Shares from CDP to CCASS" above. After the Prudential Shares have been moved to CCASS, the Prudential Shares may be withdrawn from CCASS and registered on the HK Register, and thereafter removed to the UK Register as described in "Removals of Prudential Shares between Registers" above. Prudential Shares held on the UK Register may be deposited in CREST for trading on the London Stock Exchange.

### **32. Documents registered with the Registrar of Companies in Hong Kong**

A copy of each of this prospectus, the Provisional Allotment Letter and the written consents given by KPMG Audit Plc, KPMG LLP, KPMG and PricewaterhouseCoopers as referred to in paragraph 22 above, have been registered with the Registrar of Companies in Hong Kong.

## DEFINITIONS

The following terms apply throughout this document unless the context otherwise requires:

<b>Acquisition</b>	the proposed purchase of the AIA Group by New Prudential pursuant to the terms of, and subject to the conditions in, the Acquisition Agreement;
<b>Acquisition Agreement</b>	the agreement (as amended) between AIA Aurora LLC, AIG, Prudential and New Prudential for the acquisition of the entire issued share capital of AIA by New Prudential;
<b>ADRs</b>	American depositary receipts;
<b>AIA</b>	AIA Group Limited, a company incorporated on 24 August 2009 under the Companies Ordinance;
<b>AIA-B</b>	American International Assurance Company (Bermuda) Limited, an AIA Co subsidiary;
<b>AIA-CM</b>	AIA Corporate Marketing Company Limited, an AIA subsidiary;
<b>AIA Co</b>	American International Assurance Company, Limited, an AIA subsidiary;
<b>AIA Aurora</b>	AIA Aurora LLC, a subsidiary of AIG;
<b>AIA Australia</b>	AIA Australia Limited, an AIA Co subsidiary;
<b>AIA Brunei</b>	the business and operations of AIA Co's branch in Brunei;
<b>AIA Central</b>	building located at 1 Connaught Road, Central, Hong Kong;
<b>AIA China</b>	the business and operations of AIA Co's China branches and sub-branches;
<b>AIA Group</b>	AIA and, except where the context otherwise requires, all of its subsidiaries and branches, or where the context refers to any time prior to AIA's incorporation, the business which its present subsidiaries and branches were engaged in and which were subsequently assumed by AIA;
<b>AIA Hong Kong</b>	the business and operations of AIA Co's and AIA-B's Hong Kong branches;
<b>AIA India</b>	Tata AIG Life Insurance Company Limited, a joint venture between Tata Sons Limited and AIA-B;
<b>AIA Indonesia</b>	PT AIA Financial, an AIA Co subsidiary;
<b>AIA Korea</b>	the business and operations of AIA-B's Korea branch;
<b>AIA Macau</b>	the business and operations of AIA-B's Macau branch;
<b>AIA Malaysia</b>	American International Assurance Bhd., an AIA Co subsidiary;
<b>AIA New Zealand</b>	the business and operations of AIA-B's New Zealand branch;
<b>AIA Pension</b>	AIA-T and AIA-PT, collectively;
<b>AIA-PT</b>	AIA Pension and Trustee Company Limited, an AIA Co subsidiary;
<b>AIA Singapore</b>	the business and operations of AIA Co's Singapore branch;
<b>AIA-T</b>	American International Assurance Company (Trustee) Limited, an AIA Co subsidiary;
<b>AIA Taiwan</b>	the business and operations of AIA-B's Taiwan branch;
<b>AIA Thailand</b>	the business and operations of AIA Co's Thailand branch;
<b>AIA Vietnam</b>	AIA (Vietnam) Life Insurance Company Limited, an AIA-B subsidiary;
<b>AIG</b>	American International Group, Inc.;
<b>AIG Events</b>	the events involving AIG during the second half of 2008 as described in paragraph 2.2 of Part VIII of this prospectus;

<b>AIG Group</b>	AIG and its subsidiary undertakings from time to time, excluding the AIA Group;
<b>AIRCO</b>	American International Reinsurance Company, Limited, an AIG subsidiary;
<b>ALICO</b>	American Life Insurance Company, an AIG subsidiary;
<b>Articles of Association or Articles</b>	the articles of association of Prudential details of which are set out in section 4 of Part XIX of this document;
<b>Board</b>	the board of Directors;
<b>Bond Offerings</b>	has the meaning given in section 3 of Part V;
<b>BPI</b>	the Bank of the Philippine Islands;
<b>bps</b>	basis points;
<b>Bridge Facility</b>	has the meaning given in section 3 of Part V;
<b>business day</b>	a day (excluding Saturdays, Sundays and public holidays in England and Wales) on which banks generally are open for business in London for the transaction of normal banking business;
<b>CAGR</b>	compound annual growth rate;
<b>Cashless Take Up</b>	the procedure described in Part IX of this document enabling Qualifying Non-CREST Shareholders to sell a sufficient number of Nil Paid Rights to raise money to take up the remainder using the Equiniti Dealing Facility;
<b>CCASS</b>	the Central Clearing and Settlement System established and operated by HKSCC;
<b>CCASS Clearing Participant</b>	a person admitted to participate in CCASS as a direct clearing or a general clearing participant;
<b>CCASS Custodian Participant</b>	a person admitted to participate in CCASS as a custodian participant;
<b>CCASS Investor Participant</b>	a person admitted to participate in CCASS as an investor participant who may be an individual or joint individuals or a corporation;
<b>CCASS Participant</b>	a CCASS Clearing Participant, a CCASS Custodian Participant or a CCASS Investor Participant;
<b>CCSS</b>	the CREST Courier and Sorting Service established by Euroclear to facilitate, among other things, the deposit and withdrawal of securities;
<b>CDP</b>	The Central Depository (Pte) Limited, which operates the Central Depository System for the holding and transfer of book-entry securities traded on the SGX-ST;
<b>certificated or in certificated form</b>	where a share or other security is not in uncertificated form;
<b>China or the PRC</b>	the People's Republic of China excluding, for the purpose of this document only, Hong Kong, Macau and Taiwan, unless otherwise specified;
<b>Circular</b>	the circular dated 17 May 2010 sent to the holders of Prudential Shares containing details of the Transactions;
<b>City Code</b>	the City Code on Takeovers and Mergers issued by the Panel on Takeovers and Mergers;
<b>Closing Price</b>	the closing middle market quotation in pounds sterling of a Prudential Share, as published in the daily official list of the London Stock Exchange;
<b>Co-Lead Managers</b>	Barclays Bank PLC, BNP PARIBAS, Credit Agricole Corporate and Investment Bank, Mediobanca — Banca di Credito Finanziario S.p.A., Natixis, Nomura International plc, Scotiabank Europe plc,

	Société Générale, Standard Chartered Securities (Hong Kong) Limited, UniCredit Bank AG, United Overseas Bank Limited;
<b>Co-Managers</b>	Banco Bilbao Vizcaya Argentaria S.A., BOCI Asia Limited, Commerzbank Aktiengesellschaft, DBS Bank Ltd., Fortis Bank (Nederland) N.V., ICBC International Securities Limited, Keefe, Bruyette & Woods Limited, Lloyds Bank Plc, Macquarie Capital (Europe) Limited, Royal Bank of Canada Europe Limited;
<b>Combined Code</b>	the Combined Code on Corporate Governance dated June 2008;
<b>Companies Act</b>	the UK Companies Act 2006 (as amended or re-enacted);
<b>Companies Ordinance</b>	the Companies Ordinance (Cap. 32 of the Laws of Hong Kong), as amended or re-enacted;
<b>Court</b>	the High Court of Justice in England and Wales;
<b>Court Hearing</b>	the hearing (or hearings) by the Court of the petition to sanction the Scheme and grant the Court Order;
<b>Court Meeting</b>	the meeting of the holders of Prudential Shares convened by order of the Court pursuant to section 896 of the Companies Act to consider, and if thought fit, approve the Scheme (with or without amendment), and any adjournment thereof;
<b>Court Order</b>	the order of the Court sanctioning the Scheme under section 899 of the Companies Act;
<b>Credit Suisse</b>	Credit Suisse Securities (Europe) Limited;
<b>CREST</b>	a computerised system for the paperless settlement of sales and purchases of securities and the holding of uncertificated securities operated by Euroclear in accordance with the CREST Regulations;
<b>CREST Regulations</b>	the Uncertificated Securities Regulations 2001 (SI 2001 No. 3755) as from time to time amended;
<b>Designated Dealers</b>	Credit Suisse Securities (Hong Kong) Limited, HSBC Securities Brokers (Asia) Limited; and J.P. Morgan Broking (Hong Kong) Limited and/or their respective affiliates;
<b>Designated Period</b>	the period from the date of commencement of trading of Prudential Shares on the Hong Kong Stock Exchange (i) up to and including the date of commencement of trading in the Rights Issue Shares (fully paid) on the Hong Kong Stock Exchange or (ii) up to one month after the commencement of trading in shares on the Hong Kong Stock Exchange, whichever is later;
<b>Directors</b>	before the Scheme Effective Date the directors from time to time of Prudential and after the Scheme Effective Date, the directors from time to time of New Prudential;
<b>Disclosure and Transparency Rules</b>	the disclosure rules and transparency rules issued by the UKLA for the purposes of Part VI of FSMA 2000;
<b>DPF</b>	discretionary participation features (see Glossary);
<b>EEA States</b>	the member states of the European Economic Area;
<b>EEV</b>	European Embedded Value;
<b>Enlarged Group</b>	the group of companies, which will following completion of the Acquisition and the Scheme, comprise New Prudential, the Prudential Group and the AIA Group;
<b>Equiniti Dealing Facility</b>	the share dealing service described in Part IX of this document provided by Equiniti Financial Services Limited;
<b>EU</b>	the European Union;
<b>Euroclear</b>	Euroclear UK & Ireland Limited, the operator of CREST;

<b>Excluded Shareholders</b>	subject to certain exceptions, shareholders of Prudential who have an address in any Excluded Territory on Prudential’s register of members;
<b>Excluded Territories</b>	the United States, India, Japan, Malaysia, New Zealand, South Africa and any other jurisdiction where the extension to or availability of the Rights Issue would breach any applicable law;
<b>Existing Shares</b>	the Prudential Shares in issue at the date of this document and, following their issue, the Prudential Shares expected to be issued on 27 May 2010 to shareholders who have elected to receive the scrip dividend alternative for the 2009 final dividend;
<b>Form of Proxy</b>	either or both of the Blue Form of Proxy for use at the Court Meeting and the Pink Form of Proxy for use at the General Meeting and “Forms of Proxy” shall be construed accordingly.
<b>FRBNY</b>	the Federal Reserve Bank of New York;
<b>FSA</b>	the Financial Services Authority, granted powers as a regulator under FSMA 2000;
<b>FSMA 2000</b>	the Financial Services and Markets Act 2000, as amended;
<b>Fully Paid Rights</b>	rights to acquire Rights Issue Shares, fully paid;
<b>FY 2007</b>	in relation to Prudential and the Prudential Group, the financial year ending 31 December 2007 and in relation to AIA and the AIA Group, the financial year ending 30 November 2007;
<b>FY 2008</b>	in relation to Prudential and the Prudential Group, the financial year ending 31 December 2008 and in relation to AIA and the AIA Group, the financial year ending 30 November 2008;
<b>FY 2009</b>	in relation to Prudential and the Prudential Group, the financial year ending 31 December 2009 and in relation to AIA and the AIA Group, the financial year ending 30 November 2009;
<b>General Meeting</b>	the meeting of the holders of the Prudential Shares to consider, and if thought fit, approve the Rights Issue Resolution and other resolutions in relation to the Transactions, including any adjournment thereof;
<b>HK or Hong Kong</b>	the Hong Kong Special Administrative Region of the People’s Republic of China;
<b>HK Admission</b>	the admission of the Rights Issue Shares (nil paid) to listing and trading on the Hong Kong Stock Exchange becoming effective;
<b>HK Business Day</b>	any day (other than a Saturday, Sunday or public holiday) on which banks in Hong Kong are generally open for business;
<b>HK Register</b>	the Hong Kong overseas branch register of members of Prudential;
<b>HK Registrar</b>	Computershare Hong Kong Investor Services Limited;
<b>HKSCC</b>	Hong Kong Securities Clearing Company Limited;
<b>HKSCC Nominees</b>	HKSCC Nominees Limited, a wholly-owned subsidiary of HKSCC;
<b>HK Shareholders</b>	holders of Prudential Shares who are registered on the HK Register on the Record Date;
<b>HM Revenue and Customs or HMRC</b>	Her Majesty’s Revenue and Customs and, where relevant, any predecessor body which carried out part of its functions and references to any approval by Her Majesty’s Revenue and Customs shall, where appropriate, include approval by an officer of Her Majesty’s Revenue and Customs;
<b>Hong Kong dollar or HK\$</b>	the lawful currency of Hong Kong;
<b>Hong Kong Listing Rules</b>	the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange;

<b>Hong Kong Sponsor</b>	Credit Suisse (Hong Kong) Limited, a licensed corporation under SFO to conduct type 1 (dealing in securities), type 2 (dealing in futures contracts), type 4 (advising on securities), type 5 (advising on futures contracts), type 6 (advising on corporate finance) and type 7 (providing automated trading services) regulated activities under the Securities and Futures Ordinance;
<b>Hong Kong Stock Exchange</b>	The Stock Exchange of Hong Kong Limited;
<b>HSBC</b>	HSBC Bank plc;
<b>Hybrid Capital Facility</b>	has the meaning given in section 3 of Part V;
<b>IASB</b>	the International Accounting Standards Board;
<b>ICO</b>	the Insurance Companies Ordinance, Chapter 41 of the Laws of Hong Kong;
<b>IFRS</b>	International Financial Reporting Standards;
<b>Irish Register</b>	the Irish overseas branch register of members of Prudential;
<b>Issue Price</b>	104 pence per Rights Issue Share or, for HK Shareholders and Singapore Shareholders, HK\$11.78 per Rights Issue Share (being the Hong Kong dollar equivalent of 104 pence using the £:HK\$ exchange rate of 11.3277, the noon buying rate on 14 May 2010 as derived from Bloomberg (as the case may be));
<b>Jackson</b>	Jackson National Life Insurance Company, a wholly-owned subsidiary of Prudential;
<b>Joint Bookrunners</b>	Credit Suisse, HSBC and J.P. Morgan Cazenove;
<b>Joint Global Co-ordinators</b>	Credit Suisse, HSBC and J.P. Morgan Cazenove;
<b>Joint Lead Arrangers</b>	has the meaning given in section 3 of Part V of this prospectus;
<b>Joint Lead Managers</b>	Banca IMI S.p.A., Banco Santander, S.A., Merrill Lynch International, Citigroup Global Markets U.K. Equity Limited, Deutsche Bank AG London Branch, ING Bank N.V., Morgan Stanley Securities Limited, RBS Hoare Govett Limited, UBS Limited;
<b>Joint Sponsors</b>	Credit Suisse, HSBC and J.P. Morgan Cazenove;
<b>J.P. Morgan Cazenove</b>	J.P. Morgan plc in its role as financial advisor to the Transactions or J.P. Morgan Securities Ltd. in its role as joint sponsor, joint global co-ordinator, joint bookrunner and underwriter to the Rights Issue and joint sponsor to the introduction of New Prudential, as applicable;
<b>Key Geographical Markets</b>	in relation to AIA Group, means Hong Kong, Thailand, Singapore, Malaysia, China and Korea;
<b>Key Markets</b>	in relation to AIA Group, means Hong Kong (including Macau), Thailand, Singapore (including Brunei), Malaysia, China and Korea;
<b>Lazard</b>	Lazard Frères & Co LLC and Lazard & Co., Limited;
<b>Listing Rules</b>	the listing rules issued by the UKLA for the purposes of Part VI of FSMA 2000;
<b>London Stock Exchange</b>	London Stock Exchange plc;
<b>M&amp;G</b>	the Prudential Group's UK and European fund management business;
<b>Macau</b>	the Macau Special Administrative Region of the People's Republic of China;
<b>MAS</b>	Monetary Authority of Singapore;
<b>Mandatory Convertible Notes or MCNs</b>	the mandatory convertible notes to be issued by New Prudential as described in paragraph 2 of Part V of this prospectus;
<b>MDRT</b>	the Million Dollar Round Table, an association that represents sales professionals in the life insurance-based financial services industry;

