# Prudential plc
# 2012 Half Year Financial Report

Long-term thinking

HK Stock Code: 2378

PRUDENTIAL

Prudential has produced a strong performance during the first six months of 2012 across our key financial metrics – IFRS, new business profit and cash – despite considerable global macroeconomic challenges. Our track record of profitable growth has continued as we have delivered our highest-ever first-half new business profit and IFRS operating profit of £1.14 billion and £1.16 billion respectively. Net cash remittances from our business units to the Group have grown in line with our strategy and we retain one of the strongest capital positions in the sector.

To view our reports online go to www.prudential.co.uk

## Quick links

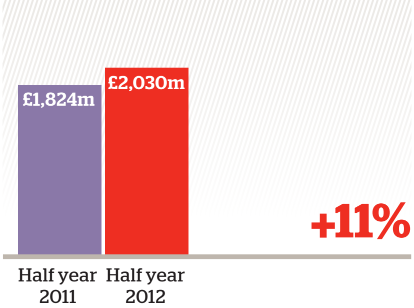
For further information about our KPIs, go to page 2

For further information about our financial highlights, go to page 10

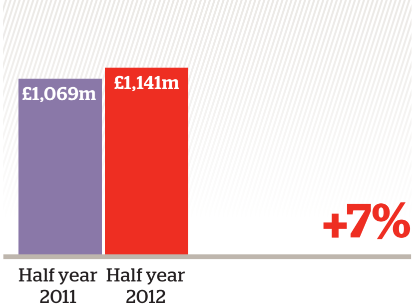
# Highlights

## Key performance indicators

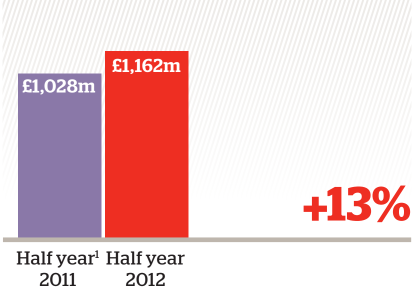
### Annual Premium Equivalent new business premiums



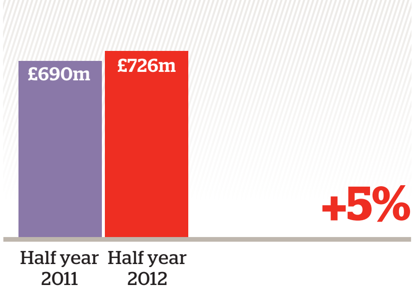

### European Embedded Value new business profit




### International Financial Reporting Standards operating profit based on longer-term investment returns




### Cash remitted to Group




1 The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

## Business unit performance highlights

### Prudential Corporation Asia

- Asia life insurance business operating profit[1] up 26 per cent to £409 million
- High performing multi-channel distribution with increasing agent activity and productivity and strongly growing sales through an extensive range of bank partners
- Well balanced life insurance product portfolio emphasising regular premium savings and protection that offers good returns for customers and shareholders
- More market leading positions than any other life insurer in the region and one of the region's largest onshore mutual fund managers

### Jackson

- New business profit of £442 million
- Top three provider of variable and total annuities in US
- Rated as a 'World Class' service provider for six successive years by Service Quality Measurement Group
- Highest Customer Satisfaction by Industry award from Service Quality Measurement Group

### Prudential UK

- Total IFRS operating profit of £353 million
- Strength and investment performance of With-Profits Fund allowed Prudential to deliver strong annualised returns for policyholders
- Two 'Five Star' ratings for excellent service in the Investment and Life and Pensions categories at the Financial Adviser Service Awards 2011

### M&G

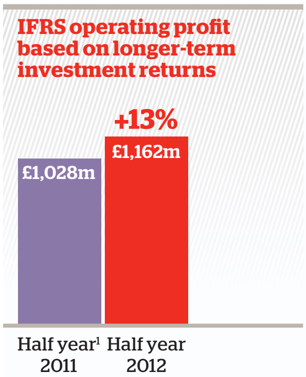
- Net inflows of £4.9 billion
- M&G's retail business has been awarded the prestigious Outstanding Investment House of the Year 2011 Award for the second year running at the OBSR Awards
- M&G's institutional business was recognised for its strength and expertise at the industry flagship Financial News Awards for Excellence in Institutional Asset Management, where it was named Fixed Income Manager of the Year 2011

1 Operating profit from long-term operations excluding Eastspring Investments, development costs and Asia regional head office costs.

# Group Chief Executive's report

'Asia continues to be the most significant profitable growth opportunity for the Group with a rapidly expanding middle class who have a strong demand for savings and protection products.'

**Tidjane Thiam**
Group Chief Executive




**I am pleased to report a strong performance in the first half of 2012 across the Group's key financial metrics of IFRS operating profit, new business profit and cash remittances. We continue to make progress towards achieving the 2013 'Growth and Cash' objectives. Asia has again led the Group's profitable growth. We remain on track to achieve our targets of doubling 2009 new business profit and IFRS profit in the region by 2013. This performance has been delivered against a backdrop of market turbulence, combined with persistent low interest rates.**

## Group performance

New business profit is up 7 per cent to £1,141 million (2011: £1,069 million), with a new business margin of 56 per cent (2011: 59 per cent). APE sales have increased by 11 per cent to £2,030 million (2011: £1,824 million) in the first half of 2012. M&G has attracted strong net inflows of £4.9 billion (2011: £2.9 billion), continuing its trend of high relative performance in difficult market conditions.