<b>Money Laundering Regulations</b>	the Money Laundering Regulations 2007 (SI 2007/2157);
<b>New Prudential</b>	Prudential Group plc, a company registered in England and Wales with registered number 07163561 and with its registered office at Laurence Pountney Hill, London EC4R 0HH;
<b>New Prudential ADRs</b>	the American depository shares each representing two New Prudential Shares, evidenced by American depository receipts;
<b>New Prudential Prospectus</b>	the prospectus dated the same date as this prospectus issued by New Prudential for the introduction of New Prudential Shares to the premium segment of the Official List and to trading on the London Stock Exchange;
<b>New Prudential Reduction of Capital</b>	the proposed reduction of capital of New Prudential by the reduction of the nominal value of each New Prudential Share from 100 pence to 5 pence as described in Part II of the Circular;
<b>New Prudential Shares</b>	the ordinary shares of 100 pence each in the capital of New Prudential;
<b>New Share Plans</b>	the New Prudential Group Performance Share Plan, the New Prudential Business Unit Performance Plans, the New Prudential UK Savings Related Share Option Scheme, the New Prudential Irish SAYE Scheme, the New Prudential International Employees SAYE Scheme, the New Prudential International (Non-Employees) SAYE Scheme, the New Prudential Share Incentive Plan, the New Prudential Share Option Plan, the Momentum Retention Plan the M&G Executive Long Term Incentive Plan 2010 and the New Prudential Europe Share Participation Plan;
<b>Nil Paid Rights</b>	rights to acquire Rights Issue Shares, nil paid;
<b>OCI</b>	the Office of the Commissioner of Insurance, a regulatory body responsible for the supervision and regulation of the Hong Kong insurance industry;
<b>Official List</b>	the list maintained by the FSA in accordance with section 74(1) of FSMA 2000 for the purposes of Part VI of FSMA 2000;
<b>Ondra Partners</b>	Ondra LLP, trading as Ondra Partners;
<b>Other Geographical Markets</b>	in relation to the AIA Group, means Australia, the Philippines, Indonesia, Vietnam, Taiwan, New Zealand, Macau, Brunei and the AIA Group's interests in its joint venture in India;
<b>Other Markets</b>	in relation to AIA Group, means Australia, the Philippines, Indonesia, Vietnam, Taiwan, New Zealand and the AIA Group's interest in its joint venture in India;
<b>Overseas Shareholders</b>	holders of Prudential Shares with registered addresses outside the UK, Hong Kong or Singapore or who are citizens or residents of countries outside the UK, Hong Kong or Singapore;
<b>PAC</b>	The Prudential Assurance Company Limited (a wholly-owned subsidiary of Prudential), a company incorporated in England and Wales with registered number 15454;
<b>Philamlife</b>	the Philippine American Life and General Insurance Company, an AIA subsidiary;
<b>pounds sterling or £</b>	the lawful currency of the United Kingdom;
<b>Prospectus Rules</b>	the prospectus rules of the FSA made under section 73A of FSMA 2000;
<b>Provisional Allotment Letter</b>	the renounceable provisional allotment letter expected to be sent to Qualifying Non-CREST Shareholders, Qualifying Non-CCASS Shareholders and HKSCC Nominees (other than certain Overseas Shareholders) in respect of the Rights Issue Shares to be provisionally allotted to them pursuant to the Rights Issue;

<b>Prudential</b>	Prudential plc, a company incorporated in England and Wales, with registered number 1397169 and with its registered office at Laurence Pountney Hill, London EC4R 0HH;
<b>Prudential ADRs</b>	the American depositary shares each representing two Prudential Shares, evidenced by American depositary receipts;
<b>Prudential Corporation Asia</b>	the Prudential Group's Asian operations;
<b>Prudential Group</b>	Prudential and its subsidiary undertakings from time to time;
<b>Prudential Shares</b>	the ordinary shares of 5 pence each in the capital of Prudential (including, if the context requires, the Rights Issue Shares);
<b>Prudential Share Schemes</b>	the Prudential Group Performance Share Plan, the Prudential Business Unit Performance Plan, the Prudential Savings Related Share Option Scheme, the Prudential 2003 Savings Related Share Option Scheme, the Prudential International Savings Related Share Option Scheme, the Prudential International Savings Related Share Option Scheme for non-employees, the Prudential International Assurance ShareSave Plan, the Prudential Group Deferred Bonus Plan 2010, the Prudential Services Limited Share Incentive Plan, the Prudential Assurance Company Limited Share Incentive Plan, the Prudential UK Services Limited Share Incentive Plan, the Prudential Group Share Incentive Plan, the Prudential Europe Share Participation Plan, the Prudential-Jackson National Life US Performance Share Plan, the PCA Long Term Incentive Plan, the PCA Deferred Bonus Plan, the PruCap Business Deferred Bonus Plan, the Momentum Retention Plan, the Annual Incentive Plan, the Annual Incentive Plan (US tax payers) and the Prudential Restricted Share Plan;
<b>Qualifying CCASS Shareholders</b>	persons holding Prudential Shares in the name of HKSCC Nominees on the HK Register and deposited directly into CCASS at the Record Date;
<b>Qualifying CDP Shareholders</b>	persons holding an interest in Prudential Shares on the HK Register at the Record Date in uncertificated form through CDP and who had, at least three Singapore Business Days prior to the Record Date, provided CDP with an address in Singapore for the service of notices and documents;
<b>Qualifying CREST Shareholders</b>	Qualifying Shareholders holding Prudential Shares on the UK Register in uncertificated form through CREST;
<b>Qualifying Non-CCASS Shareholders</b>	Qualifying Shareholders holding Prudential Shares on the HK Register in certificated form (other than those being held in the name of HKSCC Nominees);
<b>Qualifying Non-CREST Shareholders</b>	Qualifying Shareholders holding Prudential Shares on the UK Register in certificated form (that is, not through CREST);
<b>Qualifying Shareholders</b>	holders of Prudential Shares on the relevant register of members of Prudential at the Record Date;
<b>Receiving Agent</b>	Equiniti Limited;
<b>Record Date</b>	for UK Shareholders is 5.00 p.m. (London time) on 4 June 2010, for HK Shareholders is 4.30 p.m. (Hong Kong time) on 4 June 2010 and for Singapore Shareholders is 5.00 p.m. (Singapore time) on 4 June 2010;
<b>Registrar</b>	Equiniti Limited;
<b>Registrars</b>	the Registrar and the HK Registrar;
<b>Regulatory Information Service</b>	one of the regulatory information services authorised by the UKLA to receive, process and disseminate regulatory information in respect of listed companies;

<b>Rights Issue</b>	the proposed issue of Rights Issue Shares by way of rights to Qualifying Shareholders on the basis described in this prospectus and in the case of Qualifying Non-CREST Shareholders, Qualifying Non-CCASS Shareholders and HKSCC Nominees only, in the Provisional Allotment Letter and, in the case of Qualifying CDP Shareholders only, the Singapore Application Form;
<b>Rights Issue Resolution</b>	the ordinary resolution numbered 2 and set out in the notice of the General Meeting set out in the Circular and which is to be proposed at the General Meeting;
<b>Rights Issue Shares</b>	the new Prudential Shares to be allotted and issued pursuant to the Rights Issue;
<b>RTGS</b>	real time gross settlement;
<b>Scheme</b>	the proposed scheme of arrangement under sections 895 to 899 of the Companies Act between Prudential and the Scheme Shareholders as set out in Part V of the Circular, with or subject to any modification, addition or condition approved or imposed by the Court;
<b>Scheme Effective Date</b>	the date on which the Scheme becomes effective in accordance with its terms;
<b>Scheme Record Time</b>	6.00 p.m. (London time) on the business day prior to the Scheme Effective Date;
<b>Scheme Resolutions</b>	the resolution set out in the notice of Court Meeting set out in the Circular and/or the special resolution, numbered 1, set out in the notice of General Meeting set out in the Circular which will be proposed at the Court Meeting and General Meeting, respectively;
<b>Scheme Shareholder</b>	a holder of Scheme Shares;
<b>Scheme Shares</b>	(i) all Prudential Shares in issue at the date of this document; (ii) all (if any) Prudential Shares issued after the date of this document and prior to the Scheme Record Time; and (iii) all (if any) Prudential Shares issued at or after the Scheme Record Time and prior to the confirmation by the Court of the reduction of capital provided for under the Scheme in respect of which the original or any subsequent holders thereof shall be bound by the Scheme or shall by such time have agreed in writing to be bound by the Scheme;
<b>Securities and Futures Ordinance</b>	the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong), as amended or re-enacted;
<b>SFC</b>	Securities and Futures Commission of Hong Kong;
<b>SGX-ST</b>	the Singapore Exchange Securities Trading Limited;
<b>S\$ or Singapore dollar</b>	the lawful currency of Singapore;
<b>Singapore Admission</b>	the admission of the Rights Issue Shares (nil paid) to listing and trading on the SGX-ST becoming effective;
<b>Singapore Application Form</b>	the application form to be sent to Qualifying CDP Shareholders (other than certain Overseas Shareholders), containing details of terms and conditions of the Rights Issue applicable to Qualifying CDP Shareholders and the procedures by which such Shareholders may apply to take up Rights Issue Shares;
<b>Singapore Business Day</b>	a day on which the SGX-ST is open for trading in securities;
<b>Singapore Official List</b>	the list of issuers maintained by the SGX-ST in relation to the SGX-ST Main Board or Catalyst;
<b>Singapore Renounee</b>	a purchaser of the Nil Paid Rights through CDP's book-entry (scripless) settlement system;

<b>Singapore Shareholders</b>	holders of an interest in Prudential Shares on the HK Register in uncertificated form through CDP on the Record Date;
<b>Subordinated Debt Financing Facility</b>	has the meaning given in section 16.8 of Part XIX;
<b>Subordinated Note Commitment Letter</b>	has the meaning given in section 3 of Part V;
<b>Tier 1 Notes</b>	the tier one notes to be issued by Prudential as described in paragraph 2 of Part V of this prospectus;
<b>Transactions</b>	the transactions involved in the Acquisition and Scheme;
<b>TWPI</b>	the total weighted premium income (see Glossary);
<b>UK or United Kingdom</b>	the United Kingdom of Great Britain and Northern Ireland;
<b>UK Admission</b>	the admission of the Rights Issue Shares, (nil paid) to the premium segment of the Official List and to trading on the main market for listed securities of the London Stock Exchange becoming effective;
<b>UKLA</b>	the Financial Services Authority acting in its capacity as the competent authority for listing under Part VI of FSMA 2000;
<b>UK Shareholders</b>	holders of Existing Shares who are registered on the UK Register or the Irish Register on the Record Date;
<b>UK Register</b>	the register of members of Prudential kept in the UK and includes, where the context requires it, the Irish Register;
<b>uncertificated or in uncertificated form</b>	in relation to shares, means recorded on the relevant register as being held in uncertificated form in CREST and title to which may be transferred by means of CREST (as applicable);
<b>Underwriters</b>	Credit Suisse, HSBC, J.P. Morgan Cazenove, each of the Joint Lead Managers, each of the Co-Lead Managers, each of the Co-Managers, Government of Singapore Investment Corporation Private Limited and Qatar Holding LLC;
<b>Underwriting Agreement</b>	the underwriting agreement dated 17 May 2010, between Prudential and the Underwriters relating to the Rights Issue as further described in paragraph 16.2 of Part XIX;
<b>Underwriting Proportions</b>	in relation to an Underwriter, means that proportion of the total underwriting commitment that such Underwriter has given pursuant to the Underwriting Agreement;
<b>US or United States</b>	the United States of America, its territories, its possessions and all areas subject to its jurisdiction;
<b>US\$</b>	the lawful currency of the United States;
<b>US Depository</b>	JPMorgan Chase Bank, N.A.;
<b>US Securities Act</b>	the United States Securities Act of 1933, as amended from time to time; and
<b>US Treasury Department</b>	the United States Department of the Treasury.

## GLOSSARY

This glossary contains explanations of certain terms used in this prospectus. These terms and their meanings may not always correspond to standard industry meanings or usage of these terms.