Our IFRS operating profit based on longer-term investment returns increased by 13 per cent during the first six months of the year to £1,162 million (2011: £1,028 million[1]). IFRS shareholders' funds increased by 8 per cent to £9.3 billion, compared to £8.6 billion[1] as at 31 December 2011.

Underlying free surplus generation from our life and asset management businesses, before reinvestment in new business, was broadly in line with prior year at £1,403 million. Investment in new business has increased to £364 million (2011: £297 million), reflecting a combination of growth in new business volumes, changes in business mix and the impact of lower interest rates.

Net cash remittances to Group from our businesses increased by 5 per cent to £726 million (2011: £690 million). Our balance sheet continues to be defensively positioned and at the end of the period our IGD surplus was £4.2 billion (31 December 2011: £4.0 billion).

## 2013 'Growth and Cash' objectives

The Group continues to focus on delivering the challenging 'Growth and Cash' objectives we set out at our 2010 investor conference.

In Asia, where the opportunities for profitable growth are greatest, by 2013, we are targeted to double 2009 new business profit to £1.4 billion and double our 2009 IFRS operating profit to £930 million. At full year 2011, we were more than half way towards reaching both these targets. In the first half of 2012, we made further progress with Asia new business profit reaching £547 million (2011: £465 million) and IFRS operating profits at £440 million (2011: £365 million[1]).

Turning to the cash objectives, each of our businesses are demonstrating clear progress. Asia, which is targeted to remit a total of £300 million to the Group in 2013, made remittances of £126 million in the first half of 2012 (2011: £105 million). The US, which is targeted to remit £200 million[2] next year, made remittances in excess of this amount at £247 million in half year 2012 (2011: £320 million including exceptional release of surplus). Prudential UK, tasked with remitting £350 million in 2013, made remittances to the Group of £230 million in the first half (2011: £265 million). Looking at the cumulative cash target of £3.8 billion over the four-year period from 2010 to end-2013, we have so far achieved 73 per cent of the total objective.

### Group operating principles

- Use of balanced metrics
- Disciplined capital allocation
- Proactive risk management

### Strategic framework

Accelerating
**Asia**
For further information go to page 18

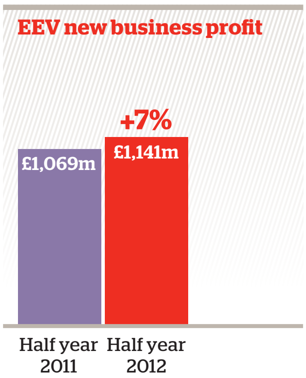
Strengthening
**United States**
For further information go to page 24

Focusing
**United Kingdom**
For further information go to page 28

Optimising
**Asset Management**
For further information go to page 31

Notes
1 The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.
2 Before changes as a result of acquisition of Reassure America Life Insurance Company.

# Group Chief Executive's report




'Prudential Corporation Asia's delivery of both profitable growth and cash increasingly validates the central place that the high margin and high growth markets of South-east Asia occupy in our strategy.'

'The US market is the world's largest retirement market... Our strategy in the US is to take advantage of this profitable growth opportunity while maintaining strict financial and risk management discipline.'

## Our operating performance by business unit

### Prudential Corporation Asia

Asia continues to be the most significant profitable growth opportunity for the Group with a rapidly expanding middle class who have a strong demand for savings and protection products. The seven South-east Asia markets that make up our 'sweet spot' have a combined population of more than 500 million and total GDP of more than US$2 trillion, equivalent to that of a G5 economy[1]. We are well positioned to capture this profitable growth opportunity.

In the first half, we have reported record new business profit across the region of £547 million (2011: £465 million). Collectively our four largest markets of Hong Kong, Indonesia, Singapore and Malaysia have grown new business profit by 20 per cent, with particularly strong growth in Indonesia up 49 per cent and Malaysia up by 27 per cent. Indonesia remains our largest market with an agency force of more than 180,000 and an emerging bancassurance channel that is showing good early momentum. We continue to see rapid growth in some of our smaller markets. New business sales in Thailand were up 73 per cent and in the Philippines up by 50 per cent.

Despite the challenge of low interest rates in some of our markets the new business profit margin remains strong at 61 per cent, albeit 2 percentage points lower than 2011. Importantly, due to actions taken by management in these regions, we have maintained strong internal rates of return of more than 20 per cent across all businesses, with a payback period in Asia of four years.

Our products are central to our strategy. We continue to innovate and develop products that are suitable for the evolving needs of customers in these regions, with a particular focus on regular premium savings and protection. Health and protection products contributed 32 per cent of APE sales in the period, and 93 per cent of APE sales came from regular premium business.

Our success throughout Asia is underscored by our powerful multi-distribution model. Agency remains our largest channel and despite our success to date there remains an opportunity to continue to increase both the scale and productivity of our agency force. Bancassurance is expanding as we develop our capabilities across the region, and we are seeing significant growth across all of our major partnerships.

IFRS long-term operating profit in Asia increased by 26 per cent in the period to £409 million (2011: £324 million[2]) and net cash remittances increased by 20 per cent to £126 million (2011: £105 million). Prudential Corporation Asia's delivery of both profitable growth and cash increasingly validates the central place that the high margin and high growth markets of South-east Asia occupy in our strategy.

We have recently received in principle a licence to operate in Cambodia, an economy which has delivered GDP growth at a CAGR of 11 per cent over the past 10 years and where there are excellent opportunities to establish and develop a fast growing and profitable life insurance industry.

### Jackson National Life Insurance Company (Jackson)

The US market is the world's largest retirement market, with many of the 78 million baby boomers[3] reaching retirement age each year, creating significant demand for retirement income products. Our strategy in the US is to take advantage of this profitable growth opportunity while maintaining strict financial and risk management discipline. We achieve this by taking a conservative approach to pricing and balance sheet management.

In the first half of 2012, new business profit – a metric we focus on ahead of sales – is broadly in line with the prior year with APE sales growing 7 per cent. As expected, new business margin decreased as a direct result of the recent decline in long-term yields, however, pricing actions we have taken in previous periods have contributed positively to margin. Variable annuity sales for the first six months have increased slightly to £611 million, compared to the same period last year. Excluding currency translation effects, all of the increase came from the launch of our Elite Access product. This is a variable annuity without guarantees offering access to alternative investments, which has been particularly well received by distributors.

Notes
1 CIA World Fact Book, 2011 estimates.
2 Comparatives adjusted for retrospective application of the accounting policy improvement for deferred acquisition costs as discussed in 'Basis of preparation' later in this document.
3 Source: US Census Bureau.
4 Before investments in new business.

Jackson delivered IFRS operating profit of £442 million in the period, up 30 per cent on the prior year (2011: £340 million[1]). The increase was due to increased fee income and the non-repeat of an accelerated deferred acquisition cost amortisation charge of £66 million in the prior period. Offsetting these amounts were lower spread income and higher asset-based commission payments. Jackson delivered net cash remittances of £247 million in the first half of the year (2011: £320 million including exceptional release of surplus) reflecting our strategy of profitable controlled growth.

In May, we announced plans to acquire Reassure America Life Insurance Company (REALIC), a traditional US life business which is expected to deliver increased profit and cash and improve the diversification of Jackson's earnings. As a result of the acquisition, Jackson's net remittance objective for 2013 was increased from £200 million to £260 million.

**Prudential UK**

In the UK, Prudential competes selectively to help Britain's ageing population convert their accumulated wealth into retirement income. We have a clear focus on writing profitable new business combined with sustainable cash generation and capital preservation. We concentrate on areas in which we have a clear competitive advantage, namely individual annuities and with-profits products, where we continue to be market leaders with a highly selective presence in the bulk annuity market.

Our performance over the first half of 2012 has been resilient, with an increase in new business profit to £152 million (2011: £146 million). We completed a single large bulk annuity deal that contributed £23 million to this figure. Our retail business delivered APE sales of £385 million (2011: £381 million) as an increase in sales of individual annuities and with-profits bonds was offset by a reduction in sales of corporate pensions business, after exceptionally high volumes in the first half of 2011.

IFRS operating profit in the UK was robust at £353 million (2011: £353 million). Net cash remittances were £230 million (2011: £265 million). Our inherited estate, which is in surplus by £6.1 billion (31 December 2011: £6.1 billion), continues to provide a key source of relative capital strength versus our peers.

'In the UK… we have a clear focus on writing profitable new business combined with sustainable cash generation and capital preservation.'

**Asset management**

Our asset management business, M&G, has continued to focus on delivering superior investment performance for our customers while maximising the strength of its distribution capabilities. This has allowed the business to continue to attract significant new assets during a time of high and enduring global market volatility with total retail and institutional net inflows of £4.9 billion. M&G has continued to achieve considerable success in the retail market, with net investment inflows increasing by 53 per cent to £4.3 billion (2011: £2.8 billion). Institutional net inflows increased from £0.1 billion in the first half of 2011 to £0.6 billion in 2012. Operating profit for M&G (including Prudential Capital) was £199 million, consistent with 2011.

M&G's funds under management of £204 billion were broadly unchanged since the end of 2011, which partly reflects our decision to reduce our stake in M&G's South African subsidiary. M&G continues to be number one for gross and net retail sales in the UK, a position it has now held for 14 consecutive quarters[2], and is now ranked as the largest player in the UK retail market by funds under management[3].

Eastspring, our rebranded Asia asset management business, delivered £426 million[4] of net inflows in the first six months of the year and funds under management grew by 7 per cent to £53.8 billion (31 December 2011: £50.3 billion). IFRS operating profit declined to £34 million (2011: £43 million) in the first half primarily due to changes in the product mix, towards bonds and institutional business. We have also continued to invest in people and infrastructure as we build out our offshore capabilities following the launch of the new brand. We continue to be well positioned to capture the long-term profitable growth opportunities in the Asia asset management markets.

'M&G has continued to focus on delivering superior investment performance for our customers while maximising the strength of its distribution capabilities.'

Notes
1 Comparatives adjusted for retrospective application of the accounting policy improvement for deferred acquisition costs as discussed in 'Basis of preparation' later in this document.
2 Source: Fundscape. (Q1 issue, May 2012). The Pridham Report, Fundscape LLP.
3 Source: IMA (June 2012, data as at May 2012).
4 Excludes Asia Money Market Fund (MMF).