<b>AER</b>	Actual Exchange Rate;
<b>affinity customers</b>	a group of customers who share a common enterprise or social affinity or relationship;
<b>agency leaders</b>	an agent who manages a group of agents;
<b>allocated equity</b>	equity attributable to shareholders of AIA, less amounts reflected in other comprehensive income, consisting of the fair value reserve and the foreign currency translation reserve;
<b>allocated segment equity</b>	segment assets less segment liabilities in respect of each reportable segment less fair value less non-controlling interests and foreign currency translation reserves;
<b>annual premium equivalent or APE</b>	a measure of new business activity that is calculated as the sum of annualised regular premiums from new business plus 10% single premiums on new business written during the period;
<b>annuity</b>	a contract providing for periodic payments to an annuitant for a specified period of time, often until the annuitant's death;
<b>bancassurance</b>	the distribution of insurance products through bank branches and/or joint ventures with banks;
<b>cash surrender value</b>	the amount of cash available to a policy holder on the surrender of or withdrawal from a life insurance policy or annuity contract;
<b>cede</b>	when an insurer reinsures its risk with another insurer, it "cedes" business;
<b>claim</b>	an occurrence that is the basis for submission and/or payment of a benefit under an insurance policy. Depending on the terms of the insurance policy, a claim may be covered, limited or excluded from coverage;
<b>commission</b>	a fee paid to an agent or broker by an insurance company for services rendered in connection with the sale or maintenance of an insurance product;
<b>credit risk</b>	the risk of loss if another party fails to meet its obligations, or fails to do so in a timely fashion;
<b>currency risk</b>	the risk that asset or liability values, cash flows, income or expenses will be affected by changes in exchange rates. Also referred to as foreign exchange risk;
<b>deferred acquisition costs or DAC</b>	deferred acquisition costs are expenses of an insurer which are incurred in connection with the acquisition of new insurance contracts or the renewal of existing insurance policies. They include commissions and other variable sales inducements and the direct costs of issuing the policy, such as underwriting and other policy issue expenses;
<b>density rate</b>	a market's life insurance premium per capita;
<b>discretionary participation features or DPF</b>	a contractual right to receive, as a supplement to guaranteed benefits, additional benefits: <ul style="list-style-type: none"><li>• that are likely to be a significant portion of the total contractual benefits;</li><li>• whose amount or timing is contractually at the discretion of the issuer; and</li></ul>

	<ul style="list-style-type: none"> <li>that are contractually based on asset, fund, company or other entity performance as discussed in IFRS 4;</li> </ul>
<b>duration</b>	the number of years required to receive the present value of a stream of future cash flow, which is often used as an indicator of a bond's price volatility resulting from changes in interest rates;
<b>endowment product</b>	an ordinary individual life insurance product that provides the insured party with various guaranteed benefits if it survives specific maturity dates or periods stated in the policy. Upon the death of the insured party within the coverage period, a designated beneficiary receives the face value of the policy;
<b>European Embedded Value or EEV</b>	financial results prepared in accordance with a set of Principles issued by the Chief Financial Officers' Forum of European Insurance Companies in May 2004 and expanded by the Additional Guidance of EEV Disclosures published in October 2005;
<b>fixed annuity</b>	annuities, which allow for tax-deferred accumulation of funds, are used for asset accumulation in retirement planning and for providing income in retirement and offer flexible payout options. The contract holder pays the insurer a premium, which is credited to the contract holder's account. Periodically, interest is credited to the contract holder's account and administrative charges are deducted, as appropriate;
<b>fixed indexed annuity</b>	fixed index annuities are similar to fixed annuities in that the contract holder pays the insurer a premium, which is credited to the contract holder's account, and periodically, interest is credited to the contract holder's account and administrative charges are deducted, as appropriate. An annual minimum interest rate may be guaranteed, although actual interest credited may be higher and is linked to an equity index over its indexed option period;
<b>first year premiums</b>	premiums received in the first year of a recurring premium policy;
<b>health and protection</b>	health and personal accident insurance products, which provide morbidity or sickness benefits and include health, disability, critical illness and accident coverage. Health and protection products are sold both as standalone policies and as riders that can be attached to life insurance products. Health and Protection riders are presented together with ordinary individual life insurance products for purposes of disclosure of financial information;
<b>high net worth</b>	individuals who have investable assets of US\$1.0 million or more;
<b>IFA</b>	independent financial adviser;
<b>IGD surplus</b>	the Prudential Group's solvency surplus measured in accordance with the EU Insurance Groups Directive;
<b>in-force</b>	an insurance policy or contract reflected on records that has not expired, matured or otherwise been surrendered or terminated;
<b>investment funds</b>	pools of funds held for collective investment purposes;
<b>investment grade</b>	BBB- or above for S&P Baa3 or above for Moody's;
<b>investment-linked investments</b>	investments held to back investment-linked contracts;
<b>investment-linked products or investment-linked contracts</b>	investment-linked products are insurance products where the surrender value of the policy is linked to the value of underlying investments (such as collective investment schemes, internal investment pools or other property) or fluctuations in the value of underlying investment or indices. Investment risk associated with the product is usually borne by the policyholder. Insurance coverage, investment and administration services are provided for which the

	charges are deducted from the investment fund assets. Benefits payable will depend on the price of the units prevailing at the time of surrender, death or the maturity of the product, subject to surrender charges. These are also referred to as unit linked products or unit linked contracts;
<b>investment property</b>	property (land and/or a building or part of a building) held to earn rentals or for capital appreciation or both rather than for use by the Prudential Group's or AIA Group's operations;
<b>life insurance premiums</b>	consideration received with respect to life insurance policies issued or reissued by an insurance company;
<b>loans</b>	policy loans, mortgage loans on residential and commercial real estate and other loans outside of AIA Group or Prudential Group;
<b>morbidity rate</b>	incidence rates and period of disability, varying by such parameters as age, gender and period since disability, used in pricing and computing liabilities for insurance products containing morbidity risk;
<b>mortality rate</b>	rate of death, varying by such parameters as age, gender, and health, used in pricing and computing liabilities for future policyholders of life and annuity products, which contain mortality risks;
<b>net premiums</b>	life insurance premiums net of reinsurance premiums ceded to third party reinsurers;
<b>new business contribution</b>	the profits, calculated in accordance with European Embedded Value Principles, from business sold in the financial reporting period under consideration;
<b>new business margin</b>	the value of new business on an EEV basis expressed as a percentage of the present value of new business premiums expected to be received from the new business;
<b>participating funds</b>	participating funds are distinct portfolios where the policyholders have a contractual right to receive at the discretion of the insurer additional benefits based on factors such as the performance of a pool of assets held within the fund, as a supplement to any guaranteed benefits. The insurer may either have discretion as to the timing of the allocation of those benefits to participating policyholders or may have discretion as to the timing and the amount of the additional benefits. These also are referred to as with-profits funds;
<b>participating policies or participating business</b>	contracts of insurance where the policyholders have a contractual right to receive, at the discretion of the insurer, additional benefits based on factors such as investment performance, as a supplement to any guaranteed benefits. This is also referred to as with-profits business;
<b>penetration rate</b>	life insurance premium as a percentage of GDP;
<b>policy fees</b>	an annual charge to the policyholder collected in addition to the premium to cover the costs of policy administration (premium collected and tax payments);
<b>present value of new business premiums or PVNBP</b>	the present value of new business premiums is calculated as equalling single premiums plus the present value of expected premiums of new regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution;
<b>private equities</b>	ordinary shares in a company that are not publicly traded on a stock exchange;
<b>public equities</b>	ordinary shares publicly traded on an exchange;
<b>recapture</b>	the voluntary termination of a contract of life insurance;

<b>regular premium product</b>	a life insurance product with regular periodic premium payments;
<b>RBV</b>	Risk based valuation;
<b>reinsurance</b>	the practice whereby an insurer, in consideration of a premium paid to it, agrees to indemnify another party for part or all of the liabilities assumed by the reinsured party under an insurance contract, which the reinsured party has issued;
<b>renewal premiums</b>	premiums receivable in subsequent years of a multi-year insurance policy;
<b>repurchase agreement</b>	a repurchase transaction involves the sale of financial investments by the AIA Group to a counterparty, subject to a simultaneous agreement to repurchase those securities at a later date at an agreed price;
<b>re-Takaful</b>	reinsurance of Takaful business compliant with Islamic principles;
<b>rider</b>	a supplemental plan that can be attached to a basic insurance policy, with payment of additional premium;
<b>savings rate</b>	savings as a percentage of disposable income;
<b>securities lending</b>	securities lending consists of the loan of certain of the AIA Group's financial investments in third parties securities on a short term basis. AIG established a global securities lending programme in the late 1990s, in which AIA-B, AIA and AIA-B's Hong Kong branches and AIA's Brunei branch participated to enhance portfolio return. AIG Global Securities Lending Group acted as an agent for AIG subsidiaries in this programme. The operating units that participated in the programme lent assets, primarily bonds for long-term holdings, from their Policyholder and Shareholder Investments in exchange for cash as collateral from the borrowers of the assets. The cash collateral was then used to reinvest generally in securities which were rated as investment grade at the date of purchase. Due to the deterioration of market conditions and liquidity issues in the securities lending programme at AIG, the AIA Group began to restructure and wind down its participation in this programme, which was largely completed by 30 November 2009. References to the effects of securities lending in Parts VIII and Parts XIII relate to the investment income, investment management expenses and finance costs and non-operating investment return directly arising from this programme of securities lending and their consequent impact on operating profit, Operating Profit After Tax and net profit attributable to shareholders of AIA;
<b>separate account</b>	a separate account is a pool of investments held by an insurance company not in or "separate" from its general account. The returns from the separate account generally accrue to the policyholder. A separate account allows an investor to choose an investment category according to his individual risk tolerance, and desire for performance;
<b>single premiums</b>	single premium policies of insurance are those that require only a single lump sum payment from the policyholder;
<b>solvency margin</b>	a measure of an insurance company's solvency;
<b>surrender</b>	the termination of a life insurance policy or annuity contract at the request of the policyholder after which the policyholder receives the cash surrender value, if any, of the contract;
<b>surrender charge or surrender fee</b>	the fee charged to a policyholder when a life insurance policy or annuity contract is surrendered for its cash surrender value prior to the end of the surrender charge period;
<b>Takaful</b>	insurance that is compliant with Islamic principles;

<b>tied agency, tied agent</b>	an agency model which employs sales representatives who sell the products of one company exclusively; a sales representative who sells the products of one company exclusively;
<b>total investment portfolio</b>	investment portfolio composed of cash and cash equivalents, investment property and financial investments but excluding receivables (consisting of amounts due from insurance and investment contract holders, amounts due from agents, brokers and intermediaries as well as insurance and intercompany receivables, receivables from sales of investments and other receivables);
<b>total premiums</b>	life insurance premiums for both in-force insurance policies and insurance policies sold during that year;
<b>total weighted premium income or TWPI</b>	total weighted premium income consists of 100% of renewal premiums, 100% of first year premiums and 10% of single premiums (which the AIA Group refers to as weighted single premiums); it provides an indication of the AIA Group's longer term business volumes as it smooths the peaks and troughs in single premiums;
<b>underwriting</b>	the process of examining, accepting or rejecting insurance risks, and classifying those accepted, in order to change an appropriate premium for each accepted risk;
<b>unit-linked products or unit-linked contracts</b>	see "investment-linked products or investment-linked contracts" above;
<b>universal life</b>	an insurance product where the customer pays flexible premiums, subject to specified limits, that are accumulated in an account and are credited with interest (at a rate either set by the insurer or reflecting returns on a pool of matching assets). The customer may vary the death benefit and the contract may permit the customer to withdraw the account balance, typically subject to a surrender charge;
<b>variable annuity</b>	variable annuities are tax-advantaged deferred annuities where the rate of return depends upon the performance of the underlying portfolio. Insurers often offer a choice of guaranteed benefit options to attach to a variable annuity, which customer can elect and pay for. These include the guaranteed minimum death benefit ("GMDB"), which guarantees that, upon death of the annuitant, the contract holder or beneficiary receives a minimum value regardless of past market performance;
<b>value of new business or VNB</b>	embedded value of new insurance contracts written in the year;
<b>weighted single premium</b>	10% of single premium; it provides an indication of longer term business volumes that takes account of changes in the mix of regular and single premium business; and
<b>with-profits funds</b>	see "participating funds" above.

APPENDIX  
FIRST QUARTER 2010 INTERIM MANAGEMENT STATEMENT



**PRUDENTIAL**

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NEWS RELEASE

07:00 a.m. 17 May 2010

**PRUDENTIAL PLC FIRST QUARTER 2010 INTERIM MANAGEMENT STATEMENT**

**NEW RECORD FOR FIRST QUARTER NEW BUSINESS SALES AT £807 MILLION**

- **GROUP-WIDE SALES OF £807 MILLION UP 26 PER CENT. NEW BUSINESS PROFIT UP 27 PER CENT**
- **OUTSTANDING FIRST QUARTER IN ASIA. SALES UP 30 PER CENT, NEW BUSINESS PROFIT UP 35 PER CENT**
- **CONTINUED POWERFUL MOMENTUM IN US. SALES UP 39 PER CENT, NEW BUSINESS PROFIT UP 25 PER CENT**
- **UK FOCUS ON VALUE OVER VOLUME DELIVERS HIGH MARGINS**
- **ASSET MANAGEMENT NET INFLOWS OF £1.2 BILLION**
- **CAPITAL POSITION REMAINS STRONG — IGD SURPLUS ESTIMATED AT £3.4 BILLION<sup>1</sup>**

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Group Insurance</b> <sup>2,3</sup>			
Sales — APE . . . . .	<b>£807m</b>	£640m	26%
New Business Profit <sup>4</sup> . . . . .	<b>£427m</b>	£336m	27%
Margin — APE% . . . . .	<b>53%</b>	53%	—
<b>Investment Net Inflows</b> . . . . .	<b>£1,203m</b>	£2,728m	(56%)

**Tidjane Thiam, Group Chief Executive said:**

“Our record performance in 2009 continued into the first quarter of 2010. We maintained our focus of allocating capital to the most profitable opportunities, and as a result have delivered strong growth in new business profit. This first quarter interim management statement represents a significant evolution in our financial communication as it includes for the first time new business profit, as well as new business sales. This change reflects our continued commitment to greater disclosure.

In the first quarter, APE new business across the Group was £807 million, up 26 per cent (first quarter 2009: £640 million), and new business profit was £427 million, up almost £100 million and 27 per cent (first quarter 2009: £336 million).

In Asia we delivered strong growth in new business compared to the first quarter 2009. APE sales in the first quarter 2010 were £359 million, an increase of 30 per cent on the first quarter last year of £276 million. New business profit

<sup>1</sup> Before allowing for the 2009 final dividend

<sup>2</sup> Asia 2010 and 2009 comparative APE new business sales and new business profit exclude the Taiwan agency business disposed of during Q2 2009 and the Japanese insurance operations which we have closed to new business from 15 February 2010

<sup>3</sup> Unless otherwise stated all growth rates are on a sterling basis. Growth rates on constant currency are presented on schedule 1B of the Interim Management Statement

<sup>4</sup> For Q1 2010 we have presented new business profit and margin for the 3 month period ended 31 March 2010 and the comparative period. The assumptions underlying new business profit are presented in schedule 5 to the Interim Management Statement

for the first quarter was £183 million, an increase of 35 per cent. This performance demonstrates the strength of our businesses in Asia and emphasises the return to economic growth experienced across the region.

In the US, Jackson's focused approach and strict pricing discipline also delivered an improved first quarter with new business profit of £175 million, up 25 per cent (first quarter 2009: £140 million) and APE new business sales of £255 million up 39 per cent (first quarter 2009: £184 million). We maintained our deliberate emphasis on variable annuities in which we ranked fourth in the US in 2009, with a market share of 8 per cent.

Prudential UK continued to serve targeted segments of the retirement savings and income markets, emphasising value over volume. This strategy delivered attractive returns on the capital employed in the first quarter. New business profit was £69 million, up 15 per cent (first quarter 2009: £60 million) and APE new business sales were £193 million, up 7 per cent (first quarter 2009: £180 million).

M&G continued to outperform the market with net fund inflows of £1,889 million (first quarter 2009: £2,543 million). After making allowance for the exceptional nature of the inflows into corporate bond funds in the first quarter of 2009, this is a very strong performance in a reinvigorated and competitive environment.

Our performance has been delivered while taking a disciplined approach to risk management and targeted Group-wide actions to protect our strong capital position. Our estimated IGD surplus was £3.4 billion at 31 March 2010 (31 December 2009 £3.4 billion). This capital strength underpins our ability to exploit growth opportunities.

In 2010 we said that we would accelerate our proven strategy to capitalise on the most profitable growth opportunities in our chosen markets and these strong results demonstrate we are delivering on that objective. Going forward, we expect momentum in Asia to continue, whilst the economic conditions in the UK and the US stabilise."