# Group Chief Executive's report

## 2013 financial objectives

### Group

- All business units in aggregate to deliver cumulative net cash remittances of at least £3.8 billion over the period 2010 to end-2013
- Net remittances underpinned by targeted level of cumulative underlying free surplus generation of £6.5 billion over the period 2010 to end-2013

### Accelerating Asia

- Double 2009 value of IFRS life and asset management pre-tax operating profit
- Double 2009 value of new business profits
- Deliver £300 million of net cash remittance to the Group

### Strengthening United States

- Deliver £200 million of net cash remittance to the Group

### Focusing United Kingdom

- Deliver £350 million of net cash remittance to the Group

## Capital and risk management

We take a disciplined approach to capital management and have continued to implement a number of measures over the last few years to enable us to make our capital work more efficiently and more effectively for the Group. Using the regulatory measure of the Insurance Groups Directive, our Group capital surplus position at 30 June 2012 was estimated at £4.2 billion, before allowing for the interim dividend (30 June 2011: £4.1 billion; 31 December 2011: £4.0 billion). The Group's required capital is covered 2.7 times.

Solvency II, the proposed new capital adequacy regime for European insurers, is currently anticipated to be implemented from 1 January 2014. As reported previously, uncertainty remains about the final outcome. We continue to evaluate actions, including continuing consideration of the Group's domicile, in the event that the final outcome is negative in terms of our ability to deliver value to our customers and shareholders.

## Dividend

The Board has approved a 2012 interim dividend of 8.4 pence per share, which translates into an increase of 5.7 per cent. The interim dividend has been calculated as one third of the prior year's full-year dividend, which is in line with previous years' practice.

The Board will maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account the Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

## Outlook

In the first half of 2012, we have delivered a good financial performance and continued to make progress towards the 'Growth and Cash' objectives we set ourselves for 2013. We remain on track to achieve these objectives despite the challenging macroeconomic conditions in which we are operating. Clearly, as a large insurance company with a substantial balance sheet we are not immune to these conditions. However, we manage our business so that it is resilient in times of economic and financial market stress, and our track record through the crisis is evidence of this. Our balance sheet remains defensively positioned and we continue to capitalise on the long-term growth opportunities available to us.

Those opportunities are most evident in South-east Asia, where the depth and breadth of Prudential's franchise is a source of strength. Long-term savings and protection businesses such as ours are playing an integral role in the economic and social transformation that has only just started to take place, and will deliver growth for many years to come, long after the current worries that beset the global economy have passed. For this reason, we remain confident in our ability to grow earnings over the long-term while continuing to create value for our shareholders.

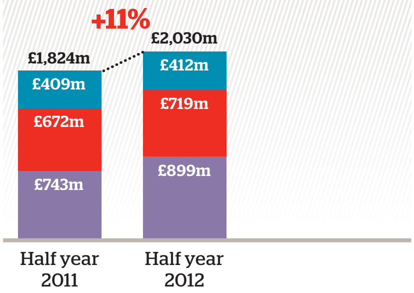
**Tidjane Thiam**
Group Chief Executive

Section 2
# Business review

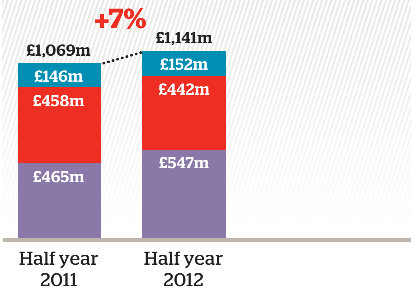
# Financial highlights

## Life APE new business sales, profits and investment in new business
Balancing capital consumption and value optimisation

### Life APE new business sales

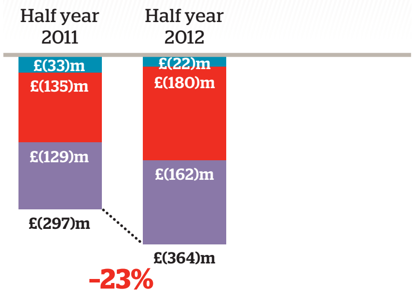



### New business profit



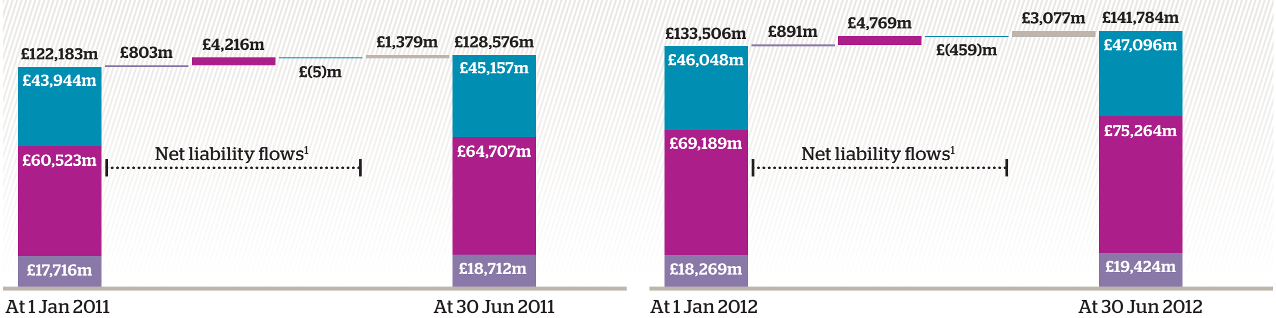

Asia US UK

### Free surplus investment in new business




| | Asia | | US | | UK | | Group | |
|---|---|---|---|---|---|---|---|---|
| | Half year | | Half year | | Half year | | Half year | |
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| New business profit margin | 61% | 63% | 61% | 68% | 37% | 36% | 56% | 59% |
| Payback period | 4 years | 4 years | 2 years | 2 years | 3 years | 5 years | 3 years | 3 years |
| Internal rate of return | >20% | >20% | >20% | >20% | >20% | >20% | >20% | >20% |