## 1. Q1 2010 Business Unit financial highlights

<u>Sales - APE</u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Insurance</b>			
Asia <sup>5</sup> . . . . .	<b>£359m</b>	£276m	30%
US . . . . .	<b>£255m</b>	£184m	39%
UK . . . . .	<b>£193m</b>	£180m	7%
<b>Total Group Insurance</b> . . . . .	<b>£807m</b>	<b>£640m</b>	<b>26%</b>
<u>New Business Profit<sup>6</sup></u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
Asia <sup>5</sup> . . . . .	<b>£183m</b>	£136m	35%
US . . . . .	<b>£175m</b>	£140m	25%
UK . . . . .	<b>£69m</b>	£60m	15%
<b>Total Group Insurance</b> . . . . .	<b>£427m</b>	<b>£336m</b>	<b>27%</b>
<u>Margin — APE %</u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>+/- %pts</u>
Asia . . . . .	<b>51%</b>	49%	+2pts
US . . . . .	<b>69%</b>	76%	-7pts
UK . . . . .	<b>36%</b>	33%	+3pts
<b>Total Group Insurance</b> . . . . .	<b>53%</b>	<b>53%</b>	<b>0pts</b>
<u>Investment Net Inflows</u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
M&G . . . . .	<b>£1,889m</b>	£2,543m	(26%)
Asia Asset Management . . . . .	<b>(£686m)</b>	£185m	(471%)
<b>Total</b> . . . . .	<b>£1,203m</b>	<b>£2,728m</b>	<b>(56%)</b>

### 1.1 Asia Insurance operations

<u>Asia</u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Sales — APE</b> . . . . .	<b>£359m</b>	£276m	30%
<b>New Business Profit</b> . . . . .	<b>£183m</b>	£136m	35%
<b>Margin — APE %</b> . . . . .	<b>51%</b>	49%	+2pts

During the first quarter 2010 the Asian economies have continued to perform well and demand for life and savings business is rebounding strongly to pre-crisis levels. Prudential has delivered a very strong quarter, with APE new business sales of £359 million up by 30 per cent over the same period last year. Sales in the first quarter of 2010 at

5 Asia 2010 and 2009 comparative APE new business sales and new business profit exclude the Taiwan agency business disposed of during Q2 2009 and the Japanese insurance operations which we have closed to new business from 15 February 2010

6 For Q1 2010 we have presented new business profit and margin for the 3 month period ended 31 March 2010 and the comparative period. The assumptions underlying new business profit are presented in schedule 5 to the Interim Management Statement.

actual exchange rates were the second highest in our history and represent a record first quarter ahead of the previous best first quarter in 2008. Our high margin South-East Asian operations (including Singapore and Hong Kong), grew APE sales by 53 per cent to £216 million, a clear indication of the potential of these markets.

In line with the recovering economic outlook, single premiums are up 66 per cent over the first quarter last year meaning that their proportion of total APE has increased from 5 per cent to 6 per cent. The business mix is in line with the first quarter 2009, unit linked at 44 per cent, par at 29 per cent and protection at 24 per cent.

We have continued to focus on the profitability of the business we write, allocating capital in priority to those markets and products which offer the highest returns. New business profits increased by 35 per cent to £183 million resulting in an improved margin of 51 per cent (first quarter 2009: 49 per cent).

Looking at developments of our sales in each major market:

### China

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£14m</b>	£11m	27%

In **China**, Prudential's share of new business sales for the first quarter 2010, is £14 million (reflecting our 50 per cent ownership) up 27 per cent on 2009 and represents our strongest quarter ever in both local currency and at actual exchange rates. Recruiting and retaining agents in China remains challenging and CITIC-Prudential's average agent numbers have declined by 20 per cent compared to the first quarter last year. However, this has been more than offset by a significant increase in average APE per case of 31 per cent and an increase in agent activity. The bancassurance channel is also performing very well with sales up 47 per cent. Our joint venture partner CITIC-Bank in particular is showing strong growth and generated 32 per cent of the total bank new business in the quarter.

### Hong Kong

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£68m</b>	£46m	48%

**Hong Kong** delivered a very strong first quarter with March 2010 being the second highest production month ever in terms of APE for the agency channel after December 2009. A key driver of that performance is the 40 per cent increase we have achieved in the average case size as confidence returns to the market, coupled with the launch of a new linked product. Average agent numbers in the first quarter are up 14 per cent over the same period last year. The bank channel also continues to perform well and is demonstrating strong momentum over the same period last year, with new business sales up 48 per cent.

### India

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£73m</b>	£56m	30%

In **India**, ICICI-Prudential has seen a continuing resurgence in new business sales during the first quarter following on from the market related decline in 2009. This represents the second highest quarter of sales in both local currency and at actual exchange rates. Prudential's share of first quarter new business sales of £73 million (reflecting our 26 per cent ownership) is up 30 per cent over last year. The proportion of contribution of agency and other alternate channels (including bancassurance & broker channels) to the APE for the quarter were at 50 per cent each, remaining in line with the same period last year.

### Indonesia

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£ 61m</b>	£38m	61%

Strong growth in **Indonesia** continues with £61 million of new business sales up 61 per cent on the first quarter of 2009. Agency continues to be the predominant distribution channel and our successful agency management system has driven a 28 per cent increase in average agency numbers (to 85,000), a 13 per cent increase in the number of cases per active agent and a 9 per cent increase in average case size. Takaful linked products remain a significant contributor at 24 per cent of the new business mix.

### Korea

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£ 22m</b>	£37m	(41)%

As seen during 2009, the market in **Korea** remains very challenging and a key contributor to the 41 per cent decline in new business sales over the first quarter 2009 to £22 million, is our unwillingness to compete in the low margin, high capital guaranteed products sector. Our agency force has reduced by 38 per cent compared to last year. Persistency experience in Korea continues to be on an improving trend.

### Malaysia

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£ 36m</b>	£24m	50%

**Malaysia** delivered an excellent first quarter with new business sales up 50 per cent over the first quarter last year. This follows a 43 per cent increase in new business sales in the previous financial year. The first quarter sales improvement was driven by promotional activity and the launch of a very popular new par product. Agent numbers for the first quarter 2010 are up 14 per cent over the same period of last year and average case sizes are up 25 per cent reflecting renewed confidence in the market and the strong sales of the new par product that contributed 34 per cent of new business. Correspondingly the proportion of protection business has declined relative to the first quarter last year, from 57 per cent to 43 per cent and the proportion of linked business declined from 35 per cent to 22 per cent.

### Singapore

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£ 33m</b>	£22m	50%

**Singapore** also had a very strong first quarter in 2010, with new business sales up 50 per cent to £33 million driven by promotional activity and increased agency productivity. Agency incentives drove the increased agency activity. Average agent numbers are up 7 per cent in the first quarter and average case sizes are up 21 per cent. The proportion of linked business increased to 26 per cent for the first quarter compared to 19 per cent for the same period last year. Sales of our highly profitable protection business also increased by 36 per cent. The bancassurance channel delivered 23 per cent of the quarter's new business and within this the new UOB relationship is performing very well which produced £1.4m of APE in March 2010.

### Taiwan

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£ 34m</b>	£31m	10%

Following our exit from the agency channel in 2009, **Taiwan** is now successfully focused on bank distribution principally with partners E.Sun Bank and Standard Chartered Bank. New business sales of £34 million for the first quarter 2010 are up 10 per cent on the same period last year and represent our highest quarter sales since the disposal of our agency business in the second quarter of 2009. We have succeeded in increasing the proportion of protection business in the mix from 6 per cent for the first quarter last year to 18 per cent for the same period this year.

### Others — Philippines, Thailand and Vietnam

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
APE .....	<b>£18m</b>	£11m	64%

In the first quarter **Vietnam** delivered a very strong result with APE sales up 33 per cent on the prior period, driven by a 35 per cent increase in agent numbers and a 14 per cent increase in average case size. Both **Philippines** and **Thailand** delivered strong results, up 150 per cent and 25 per cent respectively with direct marketing successes in Philippines and our new distribution relationship with UOB in Thailand already contributing over 50 per cent of the total APE from the bank channel.

### Japan

We announced at the start of 2010 that PCA Life **Japan** was suspending writing new business sales with effect from 15 February 2010. Sales for Japan in the first quarter of 2010 amounted to £7 million (first quarter 2009: £17 million). In order to reflect the results of our ongoing Asian operations, all of the headline financial metrics included in this announcement exclude the contribution from Japan.

## 1.2 US operations

### a) Insurance operations

<u>US</u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Sales — APE</b> . . . . .	<b>£255m</b>	£184m	39%
<b>New Business Profit</b> . . . . .	<b>£175m</b>	£140m	25%
<b>Margin — APE %</b> . . . . .	<b>69%</b>	76%	–7pts

The US equity markets continued to recover during the first quarter of 2010 while interest rates remained generally flat and AA corporate spreads and volatility declined somewhat from year-end 2009 levels. While market conditions have improved, companies that were hit hardest by the market disruption of the last 18 months are still struggling to regain market share as customers are increasingly seeking product providers that offer consistency, stability and financial strength. Jackson has continued to benefit significantly from this flight to quality. Our strategy remains focused on increasing sales in variable annuities whilst managing fixed annuity sales in line with the goal of capital preservation. There were no institutional sales during the first quarter of 2010 as Jackson directed available capital to support higher-margin annuity sales.

Jackson delivered APE new business sales of £255 million in the first quarter of 2010, representing a 39 per cent increase over the same period in 2009 and the highest level of sales during the first quarter at actual exchange rates and local currency of any year in the company's history. Jackson achieved exceptionally high new business margins in 2009, partially as a result of our ability to take advantage of extreme dislocation in the corporate bond market. While recovery in the corporate bond market has led to somewhat lower new business margins for fixed index and fixed annuities due to lower spreads in 2010, we continue to write new business at Internal Rates of Return in excess of 20%.

Our pricing discipline has enabled us to substantially preserve the 2009 margin improvement. Jackson achieved an overall margin of 69% in the first quarter 2010. Whilst lower corporate bond spreads have resulted in fixed index and fixed annuity margins normalising to pre-crisis levels, variable annuity margins have remained high at 77%.

#### Variable annuity

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>APE</b> . . . . .	<b>£201m</b>	£105m	91%

**Variable annuity (VA)** APE sales of £201 million in the first quarter of 2010 were 91 per cent higher than the same period in 2009, reflecting the equity market rally that began in the second quarter of 2009, the relative consistency of Jackson's product offering and continued disruptions among some of our major competitors. Jackson's first quarter VA sales were the highest first quarter sales in the company's history. Jackson<sup>7</sup> ranked 4<sup>th</sup> in VA sales in 2009, with a market share of 8.1 per cent, up from 12<sup>th</sup> with a market share of 4.3 per cent in 2008. In the fourth quarter of 2009, which are the latest statistics available, Jackson<sup>8</sup> ranked 1<sup>st</sup> in VA net flows.

#### Fixed index annuity

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>APE</b> . . . . .	<b>£30m</b>	£25m	20%

**Fixed index annuity (FIA)** APE sales of £30 million in the first quarter of 2010 were up 20 per cent over the same period of 2009. Industry FIA sales have benefited from an increase in customer demand for products that offer guaranteed rates of return with additional upside potential linked to stock market index performance. Additionally, Jackson's FIA sales have benefited from the company's consistent financial strength ratings and continued disruptions among some of the top FIA sellers. Jackson<sup>9</sup> ranked 4<sup>th</sup> in sales of FIAs in 2009, with a market share of 7.5 per cent, up from 9<sup>th</sup> and a market share of 3.5 per cent in 2008.

#### Fixed Annuity

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>APE</b> . . . . .	<b>£18m</b>	£48m	(63%)

Jackson's strategy of containing **fixed annuity** volumes resulted in first quarter 2010 APE sales of £18 million, 63 per cent lower than the same period in 2009 and 14 per cent lower than in the fourth quarter of 2009.

<sup>7</sup> Source: VARDS

<sup>8</sup> Source: Morningstar

<sup>9</sup> Source: AnnuitySpecs.com

Total **retail annuity net flows** of £1.5 billion for the first quarter of 2010 represented a 108 per cent increase on the same period in 2009, reflecting the impacts of the significant increase in sales and continued low levels of surrender activity.

## b) Asset management

**Curian Capital**, a specialised asset management company that provides innovative fee-based separately managed accounts, had total assets under management of £2.7 billion at the end of March 2010 compared with £2.3 billion at the end of 2009. Curian generated record deposits at actual exchange rates and local currency of £309 million in the first quarter of 2010, up 218 per cent on the first quarter of 2009 and up 7 per cent on the fourth quarter of 2009.

### 1.3 UK insurance operations

<u>UK</u>	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Sales — APE</b> . . . . .	<b>£193m</b>	£180m	7%
<b>New Business Profit</b> . . . . .	<b>£69m</b>	£60m	15%
<b>Margin — APE %</b> . . . . .	<b>36%</b>	33%	+3pts

Prudential UK continues to focus on balancing writing new business with cash generation while realising value from the opportunities created by the increasing need for retirement solutions in the UK. By competing in selected areas of the UK's retirement savings and income markets Prudential has been successful in generating attractive returns on capital employed.

Total APE new business sales of £193 million were up 7 per cent on the first quarter of 2009, principally due to higher sales of corporate pensions and protection products. In continuing to apply strict return criteria, Prudential did not write any significant bulk annuity transactions in 2009 or 2010.

The new business margin improved to 36 per cent in the first quarter of 2010 from 33 per cent in the first quarter of 2009. This was primarily due to increased margins on with-profit bond business combined with the continuation of strong margins achieved on shareholder-backed annuity business.

Sales of **individual annuities** of APE £59 million were 2 per cent higher than the first quarter of 2009. Sales of external annuities of APE £26 million were up 37 per cent on the first quarter of 2009, aided by strong sales of with-profit annuities, which were up 73 per cent at £13 million following the launch of the with-profits Income Choice Annuity in the first quarter of 2009. Prudential UK continues to manage actively the flow of external conventional annuities to optimise capital consumption.

For internal vestings, APE of £33m was 15 per cent lower than 2009, impacted by a reduction of 13 per cent in average case sizes as a result of depressed asset values and by customers choosing to delay their retirement to allow asset values to recover. We continue to see a positive shift in the number of internal customers choosing to take a with-profits annuity, APE sales amounted to £4 million and were 46 per cent higher than the first quarter of 2009.

Sales of **onshore bonds** of APE £33 million were in line with the first quarter of 2009. With-profits bonds sales of APE £29 million were down 6 per cent on the first quarter of 2009, but this was offset by an increase in sales of unit-linked bonds. Demand for with-profit bonds remains strong, reflecting the attractiveness of Prudential's with-profits offering, including in particular PruFund with its optional capital guarantee.

In January 2010 five new unit-linked risk graded portfolio funds — Pru Dynamic — were launched across Prudential's retirement savings product range, providing risk managed investment for IFAs and their customers. We believe that the new funds play to Prudential's key strengths of portfolio management, asset allocation, and its reputation of being a solid, secure investment company.

Within **corporate pensions**, Prudential UK continues to focus principally on the opportunities from the substantial existing Defined Contribution book of business as well as providing Additional Voluntary Contribution (AVC) arrangements to the public sector. We have been the sole AVC provider to Teachers Pensions for 20 years and provide AVCs to 65 of the 99 Local Government Authorities in England & Wales. First quarter 2010 corporate pensions sales of APE £60m were 15 per cent higher than the first quarter of 2009.

Sales of **other products** of APE £40 million were 14 per cent above the first quarter of 2009. **Individual pensions** sales (including income drawdown) of APE £15 million were 21 per cent higher than first quarter 2009. Sales of the Flexible Retirement Plan, Prudential UK's individual pension product with customer agreed remuneration, continued to grow, with sales in the first quarter 2010 of APE £6 million up 37 per cent from the first quarter of 2009. Sales of the income drawdown product of APE £4 million were double that of the first quarter 2009. **PruProtect** sales continued to grow strongly, with APE sales in the first quarter of 2010 of £5 million, up 145 per cent on the same period last year. This represented a record quarterly performance for PruProtect. Growth continues in **PruHealth**, with APE sales up 12 per cent on the first quarter 2009. PruHealth now has more than 210,000 customers insured.

## 1.4 M&G

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Retail business inflows</b> . . . . .	<b>£1,454m</b>	£2,207m	(34%)
<b>Institutional business inflows</b> . . . . .	<b>£435m</b>	£336m	29%
<b>Total net inflows</b> . . . . .	<b>£1,889m</b>	£2,543m	(26%)

M&G is an investment-led business which aims to deliver superior long term performance for third party clients and the internal funds of the Prudential Group.

Our strategy is to recruit and nurture leading investment talent. We seek to create an environment in which this talent will thrive and so deliver the level of returns that our clients expect of us. This focus on investment performance, combined with a well-diversified business mix and well-established distribution capabilities, has helped M&G to make a strong start to 2010 as indicated by sales performance and the growth in FUM. We maintain our number two position in the UK on the basis of Retail FUM.

Net new business for the first quarter of 2010 was robust at £1.9 billion. While this is lower than the £2.5 billion of net inflows during the same quarter of the previous period, 2009 was an exceptional year for M&G as investors invested heavily in our top-performing bond funds to exploit a near unique opportunity in fixed income markets. We expect new business to return to more normal levels this year.

The UK & European Retail Business maintained its strong performance, with net inflows of £1.7 billion. Sales of our fixed income funds accounted for 35 per cent share of net inflows in the first quarter of 2010 but the continued recovery in the equity markets has meant that net inflows into M&G's top performing equity fund accounted for 49 per cent of the inflow. The total **Retail Business**, including South Africa, attracted net new business of £1.5 billion, compared with £2.2 billion in the first quarter of 2009. Gross inflows for the quarter were £4.2 billion, an increase of 26 per cent on the first quarter 2009.

These strong flows were on the back of excellent investment performance by M&G's retail funds, with 42 per cent of funds in the top quartile over the preceding three years ending 31 March 2010 and 71 per cent of funds in the top half over the preceding three years ending 31 March 2010. Performance was strong across both equity and fixed income funds with 69 per cent of the equity funds and 75 per cent of the fixed income funds in the top half over the preceding three years ending 31 March 2010.

The **Institutional Business** also attracted net new business with net inflows at £0.4 billion for the first quarter of 2010, including £0.2 billion of new money into our public debt funds and a new £0.1 billion segregated equity mandate. Gross inflows were up 99 per cent over the first quarter of 2009 at £2.2 billion.

Investment performance on the Institutional side continues to be very strong with 94% of our external mandates at or above benchmark.

M&G's total **funds under management** at 31 March 2010 were £182.3 billion, up 5 per cent on the 2009 year-end and up 35 per cent on the first quarter of 2009. Total external funds under management at 31 March 2010 were £76.2 billion, a rise of 8 per cent since the start of the year and 64 per cent compared with 31 March 2009. The increase in external funds in the first quarter represents the combined result of market and other movements of £4.1 billion and net flows of £1.9 billion.

After an exceptional 2009 and in line with expectations, net sales are showing signs of returning back to more normal levels in 2010. Nevertheless, the continuing excellent investment performance of M&G's flagship funds gives grounds for confidence that M&G will win a healthy share of new business.

## 1.5 Asia Asset Management

	<u>Q1 2010</u>	<u>Q1 2009</u>	<u>% change on Q1 09</u>
<b>Net (outflows)/inflows</b> . . . . .	<b>(£686)m</b>	£185m	(471%)

The net retail outflows for the quarter were attributed to Money Market Funds (MMFs) of £857 million, principally in India and Taiwan, offset by net inflows of £171 million in other non-MMFs. Large redemptions in MMFs are typical for the March financial year-end and during last year the MMFs were seen as a safer haven in the volatile investment markets. At 1 January 2010 MMF funds under management, at £4.9 billion, were 34 per cent higher than the beginning of last year hence influencing the volume of outflows this quarter. In the first few days of April, close to £1 billion of money had already flowed back to the MMF funds.

The non-MMF net inflows of £171 million included successes in Japan with the Asia/Oceania High Dividend Equity Fund that had net inflows of £440 million. In India ICICI-Prudential has won the "Debt Fund House" category in Morningstar's India Fund Awards 2009 for the second consecutive year.

## 2. Financial Management

The Group remains focused on the proactive management of its balance sheet and risk profile. We continue to impose stringent stress testing on our key capital measures, ensuring we could withstand, both in the short and medium term, significant market shocks.

### 2.1 Capital Management

Our capital position remains strong. We have continued to place emphasis on maintaining the Group's financial strength through optimising the balance between writing profitable new business, conserving capital and generating cash. We estimate that our Insurance Groups Directive (IGD) capital surplus was £3.4 billion at 31 March 2010 (before taking into account the 2009 final dividend of £0.3 billion), covering our capital requirements 2.7 times. This compares to £3.4 billion at the end of 2009 and £2.3 billion at the end of the first quarter of 2009 (before taking into account the 2008 final dividend of £0.3 billion).

The IGD capital surplus at 31 March 2010 is unchanged since the end of 2009. This primarily reflects a positive contribution from underlying earnings, offset by inadmissible assets arising on the purchase of UOB's life insurance subsidiary in Singapore of £0.2 million and the impact of costs incurred to the end of March 2010 in relation to the AIA acquisition and its financing.

We continue to have further available options for us to manage available and required capital. These could take the form of increasing available capital (for example, financial reinsurance) or reducing required capital (for example, through the mix and level of new business) and the use of other risk mitigation measures such as hedging and reinsurance.

As at 31 March stress testing of our IGD capital position to various events has the following results:

- An instantaneous 20 per cent fall in equity markets from 31 March 2010 levels would reduce the IGD surplus by £250 million;
- A 40 per cent fall in equity markets (comprising an instantaneous 20 per cent fall followed by a further 20 per cent fall over a four week period) would reduce the IGD surplus by £650 million;
- A 150bps reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £350 million;
- Credit defaults of ten times the expected level would reduce IGD surplus by £600 million.

In addition to our strong capital position, on a statutory (Pillar 1) basis the total credit reserve for the UK shareholder annuity funds also protects our capital position in excess of the IGD surplus. This credit reserve as at 31 March 2010 was £1.6 billion. This represents 44 per cent of the portfolio spread over swaps, compared to 41 per cent at 31 December 2009, and 31 per cent as at 30 June 2009.

### 2.2 Credit

The Group's total debt portfolio on an IFRS basis is estimated at £102.8 billion at 31 March 2010, excluding holdings attributable to external unit holders of consolidated unit trusts. Of this total, £68.9 billion is in the UK, including £44.5 billion within the UK with-profits fund. Shareholders have limited risk exposure to the with-profits fund as the solvency is protected by the inherited estate. Outside the with-profits fund there is £4.5 billion in unit-linked funds where the shareholder risk is limited, with the remaining £19.9 billion backing the shareholder annuity business and other non-linked business (of which 78.4 per cent is rated AAA to A, 18.8 per cent BBB and 2.8 per cent non-investment grade). No defaults were reported in the first quarter of 2010 for UK shareholder backed business.

Asia's debt portfolio totals £7.2 billion, of which £3.5 billion is invested in unit-linked and with-profits funds with minimal shareholder risk and £3.7 billion held by shareholder backed non-linked business. No defaults were reported in the first quarter of 2010.

The most significant area of exposure to credit risk for the shareholder remains Jackson in the US. Jackson's fixed income portfolio at 31 March is estimated at £25.4 billion. As reported at 31 December 2009 the net unrealised position continues to benefit from the market recovery from the historically wide spreads at the end of 2008. Jackson's net unrealised gains has increased to £0.4 billion at 31 March 2010 from £4 million at the end of 31 December 2009.

Gross unrealised losses on securities priced below 80 per cent of book value were £0.5 billion at 31 March 2010 compared to £0.6 billion at the end of 31 December 2009.

Jackson did not experience any defaults during the first quarter of 2010. Write downs of impaired securities in the first quarter of the year were £35 million, of which £26 million were on Residential Mortgage Backed Securities (RMBS). No write downs were reported on corporate bonds. This compares to total write downs of £152 million for the first quarter 2009. In addition losses of £76 million were incurred in the first quarter of 2010 on sales of impaired

and deteriorating bonds (first quarter 2009: £15 million). The increase over first quarter 2009 is the result of Jackson utilising opportunities to continue to de-risk the portfolio.

## ENDS

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#### **Notes:**

1. Asia 2010 and 2009 comparative APE new business sales and new business profit (NBP) exclude the Taiwan agency business disposed of during the second quarter of 2009 and the Japanese insurance operations which we have closed to new business with effect from 15 February 2010.
2. On 1 March 2010 the Group announced that it has reached agreement with American International group (AIG) on terms for Prudential to acquire AIA Group Limited, a wholly owned subsidiary of AIG. The prospectus detailing the terms of the acquisition was issued to shareholders today (details of the terms of the offer can be obtained on the Company's website).
3. Annual premium equivalent (APE) sales comprise regular premium sales plus one-tenth of single premium insurance sales and are subject to rounding.
4. Present Value of New Business Premiums (PVNBP) are calculated as equalling single premiums plus the present value of expected new business premiums of regular premium business, allowing for lapses and other assumptions made in determining the EEV new business contribution.
5. NBP assumptions for the period are detailed in the accompanying schedule 5. All references to NBP margins in this statement refer to margins on an APE basis, calculated as the ratio of new business profit to APE.
6. High resolution photographs are available to the media free of charge at [www.newscast.co.uk](http://www.newscast.co.uk) (+44 (0)20 3137 9137) or by calling the media office on +44 (0)20 7548 2466.
7. **Financial Calendar 2010:**  
AGM . . . . . 19 May 2010  
Reconvened AGM. . . . . 7 June 2010  
2010 Half Year Results . . . . . 12 August 2010  
Third Quarter 2010 New Business Release . . . . . 10 November 2010
8. Sales for overseas operations have been reported using average exchange rates for the period as shown in the attached schedules. Reference to prior year figures in the commentary is on an actual exchange rate basis unless stated. An alternative method of presentation is on a constant exchange rate basis.

Prudential plc is a company incorporated and with its principal place of business in England, and its affiliated companies constitute a large global financial services group. It provides insurance and financial services through its subsidiaries and affiliates throughout the world. It has been in existence for over 160 years and has £290 billion in assets under management (as at 31 December 2009). Prudential plc is not affiliated in any manner with Prudential Financial, Inc, a company whose principal place of business is in the United States of America.

### **Forward-Looking Statements**

This statement may contain certain “forward-looking statements” with respect to certain of Prudential’s plans and its current goals and expectations relating to its future financial condition, performance, results, strategy and objectives. Statements containing the words “believes”, “intends”, “expects”, “plans”, “seeks” and “anticipates”, and words of similar meaning, are forward-looking. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond Prudential’s control including among other things, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, and the performance of financial markets generally; the policies and actions of regulatory authorities, the impact of competition, inflation, and deflation; experience in particular with regard to mortality and morbidity trends, lapse rates and policy renewal rates; the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries; and the impact of changes in capital, solvency standards or accounting standards, and tax and other legislation and regulations in the jurisdictions in which Prudential and its affiliates operate. This may for example result in changes to assumptions used for determining results of operations or re-estimations of reserves for future policy benefits. As a result, Prudential’s actual future financial condition, performance and results may differ materially from the plans, goals, and expectations set forth in Prudential’s forward-looking statements. Prudential undertakes no obligation to update the forward-looking statements contained in this statement 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 Prospectus Rules, the Listing Rules, the Disclosure and Transparency Rules, the Hong Kong Listing Rules or the SGX-ST listing rules.

## PRUDENTIAL PLC FIRST QUARTER 2010 INTERIM MANAGEMENT STATEMENT

### Supplementary schedules

<b>Contents</b>		<b>Page</b>
<b>Schedule 1A</b>	New Business Insurance Operations (Reported Exchange Rates)	<b>924</b>
<b>Schedule 1B</b>	New Business Insurance Operations (Current Exchange Rates)	<b>925</b>
<b>Schedule 2A</b>	Total Insurance New Business APE -- By Quarter (Reported Exchange Rates)	<b>926</b>
<b>Schedule 2B</b>	Total Insurance New Business APE -- By Quarter (Current Exchange Rates)	<b>927</b>
<b>Schedule 3</b>	Investment Operations -- By Quarter (Reported Exchange Rates)	<b>928</b>
<b>Schedule 4</b>	New Business Profit and Margin ( % APE and % PVNBP) (Reported Exchange Rates)	<b>929</b>
<b>Schedule 5</b>	EEV New Business Methodology and Assumptions	<b>930</b>
<b>Schedule 6</b>	Group Debt Securities at 31 March 2010	<b>933</b>
<b>Schedule 7</b>	Basis of preparation	<b>936</b>