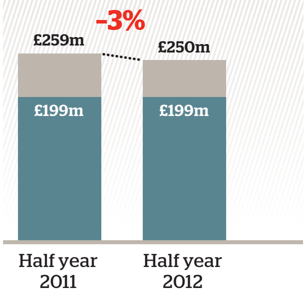
## Shareholder-backed policyholder liabilities and net liability flows



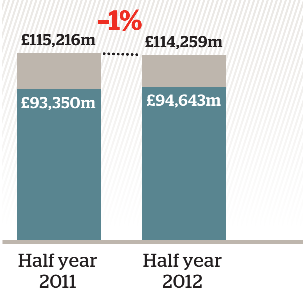

Asia US UK Other movements

## Asset management net inflows and profitability

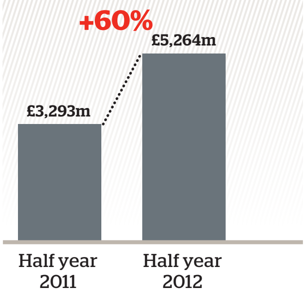
### IFRS operating profit



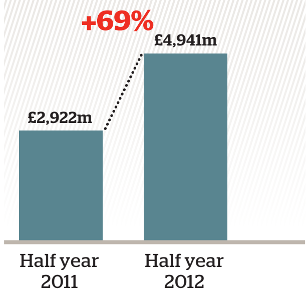

### External funds under management




### Total asset management net inflows

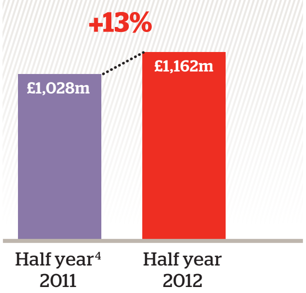



### M&G net inflows

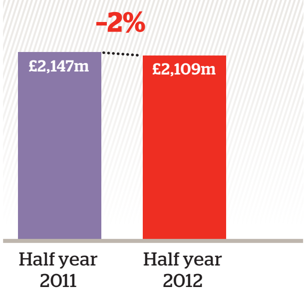



M&G[2] Other asset management business Total asset management[3]

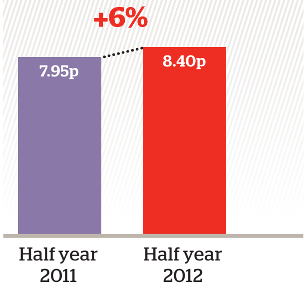
**IFRS operating profit[5]**



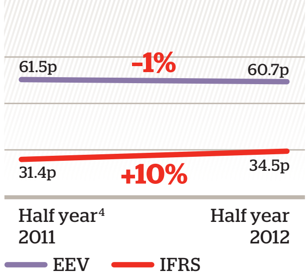

**EEV operating profit[5]**




**Dividend per share relating to the reporting year**

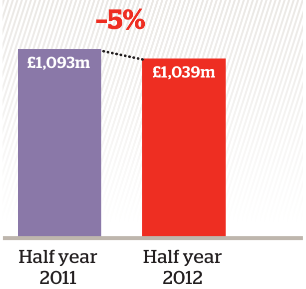



**Basic earnings per share based on operating profit after tax and non-controlling interests**

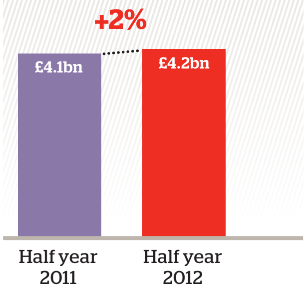



## Balance sheet, cash and capital

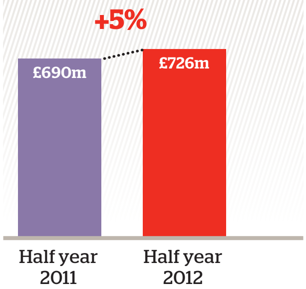
**Underlying free surplus generated[6]**



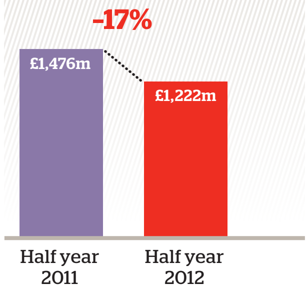

**IGD capital before final dividend[7]**




**Cash remitted to Group**

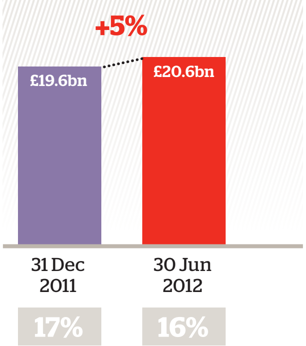



**Holding company cash balances[8]**

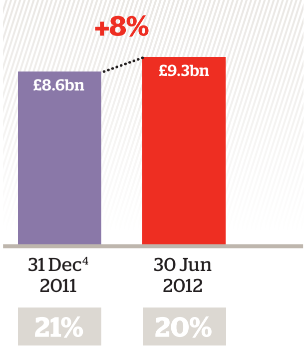



## Group shareholders' funds (including goodwill attributable to shareholders)

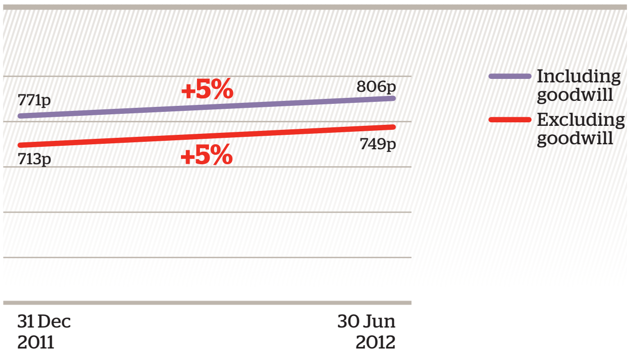
**EEV shareholders' funds**




**IFRS shareholders' funds**




## EEV shareholders' funds per share




Return on shareholders' funds[9,10]