Schedule 1A — Reported Exchange Rates

PRUDENTIAL PLC — NEW BUSINESS — Q1 2010  
INSURANCE OPERATIONS

	Single			Regular			Annual Equivalents <sup>(3)</sup>			PVNBP		
	2010 Q1	2009 Q1		2010 Q1	2009 Q1		2010 Q1	2009 Q1		2010 Q1	2009 Q1	
	YTD	YTD	+/- (%)	YTD	YTD	+/- (%)	YTD	YTD	+/- (%)	YTD	YTD	+/- (%)
	£m	£m		£m	£m		£m	£m		£m	£m	
<b>Group Insurance Operations</b>												
Asia — ex Japan <sup>(1a) (7)</sup> — (Note 1)	216	130	66%	337	263	28%	359	276	30%	1,581	1,297	22%
US <sup>(1a) (7)</sup>	2,497	1,783	40%	5	6	(17%)	255	184	39%	2,538	1,840	38%
UK	1,248	1,215	3%	68	58	17%	193	180	7%	1,557	1,490	4%
<b>Group Total — ex Japan</b>	<b>3,961</b>	<b>3,128</b>	<b>27%</b>	<b>410</b>	<b>327</b>	<b>25%</b>	<b>807</b>	<b>640</b>	<b>26%</b>	<b>5,676</b>	<b>4,627</b>	<b>23%</b>
Japan <sup>(1a) (7)</sup>	7	16	(56%)	6	15	(60%)	7	17	(59%)	32	82	(61%)
<b>Group Total</b>	<b>3,968</b>	<b>3,144</b>	<b>26%</b>	<b>416</b>	<b>342</b>	<b>22%</b>	<b>814</b>	<b>657</b>	<b>24%</b>	<b>5,708</b>	<b>4,709</b>	<b>21%</b>
<b>Asian Insurance Operations<sup>(1a) (7)</sup></b>												
Hong Kong	13	9	44%	67	45	49%	68	46	48%	370	293	26%
Indonesia	17	6	183%	59	37	59%	61	38	61%	218	127	72%
Malaysia	10	5	100%	35	23	52%	36	24	50%	177	129	37%
Philippines	9	1	800%	4	2	100%	5	2	150%	18	8	125%
Singapore	78	29	169%	25	19	32%	33	22	50%	245	152	61%
Thailand	3	2	50%	5	4	25%	5	4	25%	20	13	54%
Vietnam	—	—	0%	8	6	33%	8	5	33%	28	23	22%
<b>SE Asia Operations inc. Hong Kong</b>	<b>130</b>	<b>52</b>	<b>150%</b>	<b>203</b>	<b>136</b>	<b>49%</b>	<b>216</b>	<b>141</b>	<b>53%</b>	<b>1,076</b>	<b>745</b>	<b>44%</b>
China <sup>(8)</sup>	36	27	33%	10	8	25%	14	11	27%	83	68	22%
India <sup>(5)</sup>	18	23	(22%)	71	54	31%	73	56	30%	192	198	(3%)
Korea	9	9	0%	21	36	(42%)	22	37	(41%)	108	183	(41%)
Taiwan	23	19	21%	32	29	10%	34	31	10%	122	103	18%
<b>Total Asia Operations — ex Japan</b>	<b>216</b>	<b>130</b>	<b>66%</b>	<b>337</b>	<b>263</b>	<b>28%</b>	<b>359</b>	<b>276</b>	<b>30%</b>	<b>1,581</b>	<b>1,297</b>	<b>22%</b>
<b>US Insurance Operations<sup>(1a) (7)</sup></b>												
Fixed Annuities	181	483	(63%)	—	—	0%	18	48	(63%)	181	483	(63%)
Fixed Index Annuities	303	247	23%	—	—	0%	30	25	20%	303	247	23%
Life	3	2	50%	5	6	(17%)	6	6	0%	44	59	(25%)
Variable Annuities	2,010	1,051	91%	—	—	0%	201	105	91%	2,010	1,051	91%
<b>Total US Insurance Operations</b>	<b>2,497</b>	<b>1,783</b>	<b>40%</b>	<b>5</b>	<b>6</b>	<b>(17%)</b>	<b>255</b>	<b>184</b>	<b>39%</b>	<b>2,538</b>	<b>1,840</b>	<b>38%</b>
<b>UK &amp; Europe Insurance Operations</b>												
Direct and Partnership Annuities	200	129	55%	—	—	0%	20	13	54%	200	129	55%
Intermediated Annuities	63	59	7%	—	—	0%	6	6	0%	63	59	7%
Internal Vesting Annuities	325	391	(17%)	—	—	0%	33	39	(15%)	325	391	(17%)
<b>Total Individual Annuities</b>	<b>588</b>	<b>579</b>	<b>2%</b>	<b>—</b>	<b>—</b>	<b>0%</b>	<b>59</b>	<b>58</b>	<b>2%</b>	<b>588</b>	<b>579</b>	<b>2%</b>
Corporate Pensions	68	63	8%	53	46	15%	60	52	15%	292	277	5%
On-shore Bonds	333	336	(1%)	—	—	0%	33	34	(3%)	333	336	(1%)
Other Products <sup>(10)</sup>	252	231	9%	15	12	25%	40	35	14%	337	292	15%
Wholesale	7	6	17%	—	—	0%	1	1	0%	7	6	17%
<b>Total UK &amp; Europe Insurance Ops</b>	<b>1,248</b>	<b>1,215</b>	<b>3%</b>	<b>68</b>	<b>58</b>	<b>17%</b>	<b>193</b>	<b>180</b>	<b>7%</b>	<b>1,557</b>	<b>1,490</b>	<b>4%</b>
<b>Group Total — ex Japan</b>	<b>3,961</b>	<b>3,128</b>	<b>27%</b>	<b>410</b>	<b>327</b>	<b>25%</b>	<b>807</b>	<b>640</b>	<b>26%</b>	<b>5,676</b>	<b>4,627</b>	<b>23%</b>

<sup>1</sup> References refer to Schedule 7 — basis of preparation

Schedule 1B — Current Exchange Rates

PRUDENTIAL PLC — NEW BUSINESS — Q1 2010  
INSURANCE OPERATIONS

	Single			Regular			Annual Equivalents <sup>(3)</sup>			PVNBP		
	2010 Q1	2009 Q1		2010 Q1	2009 Q1		2010 Q1	2009 Q1		2010 Q1	2009 Q1	
	YTD	YTD	+/- (%)	YTD	YTD	+/- (%)	YTD	YTD	+/- (%)	YTD	YTD	+/- (%)
	£m	£m		£m	£m		£m	£m		£m	£m	
<b>Group Insurance Operations</b>												
Asia — ex Japan <sup>(1b)(7)</sup>	216	127	70%	337	266	27%	359	279	29%	1,581	1,303	21%
US <sup>(1b)(7)</sup>	2,497	1,640	52%	5	6	(17%)	255	170	50%	2,538	1,693	50%
UK	1,248	1,215	3%	68	58	17%	193	180	7%	1,557	1,490	4%
<b>Group Total — ex Japan</b>	<b>3,961</b>	<b>2,982</b>	<b>33%</b>	<b>410</b>	<b>330</b>	<b>24%</b>	<b>807</b>	<b>629</b>	<b>28%</b>	<b>5,676</b>	<b>4,486</b>	<b>27%</b>
Japan <sup>(1b)(7)</sup>	7	15	(53%)	6	14	(57%)	7	16	(56%)	32	78	(59%)
<b>Group Total</b>	<b>3,968</b>	<b>2,997</b>	<b>32%</b>	<b>416</b>	<b>344</b>	<b>21%</b>	<b>814</b>	<b>645</b>	<b>26%</b>	<b>5,708</b>	<b>4,564</b>	<b>25%</b>
<b>Asian Insurance Operations<sup>(1b)(7)</sup></b>												
Hong Kong	13	8	63%	67	41	63%	68	42	62%	370	269	38%
Indonesia	17	6	183%	59	42	40%	61	43	42%	218	146	49%
Malaysia	10	5	100%	35	22	59%	36	23	57%	177	127	39%
Philippines	9	1	800%	4	2	100%	5	2	150%	18	8	125%
Singapore	78	29	169%	25	18	39%	33	21	57%	245	150	63%
Thailand	3	2	50%	5	4	25%	5	4	25%	20	13	54%
Vietnam	—	—	0%	8	5	60%	8	4	100%	28	20	40%
<b>SE Asia Operations inc. Hong Kong</b>	<b>130</b>	<b>51</b>	<b>155%</b>	<b>203</b>	<b>134</b>	<b>51%</b>	<b>216</b>	<b>139</b>	<b>55%</b>	<b>1,076</b>	<b>733</b>	<b>47%</b>
China <sup>(8)</sup>	36	25	44%	10	8	25%	14	11	27%	83	63	32%
India <sup>(5)</sup>	18	23	(22%)	71	54	31%	73	56	30%	192	198	(3%)
Korea	9	10	(10%)	21	41	(49%)	22	42	(48%)	108	208	(48%)
Taiwan	23	18	28%	32	29	10%	34	31	10%	122	101	21%
<b>Total Asia Operations — ex Japan</b>	<b>216</b>	<b>127</b>	<b>70%</b>	<b>337</b>	<b>266</b>	<b>27%</b>	<b>359</b>	<b>279</b>	<b>29%</b>	<b>1,581</b>	<b>1,303</b>	<b>21%</b>
<b>US Insurance Operations<sup>(1b)(7)</sup></b>												
Fixed Annuities	181	444	(59%)	—	—	0%	18	44	(59%)	181	444	(59%)
Fixed Index Annuities	303	227	33%	—	—	0%	30	23	30%	303	227	33%
Life	3	2	50%	5	6	(17%)	6	6	0%	44	55	(20%)
Variable Annuities	2,010	967	108%	—	—	0%	201	97	107%	2,010	967	108%
<b>Total US Insurance Operations</b>	<b>2,497</b>	<b>1,640</b>	<b>52%</b>	<b>5</b>	<b>6</b>	<b>(17%)</b>	<b>255</b>	<b>170</b>	<b>50%</b>	<b>2,538</b>	<b>1,693</b>	<b>50%</b>
<b>UK &amp; Europe Insurance Operations</b>												
Direct and Partnership Annuities	200	129	55%	—	—	0%	20	13	54%	200	129	55%
Intermediated Annuities	63	59	7%	—	—	0%	6	6	0%	63	59	7%
Internal Vesting Annuities	325	391	(17%)	—	—	0%	33	39	(15%)	325	391	(17%)
<b>Total Individual Annuities</b>	<b>588</b>	<b>579</b>	<b>2%</b>	<b>—</b>	<b>—</b>	<b>0%</b>	<b>59</b>	<b>58</b>	<b>2%</b>	<b>588</b>	<b>579</b>	<b>2%</b>
Corporate Pensions	68	63	8%	53	46	15%	60	52	15%	292	277	5%
Other Products <sup>(10)</sup>	333	336	(1%)	—	—	0%	33	34	(3%)	333	336	(1%)
On-Shore Bonds	252	231	9%	15	12	25%	40	35	14%	337	292	15%
Wholesale	7	6	17%	—	—	0%	1	1	0%	7	6	17%
<b>Total UK &amp; Europe Insurance Ops</b>	<b>1,248</b>	<b>1,215</b>	<b>3%</b>	<b>68</b>	<b>58</b>	<b>17%</b>	<b>193</b>	<b>180</b>	<b>7%</b>	<b>1,557</b>	<b>1,490</b>	<b>4%</b>
<b>Group Total — ex Japan</b>	<b>3,961</b>	<b>2,982</b>	<b>33%</b>	<b>410</b>	<b>330</b>	<b>24%</b>	<b>807</b>	<b>629</b>	<b>28%</b>	<b>5,676</b>	<b>4,486</b>	<b>27%</b>

Schedule 2A — Reported Exchange Rates

PRUDENTIAL PLC — NEW BUSINESS — Q1 2010  
TOTAL INSURANCE NEW BUSINESS APE — BY QUARTER

				2009	2010
	Q1	Q2	Q3	Q4	Q1
	£m	£m	£m	£m	£m
<b>Group Insurance Operations</b>					
Asia — ex Japan <sup>(1a)(7)</sup> . . . . .	276	248	282	403	<b>359</b>
US <sup>(1a)(7)</sup> . . . . .	184	208	249	272	<b>255</b>
UK . . . . .	180	197	158	189	<b>193</b>
<b>Group Total — ex Japan</b> . . . . .	<b>640</b>	<b>652</b>	<b>689</b>	<b>864</b>	<b>807</b>
Japan <sup>(1a)(7)</sup> . . . . .	17	12	11	12	7
<b>Group Total</b> . . . . .	<b>656</b>	<b>664</b>	<b>700</b>	<b>876</b>	<b>814</b>
<b>Asian Insurance Operations<sup>(1a)(7)</sup></b>					
Hong Kong . . . . .	46	49	55	91	<b>68</b>
Indonesia . . . . .	38	46	43	64	<b>61</b>
Malaysia . . . . .	24	29	32	62	<b>36</b>
Philippines . . . . .	2	2	3	4	<b>5</b>
Singapore . . . . .	22	30	29	48	<b>33</b>
Thailand . . . . .	4	3	4	4	<b>5</b>
Vietnam . . . . .	5	9	9	11	<b>8</b>
<b>SE Asia Operations inc. Hong Kong</b> . . . . .	<b>141</b>	<b>168</b>	<b>175</b>	<b>284</b>	<b>216</b>
China <sup>(8)</sup> . . . . .	11	11	13	11	<b>14</b>
India <sup>(5)</sup> . . . . .	56	20	40	52	<b>73</b>
Korea . . . . .	37	29	30	26	<b>22</b>
Taiwan . . . . .	31	20	26	30	<b>34</b>
<b>Total Asian Insurance Operations — ex Japan</b> . . . . .	<b>276</b>	<b>248</b>	<b>282</b>	<b>403</b>	<b>359</b>
<b>US Insurance Operations<sup>(1a)(7)</sup></b>					
Fixed Annuities . . . . .	48	22	14	21	<b>18</b>
Fixed Index Annuities . . . . .	25	33	48	38	<b>30</b>
Life . . . . .	6	6	6	6	<b>6</b>
Variable Annuities . . . . .	105	147	180	207	<b>201</b>
Wholesale . . . . .	—	—	—	—	—
<b>Total US Insurance Operations</b> . . . . .	<b>184</b>	<b>208</b>	<b>249</b>	<b>272</b>	<b>255</b>
<b>UK &amp; Europe Insurance Operations</b>					
Direct and Partnership Annuities . . . . .	13	14	15	17	<b>20</b>
Intermediated Annuities . . . . .	6	8	6	5	<b>6</b>
Internal Vesting annuities . . . . .	39	34	30	33	<b>33</b>
<b>Total Individual Annuities</b> . . . . .	<b>58</b>	<b>56</b>	<b>50</b>	<b>55</b>	<b>59</b>
Corporate Pensions . . . . .	52	62	41	55	<b>60</b>
On-shore Bonds . . . . .	34	42	34	35	<b>33</b>
Other Products <sup>(10)</sup> . . . . .	35	35	33	41	<b>40</b>
Wholesale . . . . .	1	1	1	3	<b>1</b>
<b>Total UK &amp; Europe Insurance Operations</b> . . . . .	<b>180</b>	<b>197</b>	<b>158</b>	<b>189</b>	<b>193</b>
<b>Group Total — ex Japan</b> . . . . .	<b>640</b>	<b>652</b>	<b>689</b>	<b>864</b>	<b>807</b>

Schedule 2B — Current Exchange Rates

PRUDENTIAL PLC — NEW BUSINESS — Q1 2010  
TOTAL INSURANCE NEW BUSINESS APE — BY QUARTER

	2009			2010	
	Q1	Q2	Q3	Q4	Q1
	£m	£m	£m	£m	£m
<b>Group Insurance Operations</b>					
Asia — ex Japan <sup>(1b)(7)</sup> . . . . .	279	264	307	420	<b>359</b>
US <sup>(1b)(7)</sup> . . . . .	170	205	259	282	<b>255</b>
UK . . . . .	180	197	158	189	<b>193</b>
<b>Group Total — ex Japan</b> . . . . .	<b>629</b>	<b>666</b>	<b>724</b>	<b>891</b>	<b>807</b>
Japan <sup>(1b)(7)</sup> . . . . .	16	13	12	13	7
<b>Group Total</b> . . . . .	<b>645</b>	<b>679</b>	<b>736</b>	<b>904</b>	<b>814</b>
<b>Asian Insurance Operations<sup>(1b)(7)</sup></b>					
Hong Kong . . . . .	42	49	57	93	<b>68</b>
Indonesia . . . . .	43	53	48	69	<b>61</b>
Malaysia . . . . .	23	31	34	66	<b>36</b>
Philippines . . . . .	2	2	3	4	<b>5</b>
Singapore . . . . .	21	31	32	49	<b>33</b>
Thailand . . . . .	4	3	5	3	<b>5</b>
Vietnam . . . . .	4	9	8	11	<b>8</b>
<b>SE Asia Operations inc. Hong Kong</b> . . . . .	<b>139</b>	<b>178</b>	<b>188</b>	<b>296</b>	<b>216</b>
China <sup>(8)</sup> . . . . .	11	11	13	12	<b>14</b>
India <sup>(5)</sup> . . . . .	56	22	45	54	<b>73</b>
Korea . . . . .	42	33	34	26	<b>22</b>
Taiwan . . . . .	31	21	28	33	<b>34</b>
<b>Total Asian Insurance Operations — ex Japan</b> . . . . .	<b>279</b>	<b>264</b>	<b>307</b>	<b>420</b>	<b>359</b>
<b>US Insurance Operations<sup>(1b)(7)</sup></b>					
Fixed Annuities . . . . .	44	23	16	23	<b>18</b>
Fixed Index Annuities . . . . .	23	32	49	40	<b>30</b>
Life . . . . .	6	5	7	6	<b>6</b>
Variable Annuities . . . . .	97	144	187	214	<b>201</b>
<b>Total US Insurance Operations</b> . . . . .	<b>170</b>	<b>205</b>	<b>259</b>	<b>282</b>	<b>255</b>
<b>UK &amp; Europe Insurance Operations</b>					
Direct and Partnership Annuities . . . . .	13	14	15	17	<b>20</b>
Intermediated Annuities . . . . .	6	8	6	5	<b>6</b>
Internal Vesting annuities . . . . .	39	34	30	33	<b>33</b>
<b>Total Individual Annuities</b> . . . . .	<b>58</b>	<b>56</b>	<b>50</b>	<b>55</b>	<b>59</b>
Corporate Pensions . . . . .	52	62	41	55	<b>60</b>
On-shore Bonds . . . . .	34	42	34	35	<b>33</b>
Other Products <sup>(10)</sup> . . . . .	35	35	33	41	<b>40</b>
Wholesale . . . . .	1	1	1	3	<b>1</b>
<b>Total UK &amp; Europe Insurance Operations</b> . . . . .	<b>180</b>	<b>197</b>	<b>158</b>	<b>189</b>	<b>193</b>
<b>Group Total — ex Japan</b> . . . . .	<b>629</b>	<b>666</b>	<b>724</b>	<b>891</b>	<b>807</b>

Schedule 3 — Reported Exchange Rates

PRUDENTIAL PLC — NEW BUSINESS — Q1 2010  
INVESTMENT OPERATIONS — BY QUARTER

	2009				2010
	Q1	Q2	Q3	Q4	Q1
	£m	£m	£m	£m	£m
<b>Group Investment Operations</b>					
Opening FUM	62,279	61,703	72,336	85,016	89,780
Net Flows	2,725	7,344	2,898	2,450	1,203
— Gross Inflows	19,154	25,567	26,394	24,942	24,173
— Redemptions	(16,429)	(18,223)	(23,496)	(22,492)	(22,970)
Other Movements	(3,301)	3,289	9,782	2,314	5,763
<b>Total Group Investment Operations</b>	<b>61,703</b>	<b>72,336</b>	<b>85,016</b>	<b>89,780</b>	<b>96,746</b>
<b>M&amp;G</b>					
<b>Retail</b>					
Opening FUM	19,142	19,671	23,324	28,504	31,059
Net Flows	2,207	1,863	1,656	1,790	1,454
— Gross Inflows	3,325	3,126	3,315	3,802	4,190
— Redemptions	(1,118)	(1,263)	(1,659)	(2,012)	(2,736)
Other Movements	(1,678)	1,790	3,524	765	1,556
Closing FUM	19,671	23,324	28,504	31,059	34,069
<b>Institutional<sup>(4)</sup></b>					
Opening FUM	27,855	26,865	32,597	37,731	39,247
Net Flows	336	4,219	856	551	435
— Gross Inflows	1,083	5,097	2,495	2,632	2,151
— Redemptions	(747)	(878)	(1,639)	(2,081)	(1,716)
Other Movements	(1,326)	1,513	4,278	965	2,473
Closing FUM	26,865	32,597	37,731	39,247	42,155
<b>Total M&amp;G Investment Operations</b>	<b>46,536</b>	<b>55,921</b>	<b>66,235</b>	<b>70,306</b>	<b>76,224</b>
<b>Asia<sup>(1a)</sup></b>					
<b>Equity/Bond/Other</b>					
Opening FUM	10,570	10,038	10,636	12,492	13,122
Net Flows	(370)	174	322	57	166
— Gross Inflows	911	1,083	1,725	1,512	1,713
— Redemptions	(1,281)	(909)	(1,403)	(1,455)	(1,547)
Other Movements	(162)	424	1,534	573	1,635
Closing FUM	10,038	10,636	12,492	13,122	14,923
<b>MMF</b>					
Opening FUM	3,873	4,286	4,882	5,281	4,902
Net Flows	554	1,095	115	(321)	(857)
— Gross Inflows	13,808	16,248	18,854	16,618	16,107
— Redemptions	(13,254)	(15,153)	(18,739)	(16,939)	(16,964)
Other Movements	(141)	(499)	284	(58)	5
Closing FUM	4,286	4,882	5,281	4,902	4,050
<b>Third Party Institutional Mandates</b>					
Opening FUM	789	799	859	1,008	1,450
Net Flows	1	2	(2)	372	5
— Gross Inflows	24	10	5	378	12
— Redemptions	(23)	(8)	(7)	(6)	(7)
Other Movements	9	58	151	70	94
Closing FUM	799	859	1,008	1,450	1,549
<b>Total Asian Investment Operations</b>	<b>15,123</b>	<b>16,377</b>	<b>18,781</b>	<b>19,474</b>	<b>20,522</b>
<b>US</b>					
<b>Retail</b>					
Opening FUM	50	44	38	—	—
Net Flows	(3)	(9)	(49)	1	—
— Gross Inflows	3	3	—	—	—
— Redemptions	(6)	(12)	(49)	1	—
Other Movements	(3)	3	11	(1)	—
Closing FUM	44	38	—	—	—
Curian Capital — FUM	1,613	1,646	2,041	2,260	2,708

Schedule 4 — Reported Exchange Rates

PRUDENTIAL PLC — NEW BUSINESS — Q1 2010

TOTAL INSURANCE NEW BUSINESS PROFIT AND MARGIN (% APE AND % PVNBP)

	Annual Equivalents <sup>(3)</sup>			New Business Profit			New Business Margin (% APE)		
	2010 Q1	2009 Q1	+/- (%)	2010 Q1	2009 Q1	+/- (%)	2010 Q1	2009 Q1	2009 FY
	£m	£m		£m	£m		%	%	%
Total Asian Insurance									
Operations — ex Japan <sup>(1a)(7)</sup> . . . . .	359	276	30	183	136	35	51	49	60
Total US Insurance Operations <sup>(1a)(7)</sup> . . . . .	255	184	39	175	140	25	69	76	73
Total UK & Europe Insurance Operations . .	193	180	7	69	60	15	36	33	32
<b>Group Total — ex Japan</b> . . . . .	<b>807</b>	<b>640</b>	<b>26</b>	<b>427</b>	<b>336</b>	<b>27</b>	<b>53</b>	<b>53</b>	<b>57</b>
Japan <sup>(1a)(7)</sup> . . . . .	7	17	(59)	(1)	(4)	(75)	(14)	(24)	(23)
<b>Group Total</b> . . . . .	<b>814</b>	<b>657</b>	<b>24</b>	<b>426</b>	<b>332</b>	<b>28</b>	<b>52</b>	<b>51</b>	<b>56</b>

	PVNBP <sup>(3)</sup>			New Business Profit			New Business Margin (% PVNBP)		
	2010 Q1	2009 Q1	+/- (%)	2010 Q1	2009 Q1	+/- (%)	2010 Q1	2009 Q1	2009 FY
	£m	£m		£m	£m		%	%	%
Asia Operations — ex Japan <sup>(1a)(7)</sup> . . . . .	1,581	1,297	22	183	136	35	11.6	10.5	12.1
Total US Insurance Operations <sup>(1a)(7)</sup> . . . . .	2,538	1,840	38	175	140	25	6.9	7.6	7.3
Total UK & Europe Insurance Operations . .	1,557	1,490	4	69	60	15	4.4	4.0	3.9
<b>Group Total — ex Japan</b> . . . . .	<b>5,676</b>	<b>4,627</b>	<b>23</b>	<b>427</b>	<b>336</b>	<b>27</b>	<b>7.5</b>	<b>7.3</b>	<b>7.7</b>
Japan <sup>(1a)(7)</sup> . . . . .	32	82	(61)	(1)	(4)	(75)	(3.1)	(4.9)	(4.6)
<b>Group Total</b> . . . . .	<b>5,708</b>	<b>4,709</b>	<b>21</b>	<b>426</b>	<b>332</b>	<b>28</b>	<b>7.5</b>	<b>7.1</b>	<b>7.6</b>

**Valuation of new business**

The valuation of new business represents profits determined on the following basis. Non-economic assumptions used in the calculation of the new business contribution for Q1 2010 are consistent with those at 31 December 2009 with the exception of UK immediate annuity business where the mortality assumptions have been updated to reflect those at 31 March 2010. Non-economic assumptions used in the calculation of the new business contribution for Q1 2009 are consistent with those at 31 December 2008 with the exception of Asian operations where the assumptions have been updated to reflect those at 31 March 2009 and UK immediate annuity business where the mortality assumptions have been updated to reflect those at 31 March 2009.

New business target spreads for US operations reflect assumptions at the end of the period. In determining the new business contribution for UK immediate annuity and lifetime mortgage business, which is interest rate sensitive, it is appropriate to use assumptions reflecting point of sale market conditions, consistent with how the business is priced. For other business within the Group, end of period economic assumptions are used.

**Principal economic assumptions**

In most countries, the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on cash or fixed interest securities. For the Group's Asian operations, the active basis is appropriate for business written in Japan, Korea and US dollar denominated business written in Hong Kong. Except in respect of the projected returns of holdings of Asian debt and equity securities for those countries where long-term fixed interest markets are less established, the 'active' basis of assumption setting has been applied in preparing the results of all the Group's US and UK long-term business operations.

For countries where long-term fixed interest markets are less established, investment return assumptions and risk discount rates are based on an assessment of longer-term economic conditions. Except for the countries listed above, this basis is appropriate for the Group's Asian operations. Similarly, the projected returns on holdings of Asian securities in these territories by other Group businesses are set on the same basis.

Expected returns on equity and property asset classes in respect of each territory are derived by adding a risk premium, based on the long-term view of Prudential's economists, to the risk-free rate. In Asia, equity risk premiums range from 3.0 per cent to 8.35 per cent as at 31 March 2010 and 31 December 2009 and range from 3.0 per cent to 7.1 per cent as at 31 March 2009. In the US and the UK, the equity risk premium is 4.0 per cent for all periods shown below.

Assumed investment returns reflect the expected future returns on the assets held and allocated to the covered business at the valuation date.

The tables below summarise the principal financial assumptions:

**Asian operations**

	31 March 2010											
	China	Hong Kong (notes ii, iii)	India	Indonesia	Japan	Korea	Malaysia (note iii)	Philippines	Singapore (note iii)	Taiwan	Thailand	Vietnam
	%	%	%	%	%	%	%	%	%	%	%	%
New business risk discount rate . . . . .	11.75	5.7	14.25	13.8	5.2	8.0	9.3	15.75	5.7	7.5	13.0	16.75
Government bond yield . . . . .	8.25	3.9	9.25	10.25	2.0	5.0	6.5	9.25	4.25	5.5	6.75	10.25
	31 December 2009											
	China	Hong Kong (notes ii, iii)	India	Indonesia	Japan	Korea	Malaysia (note iii)	Philippines	Singapore (note iii)	Taiwan	Thailand	Vietnam
	%	%	%	%	%	%	%	%	%	%	%	%
New business risk discount rate . . . . .	11.75	5.5	14.25	13.8	5.1	8.2	9.4	15.75	5.7	7.5	13.0	16.75
Government bond yield . . . . .	8.25	3.9	9.25	10.25	1.9	5.5	6.5	9.25	4.25	5.5	6.75	10.25
	31 March 2009											
	China	Hong Kong (notes ii, iii)	India	Indonesia	Japan	Korea	Malaysia (note iii)	Philippines	Singapore (note iii)	Taiwan	Thailand	Vietnam
	%	%	%	%	%	%	%	%	%	%	%	%
New business risk discount rate . . . . .	11.75	4.3	14.25	15.25	5.0	9.2	9.2	15.75	5.65	9.25	13.0	16.75
Government bond yield . . . . .	8.25	2.7	9.25	10.25	1.9	5.2	6.5	9.25	4.25	5.5	6.75	10.25

	<b>Asia Total</b>		
	<b>31 Mar 2010</b>	<b>31 Dec 2009</b>	<b>31 Mar 2009</b>
	%	%	%
New business weighted risk discount rate (note (i)) (excluding Taiwan agency business in 2009) . . . . .	<b>9.6</b>	9.1	9.5

**Notes**

- (i) The weighted risk discount rates for Asian operations shown above have been determined by weighting each country's risk discount rates by reference to the EEV basis new business result.
- (ii) The assumptions shown are for US dollar denominated business which comprises the largest proportion of the Hong Kong business.
- (iii) The mean equity return assumptions for the most significant equity holdings in the Asian operations were:

	<b>31 Mar 2010</b>	<b>31 Dec 2009</b>	<b>31 Mar 2009</b>
	%	%	%
Hong Kong . . . . .	<b>7.9</b>	7.9	7.6
Malaysia . . . . .	<b>12.4</b>	12.4	12.5
Singapore . . . . .	<b>10.2</b>	10.2	10.2

To obtain the mean, an average over all simulations of the accumulated return at the end of the projection period is calculated. The annual average return is then calculated by taking the root of the average accumulated return minus 1.

**US operations**

	<b>31 Mar 2010</b>	<b>31 Dec 2009</b>	<b>31 Mar 2009</b>
	%	%	%
Assumed new business spread margins: <sup>note iii</sup>			
Fixed Annuity business (including the proportion of variable annuity business invested in the general account): <sup>note i</sup>			
First five years:			
January to June issues . . . . .	<b>2.25</b>	2.75	2.75
July to December issues . . . . .	<b>n/a</b>	2.25	n/a
Long-term assumption . . . . .	<b>2.0</b>	2.0	2.0
Fixed Index Annuity business			
January to June issues . . . . .	<b>2.5</b>	3.5	3.5
July to December issues . . . . .	<b>n/a</b>	2.5	n/a
New business risk discount rate <sup>note ii</sup>			
Variable annuity . . . . .	<b>8.2</b>	8.2	6.7
Non-variable annuity . . . . .	<b>6.2</b>	6.2	3.5
Weighted average total . . . . .	<b>8.0</b>	7.8	5.1
US 10-year treasury bond rate at end of period . . . . .	<b>3.9</b>	3.9	2.7
Pre-tax expected long-term nominal rate of return for US equities . . . . .	<b>7.9</b>	7.9	6.7

**Notes**

- i The spread assumptions for new tranches of fixed annuity business (including the proportion of variable annuity business invested in the general account) include a provision that crediting rates and spreads will normalise in the future. Thus, the assumption for new business spreads shown above applies for the first five years before normalising over the following 10 years to the long-term assumption of 2.0 per cent. The valuation of new business takes into account an assumed associated risk of increased lapse under certain interest rate scenarios.
- ii The increase in the discount rates at 31 December 2009 reflects the increase in the US 10-year treasury bond rate of 120 bps from 31 March 2009, and an additional allowance for a combination of credit risk premium and short-term default allowance of 30 bps for VA business and 150 bps for other business.
- iii Credit risk treatment  
The projected cash flows incorporate the expected long-term spread between the earned rate and the rate credited to policyholders. The projected earned rates reflect book value yields which are adjusted over time to reflect projected reinvestment rates. Positive net cash flows are assumed to be reinvested in a mix of corporate bonds, commercial mortgages and limited partnerships. The yield on those assets is assumed to grade from the current level to a yield that allows for a long-term assumed credit spread of 1.25 per cent over 10 years. The expected spread on new business has been determined after allowing for a Risk Margin Reserve (RMR) allowance of 25 basis points for longer-term defaults for all periods shown above.