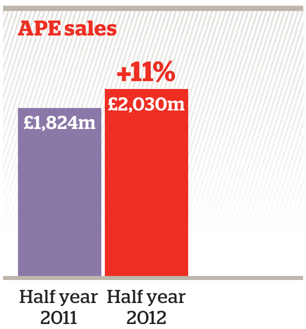
Notes

1 Defined as movements in shareholder-backed policyholder liabilities arising from premiums (net of charges), surrenders, maturities and deaths.
2 2012 includes M&G's 47 per cent proportionate share in the metrics above of PPM South Africa after the divestment transaction. 100 per cent of these metrics were included in 2011.
3 Excludes Asia Money Market Fund (MMF) net outflows of £103 million (2011: net inflows £383 million).
4 The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.
5 Including Solvency II implementation costs, restructuring costs, Asia development costs, Asia regional head office costs and in 2011 the impact of the Retail Price Index (RPI) to Commercial Price Index (CPI) inflation measure change for defined benefit pension schemes.
6 Underlying free surplus generated comprises underlying free surplus generated from the Group's long-term business (net of investment in new business) and that generated from asset management operations.
7 Estimated.
8 Including short-term investments.
9 Annualised IFRS operating profit after tax and non-controlling interests as percentage of opening IFRS shareholders' funds. Half year profits are annualised by multiplying by two. The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.
10 Annualised EEV operating profit after tax and non-controlling interests as percentage of opening EEV shareholders' funds. Half year profits are annualised by multiplying by two.

# Chief Financial Officer's overview

**Nic Nicandrou**
**Chief Financial Officer**

> 'That these results have been achieved despite continued macroeconomic headwinds highlights the quality of our businesses across Asia, the US and the UK.'




**56%**
New business margin

**Prudential has delivered a strong performance during the first half of 2012 and continued to make progress towards the 2013 'Growth and Cash' financial objectives. This performance was driven by Asia with good contributions from the other business operations set against a tougher macroeconomic and investment market backdrop compared to a year ago.**

EEV new business profit ('new business profit') increased by 7 per cent to £1,141 million (2011: £1,069 million), IFRS operating profit based on longer-term investment returns ('IFRS operating profit') increased by 13 per cent to £1,162 million (2011: £1,028 million) and net cash remitted from the business units to the Group increased by 5 per cent to £726 million (2011: £690 million). That these results have been achieved despite continued macroeconomic headwinds highlights the quality of our businesses across Asia, the US and the UK, together with the strength of our balance sheet and our ongoing financial discipline in prioritising value over volume.

## Growth

In life insurance, in the first half of 2012, APE sales were up 11 per cent to £2,030 million (2011: £1,824 million) and new business profit has increased by 7 per cent to £1,141 million (2011: £1,069 million), resulting in a new business margin of 56 per cent (2011: 59 per cent). The considerably lower interest rate environment compared to the first half of 2011, has dampened our new business margins by an estimated 6 percentage points. The effect of this on the overall new business profit was more than compensated by higher sales volumes, pricing actions and business mix. The overall new business economics remain robust as we continue to focus on the products and geographies with the most attractive returns and shortest payback periods, maintaining our proactive approach to optimising the balance between value creation and capital utilisation.

Asia delivered APE sales of £899 million (2011: £743 million) and new business profit of £547 million (2011: £465 million), up 21 per cent and 18 per cent respectively on the prior period. The growth in new business profit was driven by Indonesia (up 49 per cent) and Malaysia (up 27 per cent), while sales benefited from strong contributions in Singapore (up 37 per cent), Indonesia (up 30 per cent) and Taiwan (up 49 per cent). Our new business margin has decreased to 61 per cent (2011: 63 per cent), principally reflecting the effect of the interest rate environment on the margins.

Jackson produced APE sales of £719 million (2011: £672 million), up 7 per cent on the previous year, and new business profit of £442 million (2011: £458 million) down 3 per cent compared to the prior period. We continue to write new business at aggregate internal rates of return in excess of 20 per cent. At 61 per cent, our new business margin in the US remains above historic norms, although lower than the 68 per cent in the first half of 2011 the result of the significant declines in US Treasury yields since June last year. We remain a top three player in US variable annuities[1] and continue to balance value, risk and capital. Jackson continues to adjust pricing and product features to respond to both market conditions and the competitive environment.

Note
1 Sources: Morningstar Annuity Research Center (MARC) First Quarter 2012 Sales Report® and Fourth Quarter 2011 Sales Report®. © Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

In the UK, total APE sales were up 1 per cent to £412 million (2011: £409 million), and new business profit increased by 4 per cent to £152 million (2011: £146 million). At the retail level, strong growth in sales of individual annuities (up 22 per cent) and with-profits bonds (up 36 per cent) was offset by a decrease in corporate pensions volumes (down 29 per cent), which were exceptionally high in the first half of 2011 due to new members joining existing schemes on closure of a number of defined benefit schemes. The level of bulk annuity activity achieved in the first half of 2012 was in line with the prior year. The UK retail new business margin increased to 34 per cent (2011: 32 per cent), primarily reflecting positive mix impact from growth in higher-margin individual annuities and with-profits bonds, and lower sales of corporate pensions.