In the event that longer-term default levels are higher then, unlike for UK annuity business where policyholder benefits are not changeable, Jackson has some discretion to adjust crediting rates, subject to contract guarantee levels and general market competition considerations.

## UK operations

	<u>31 Mar</u> <u>2010</u> %	<u>31 Dec</u> <u>2009</u> %	<u>31 Mar</u> <u>2009</u> %
<b>Shareholder-backed annuity business:<sup>note i</sup></b>			
New business risk discount rate . . . . .	<b>7.1</b>	8.7	10.6
Pre-tax expected long-term nominal rate of return:			
Fixed annuities . . . . .	<b>5.0</b>	5.7	6.0
Inflation-linked annuities . . . . .	<b>5.2</b>	6.0	5.3
<b>Other business:</b>			
New business risk discount rate <sup>note ii</sup> . . . . .	<b>7.1</b>	7.7	6.8
Pre-tax expected long-term nominal rates of investment return:			
UK equities . . . . .	<b>8.4</b>	8.4	7.8
Gilts . . . . .	<b>4.4</b>	4.4	3.8
Corporate bonds . . . . .	<b>6.1</b>	6.1	5.2
Post-tax expected long-term nominal rate of return for the PAC with-profits fund:			
Pension business (where no tax applies) . . . . .	<b>6.9</b>	6.9	6.5
Life business . . . . .	<b>6.0</b>	<u>6.0</u>	<u>5.8</u>

### Notes

- i For Prudential's UK 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, the future cash flows are discounted using the swap yield curve plus an allowance for liquidity premium based on Prudential's assessment of the expected return on the assets backing the annuity liabilities after allowing for expected long-term defaults, credit risk premium and short-term downgrades and defaults. For the purposes of presentation in the EEV results, the results on this basis are reconfigured. Under this approach the projected earned rate of return on the debt securities held is determined after allowing for expected long-term defaults and, where necessary, an additional allowance for an element of short-term downgrades and defaults to bring the allowance in the earned rate up to best estimate levels. The allowances for credit risk premium and additional short-term default allowance are incorporated into the risk margin included in the discount rate. The credit assumptions used in the MCEV calculations and the residual liquidity premium element of the bond spread over swap rates for shareholder-backed annuity new business are as follows:

	<u>31 Mar</u> <u>2010</u> (bps)	<u>31 Dec</u> <u>2009</u> (bps)	<u>31 Mar</u> <u>2009</u> (bps)
Bond spread over swap rates . . . . .	<b>105</b>	<b>198</b>	<b>267</b>
Total credit risk allowance . . . . .	<b>35</b>	<b>54</b>	<b>80</b>
Liquidity premium . . . . .	<b>70</b>	<b>144</b>	<b>187</b>

- ii The risk discount rates for new business for UK insurance operations other than shareholder-backed annuities reflect weighted rates based on the type of business.

**Group Debt Securities at 31 March 2010****1 IFRS balance sheet fair value**

The Group's investments in debt securities at 31 March 2010 excluding holdings attributable to external unit holders are as follows:

	<u>With-profit (note 1a)</u> £bn	<u>Unit-linked and variable annuity (note 1a)</u> £bn	<u>Other shareholder backed business</u> £bn	<u>Total</u> £bn
UK insurance operations . . . . . (Notes 1b and 1c)	44.5	4.5	19.9	<b>68.9</b>
Jackson National Life . . . . . (Notes 1d and 3)	—	—	25.4	<b>25.4</b>
Asia long-term business . . . . .	1.2	2.3	3.7	<b>7.2</b>
Other operations . . . . .	—	—	1.3	<b>1.3</b>
<b>Total</b> . . . . .	<u>45.7</u>	<u>6.8</u>	<u>50.3</u>	<u><b>102.8</b></u>

**Notes**

- 1(a) Shareholders are not directly exposed to value movements on assets backing with-profit, unit linked, and variable annuity business.  
 1(b) Of the £19.9 bn of debt securities for UK annuity and other non-linked shareholder backed business 30.2% was rated AAA, 11.7% AA, 36.5% A, 18.8% BBB and 2.8% other.  
 1(c) For UK annuity business provision is made for possible future credit related losses. At 31 March 2010, a provision of £1.6bn was held.  
 1(d) Jackson debt securities comprise:

	<u>31 Mar 2010</u> £m	<u>31 Dec 2009</u> £m
Corporate securities (95% investment grade) . . . . .	<b>18,694</b>	16,455
Residential mortgage backed securities (62% government agency; 23% for pre 2006/2007 vintages; £514m for 2006/2007 vintages of which £383m is for the senior part of the capital structure) . . . . .	<b>3,314</b>	3,316
Commercial mortgage backed securities . . . . .	<b>2,333</b>	2,104
CDO funds . . . . .	<b>85</b>	79
Other debt securities . . . . .	<b>977</b>	877
Total . . . . .	<u><b>25,403</b></u>	<u>22,831</u>

**2 Defaults, losses from sales of impaired and deteriorating bonds and write-downs for non-linked shareholder backed business****2.1 Jackson National Life**

In general, the debt securities of Jackson are purchased with the intention and the ability to hold them for the longer-term.

The majority of Jackson's debt securities are classified as available-for-sale under IAS 39. Under this classification realised losses from defaults, sales of impaired and deteriorating bonds and write-downs are recorded in the income statement. Changes in unrealised appreciation and depreciation are recorded as a movement directly in shareholders' equity.

Jackson continues to review its investments on a case-by-case basis to determine whether any decline in fair value represents an impairment and therefore requiring an accounting write-down. IFRS requires available-for-sale debt securities which are impaired to be written down to fair value through the profit and loss account.

The defaults, write-downs and losses on sales of impaired and deteriorating bonds (net of recoveries) for the three months to 31 March 2010 were as follows:

	<u>Defaults</u>	<u>Bond write downs</u>	<u>Losses on sales of impaired and deteriorating bonds (net of recoveries)</u>
	£m	£m	£m
Corporate debt securities . . . . .	—	—	<b>18</b>
Residential mortgage backed securities			
Prime . . . . .	—	<b>5</b>	<b>33</b>
Alt-A . . . . .	—	<b>14</b>	<b>19</b>
Sub-prime . . . . .	—	<b>7</b>	—
Other . . . . .	—	<b>9</b>	<b>6</b>
Total . . . . .	—	<b>35</b>	<b>76</b>

## 2.2 Other operations

For the Group's operations, other than Jackson National Life, debt securities are accounted for on a fair value through P&L basis with all value movements recorded in the income statement. Excluding Jackson National Life there were no defaults in the first quarter of 2010 for other shareholder backed business (measured against market value).

## 3 Jackson National Life — securities in an unrealised loss position

For Jackson's securities classified as available-for-sale under IAS 39, at 31 March 2010 there was a net unrealised gain position of £438 million. This amount comprised £1,142 million of gross unrealised gains and £704 million of gross unrealised losses on individual securities. Under IFRS unrealised losses are only applicable for securities which have not been impaired during the period. Securities impaired during the period are written down to fair value through the profit and loss in full. Note 2.1 shows the element of write downs in 2010. Included within the gross unrealised losses is £454 million for securities which are valued at less than 80 per cent of book value, of which 14 per cent have been at this level for less than 6 months.

IFRS requires securities to be carried at fair value, being the amount for which the security would be exchanged between knowledgeable, willing parties in an arm's length transaction. The best evidence of fair value is quoted prices in an active market, but if the market is not active then a valuation technique is used to establish fair value.

### a) Movements in the values for the 3 months to 31 March 2010:

Movements in the values of available-for-sale securities for the three months to 31 March 2010 are included in the table shown below:

	<u>Change reflected directly in shareholders' equity</u>				
	<u>31 March 2010</u>	<u>Movement in Quarter 1</u>	<u>Foreign exchange translation*</u>	<u>Quarter 1 including Foreign exchange</u>	
	£m	£m	£m	£m	£m
<b>Assets fair valued at below book value</b>					
Book value . . . . .	<b>7,589</b>	(1,131)	500	(631)	8,220
Unrealised loss . . . . .	<b>(704)</b>	316	(54)	262	(966)
<b>Fair value (as included in balance sheet) . .</b>	<b><u>6,885</u></b>	<b><u>(815)</u></b>	<b><u>446</u></b>	<b><u>(369)</u></b>	<b><u>7,254</u></b>
<b>Assets fair valued at or above book value</b>					
Book value . . . . .	<b>17,218</b>	1,791	983	2,774	14,444
Unrealised gain . . . . .	<b>1,142</b>	106	66	172	970
<b>Fair value (as included in the balance sheet) . . . . .</b>	<b><u>18,360</u></b>	<b><u>1,897</u></b>	<b><u>1,049</u></b>	<b><u>2,946</u></b>	<b><u>15,414</u></b>
<b>Total</b>					
Book value . . . . .	<b>24,807</b>	660	1,483	2,143	22,664
Net unrealised gain . . . . .	<b>438</b>	422	12	434	4
<b>Fair value (as included in balance sheet) . .</b>	<b><u>25,245</u></b>	<b><u>1,082</u></b>	<b><u>1,495</u></b>	<b><u>2,577</u></b>	<b><u>22,668</u></b>

**b) Fair value of securities in an unrealised loss position as a percentage of book value**

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

The unrealised losses in the Jackson balance sheet on unimpaired securities are £704 million (31 December 2009: £966 million) relating to assets with fair market value and book value of £6,885 million (31 December 2009: £7,254 million) and £7,589 million (31 December 2009: £8,220 million) respectively.

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

	Fair value 31 Mar 2010	Unrealised loss 31 Mar 2010	Fair value 31 Dec 2009	Unrealised loss 31 Dec 2009
	£m	£m	£m	£m
Between 90% and 100% . . . . .	5,501	(130)	5,127	(169)
Between 80% and 90% . . . . .	678	(120)	1,201	(203)
Below 80% . . . . .	706	(454)	926	(594)
	<u>6,885</u>	<u>(704)</u>	<u>7,254</u>	<u>(966)</u>

**(ii) Fair value of sub-prime and Alt-A securities as a percentage of book value**

Included within the table above are amounts relating to sub-prime and Alt-A securities in a gross unrealised loss position for various percentages of book value of:

	Fair value 31 Mar 2010	Unrealised loss 31 Mar 2010	Fair value 31 Dec 2009	Unrealised loss 31 Dec 2009
	£m	£m	£m	£m
Between 90% and 100% . . . . .	67	(3)	102	(3)
Between 80% and 90% . . . . .	32	(6)	160	(28)
Below 80% . . . . .	124	(61)	159	(88)
	<u>223</u>	<u>(70)</u>	<u>421</u>	<u>(119)</u>

**c) Securities whose fair value were below 80 per cent of the book value**

As shown in the table above, £454 million (31 December 2009: £594 million) of the £704 million (31 December 2009: £966 million) of gross unrealised losses at 31 March 2010 related to securities whose fair value were below 80 per cent of the book value. The age analysis for this £454 million (31 December 2009: £594 million), indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

	Fair value 31 Mar 2010	Unrealised loss 31 Mar 2010	Fair value 31 Dec 2009	Unrealised loss 31 Dec 2009
	£m	£m	£m	£m
Less than 3 months . . . . .	66	(19)	153	(45)
3 months to 6 months . . . . .	33	(11)	5	(3)
More than 6 months . . . . .	607	(424)	768	(546)
	<u>706</u>	<u>(454)</u>	<u>926</u>	<u>(594)</u>

For securities valued at less than 80 per cent of book value, 70 per cent are investment grade. The analysis by category of debt securities whose fair value were below 80 per cent of the book value is as follows:

	Fair value 31 Mar 2010	Unrealised loss 31 Mar 2010	Fair value 31 Dec 2009	Unrealised loss 31 Dec 2009
	£m	£m	£m	£m
RMBS				
Prime . . . . .	247	(115)	322	(153)
Alt-A . . . . .	38	(17)	77	(33)
Sub-prime . . . . .	86	(44)	82	(55)
	<u>371</u>	<u>(176)</u>	<u>481</u>	<u>(241)</u>
Commercial mortgage backed securities . . . . .	47	(63)	87	(86)
Other asset backed securities . . . . .	178	(172)	183	(188)
Total structured securities . . . . .	596	(411)	751	(515)
Corporates . . . . .	110	(43)	175	(79)
	<u>706</u>	<u>(454)</u>	<u>926</u>	<u>(594)</u>

\* Balance sheet items for Jackson National Life have been translated at the closing rate for the period, being \$1.5169 at 31 March 2010 (31 December 2009 \$1.6149). Jackson National Life income statement movements have been translated at the average exchange rate for the period, being \$1.5592 for 3 months to 31 March 2010.

## **Schedule 7 — BASIS OF PREPARATION**

The new business schedules 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.

The format of the schedules is consistent with the distinction between insurance and investment products as applied for previous financial reporting periods. Products categorised as “insurance” refer to those classified as contracts of long-term insurance business for regulatory reporting purposes, i.e. falling within one of the classes of insurance specified in part II of Schedule 1 to the Regulated Activities Order under FSA regulations.

The details shown 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.

New business premiums for regular premium products are shown on an annualised basis. Department of Work and Pensions rebate business is classified as single recurrent business. Internal vesting business is classified as new business where the contracts include an open market option.

Investment products referred to in the tables for funds under management 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, as described in the preceding paragraph, although similar IFRS recognition and measurement principles apply to the acquisition costs and fees attaching to this type of business.

New Business Profit has been determined using the European Embedded Value (EEV) methodology set out in our 2009 Annual Report and the assumptions set out in schedule 5.

In determining the EEV basis value of new business written in the period policies incept, 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 values are presented pre-tax.

### **Notes to Schedules 1 - 6**

- (1a) Insurance and investment new business for overseas operations has been calculated using average exchange rates. The applicable rate for Jackson for the first quarter of 2010 is 1.56.
- (1b) Insurance and investment new business for overseas operations has been calculated using constant exchange rates. The applicable rate for Jackson is 1.56.
- (2) Represents cash received from sale of investment products.
- (3) Annual Equivalents, calculated as regular new business contributions plus 10 per cent single new business contributions, are subject to roundings. PVNBPs are calculated as equalling single premiums plus the present value of expected premiums of new regular premium business. In determining the present value, allowance is made for lapses and other assumptions applied in determining the EEV new business profit.
- (4) Balance includes segregated and pooled pension funds, private finance assets and other institutional clients. Other movements reflect the net flows arising from the cash component of a tactical asset allocation fund managed by PPM South Africa.
- (5) New business in India is included at Prudential’s 26 per cent interest in the India life operation.
- (6) Balance Sheet figures have been calculated at the closing exchange rate. Prior year balance is shown on a constant exchange rate.
- (7) Sales are converted using the year to date average exchange rate applicable at the time. The sterling results for individual quarters represent the difference between the year to date reported sterling results at successive quarters and will include foreign exchange movements from earlier periods.
- (8) New business in China is included at Prudential’s 50 per cent interest in the China life operation.
- (9) Mandatory Provident Fund (MPF) product sales in Hong Kong are included at Prudential’s 36 per cent interest in Hong Kong MPF operation.