Shareholder-backed policyholder liabilities across our life insurance businesses increased to £141.8 billion in the first half of 2012 (31 December 2011: £133.5 billion), primarily reflecting £5.2 billion of net inflows, together with foreign exchange and investment-related movements. This steady growth in the size of our life insurance book of business continues to underscore our forward momentum in life IFRS operating profit.

In asset management, we have delivered £5.4 billion[1] of net inflows over the first half of 2012 (2011: £2.9 billion[1]), with the strong momentum earlier in the year continuing into the second quarter, despite increased volatility in investment markets towards the end of the period. At 30 June 2012, our total funds under management were £363 billion (31 December 2011: £351 billion), of which £114.3 billion (31 December 2011: £111.2 billion) are external assets.

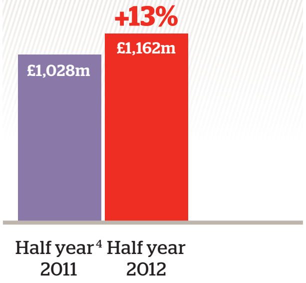
M&G produced £4.9 billion (2011: £2.9 billion) of net inflows in the period (£4.3 billion retail, £0.6 billion institutional), an excellent result given the market backdrop. M&G has ranked number 1 in the UK retail market for gross and net sales over the last 14 consecutive quarters based on data to the end of March 2012[2], and has recently taken over as the largest player in the UK retail market as measured by funds under management[3]. At 30 June 2012, M&G had external funds under management of £94.6 billion, 3 per cent higher than at the end of 2011. External funds comprise £48.3 billion (31 December 2011: £44.2 billion) of retail and £46.3 billion (31 December 2011: £47.7 billion) of institutional assets. Adding these funds to internal amounts, M&G's total funds under management were £204 billion. Eastspring Investments reported retail and institutional net inflows of £426 million[1] in the first half of 2012 (2011: £nil). At 30 June 2012, Eastspring Investments had £53.8 billion of funds under management (31 December 2011: £50.3 billion), of which £19.6 billion (31 December 2011: £19.2 billion) were external assets.

## Profitability

Group IFRS operating profit increased by 13 per cent to £1,162 million in the first half of 2012 (2011: £1,028 million), driven by strong growth in Asia and the US and a robust performance in the UK and M&G. Group EEV operating profit based on longer-term investment returns ('EEV operating profit') decreased by 2 per cent to £2,109 million (2011: £2,147 million), as the negative low interest rate effect on our life in-force profitability was largely compensated by the positive effect of new business flows. The contribution to these metrics from each business operation and each source remains well balanced, preserving both the quality and the resilience of the Group's earnings.

Our Asia long-term business continues to deliver good levels of growth, with IFRS operating profit of £409 million (2011: £324 million) up 26 per cent. The strong performance has been driven by significantly increased contributions from Indonesia, Singapore and Hong Kong, which together with Malaysia account for approximately 80 per cent of the Asia total. We continue to see attractive opportunities to build our industry-leading distribution capability across South-east Asia while maintaining good penetration of high margin health and protection insurance. Asia's long-term EEV operating profit, a measure of the economic value creation in the year, grew by 13 per cent in the first half of 2012 to £872 million (2011: £774 million) further underlining the creation of sustainable value across these operations.

**IFRS operating profit based on longer-term investment returns**




'Our Asia long-term business continues to deliver good levels of growth, with IFRS operating profit of £409 million, up 26 per cent.'

Notes
1 Excludes Asia Money Market Fund (MMF).
2 Source: Fundscape. (Q1 issue, May 2012). The Pridham Report. Fundscape LLP.
3 Source: IMA (June 2012, data as at May 2012).
4 The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

# Chief Financial Officer's overview

'The strength of the UK with-profits funds, which currently have a surplus estate of £6.1 billion, offers strong policyholder protection and assists in generating positive returns for both policyholders and shareholders.'

In the US, long-term business IFRS operating profit was up 30 per cent in the first half of 2012 to £442 million (2011: £340 million). This increase primarily reflects higher fee income and the expected non-recurring impact of accelerated deferred acquisition cost (DAC) amortisation of £66 million in 2011, the benefit of which was partly offset by the adverse effect on spread income of lower bond yields. Fee income increased by 25 per cent to £408 million in the first half of 2012 (2011: £327 million) as a result of growth in separate account asset balances which stood at £44 billion at 30 June 2012 (31 December 2011: £38 billion). Spread income (including the expected return on shareholders' assets) was £384 million in the first half of 2012 (2011: £416 million), with lower yields reducing the average spread margin that we earned on general account liabilities from 262 basis points in the first half of 2011 to 238 basis points in the first half of 2012. The general account closed the period with policyholder liabilities of £32 billion (31 December 2011: £31 billion). Jackson's long-term EEV operating profit decreased by 3 per cent to £805 million (2011: £831 million) driven by lower new and in-force business profits due to the decline in interest rates and a lower contribution from operating experience variances. The recently announced acquisition of REALIC will complete after 30 June and is therefore not included in the first half results. However, as previously disclosed, we expect the transaction to be accretive to IFRS and EEV earnings immediately, with accretion to Jackson's IFRS pre-tax profit estimated at £100 million in the first year.

In the UK, long-term business IFRS operating profit was also higher at £336 million (2011: £332 million) including £190 million from the shareholder-backed business. The strength of the with-profits funds, which currently have a surplus estate of £6.1 billion, offers strong policyholder protection and assists in generating positive returns for both policyholders and shareholders. EEV long-term operating earnings reduced by 9 per cent in the first half of 2012 to £490 million (2011: £537 million), principally due to the impact of lower interest rates on the recognition of in-force profits.

The asset management business generated IFRS operating profit of £250 million in the first half of 2012 (2011: £259 million). M&G (including Prudential Capital) IFRS operating profit at £199 million, was in line with the prior year, with the positive impact of additional inflows muted by lower average market levels in the first half of 2012. Eastspring Investments IFRS operating profit of £34 million (2011: £43 million) was also impacted by lower average margins on funds under management following a shift in business mix together with increased staff costs as the business continues to invest in growth opportunities.

'In the first half of 2012 we have continued to produce significant amounts of free capital, which we measure as free surplus generated.'

## Capital generation

We continue to promote disciplined use of our capital resources across the Group, and focus on allocating capital to the growth opportunities that offer the most attractive returns with the shortest payback periods. We have taken several important steps over the last few years to improve the efficiency and effectiveness of the capital allocation process, which has improved not only our returns on capital invested but also our capital strength and capital fungibility. In the first half of 2012, we have continued to produce significant amounts of free capital, which we measure as free surplus generated.

In the first six months of 2012, we generated £1,403 million of underlying free surplus (before reinvestment in new business) from our life in-force and asset management businesses. This is slightly higher than the £1,390 million generated in the first half of 2011, which benefited from a one-off credit of £33 million arising from a reduction in the liabilities of the Group's pension schemes following the UK government's decision to change the basis of indexation from Retail Price Index (RPI) to Commercial Price Index (CPI) for future statutory increases to pension payments. We reinvested £364 million of the free surplus generated in the period into writing new business (2011: £297 million). This represents a capital reinvestment rate of 26 per cent which is trending back towards the 2010 norms. A favourable business mix, together with other one-off factors, meant that 2011 had a lower reinvestment rate of 21 per cent.

Asia accounted for £162 million of this reinvestment. In the US, new business investment has increased to £180 million from £135 million in the first half of 2011, which primarily reflects the higher level of new business written, changes in business mix, and the impact on regulatory reserving requirements for new business from the low interest rate environment. In the UK, our capital efficient product focus on annuities and with-profits bonds means we invested just £22 million yet generated higher new business profit than last year. The IRRs on this invested capital were more than 20 per cent in Asia, the US, and the UK; with payback periods of four years, two years and three years respectively.

Of the remaining free surplus generated after reinvestment in new business, £726 million was remitted from the business units to Group. This cash was used to meet central costs of £101 million, service net interest payments of £136 million and meet dividend payments of £440 million. The total free surplus balance deployed across our life and asset management operations increased slightly from £3,421 million at the beginning of the period to £3,449 million at the end of the period.

### 'Growth and Cash' financial objectives

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

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

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

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

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

'Despite the challenging investment market conditions, our liquidity capital generation and solvency have continued to show resilience due to our on-going capital discipline, the effectiveness of our hedging activities, our low direct Eurozone exposure, the minimal level of impairments and our comparatively low interest rate sensitivity.'



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

# Chief Financial Officer's overview

'It is testament to the quality of Jackson's post-financial crisis expansion in variable annuities that it has remitted cash of £247 million while continuing to grow the business.'

As mentioned in the Group Chief Executive's report we remain focused on these objectives and are on track to achieve them. Below we set out in more detail our progress towards these objectives based on our results in the first six months of 2012.

## Asia profitability objectives

| | Actual (as originally reported) | | | | | | Objective |
|---|---|---|---|---|---|---|---|
| | 2009 £m | 2010 £m | 2011 £m | Half year 2012 £m | Change (since half year 2011) % | Change (since 2009) % | 2013 £m |
| Value of new business | | | | | | | |
| Full year | 713 | 901 | 1,076 | | | 51 | 1,426 |
| Half year | 277 | 395 | 465 | 547 | 18 | 97 | |
| IFRS operating profit* | | | | | | | |
| Full year | 465 | 604 | 784 | | | 69 | 930 |
| Half year | 228 | 295 | 367 | 440 | 20 | 93 | |

## Business unit net remittance objectives

| | Actual | | | | Objective |
|---|---|---|---|---|---|
| | 2009 £m | 2010 £m | 2011 £m | Half year 2012 £m | 2013 £m |
| Asia† | 40 | 233 | 206 | 126 | 300 |
| Jackson‡ | 39 | 80 | 322 | 247 | 200 |
| UK§ | 434 | 420 | 297 | 230 | 350 |
| M&G¶ | 175 | 202 | 280 | 123 | |
| Full year | 688 | 935 | 1,105 | | |
| Half year | 375 | 460 | 690 | 726 | |

## Objectives for cumulative period 1 January 2010 to 31 December 2013

| | Actual | Objective | Percentage achieved |
|---|---|---|---|
| | 1 Jan 2010 to 30 Jun 2012 £m | 1 Jan 2010 to 31 Dec 2013 £m | At 30 Jun 2012 % |
| Cumulative net cash remittances from 2010 onwards | 2,766 | 3,800 | 73 |
| Cumulative underlying Group free surplus generation (which is net of investment in new business) | 4,736 | 6,500 | 73 |

In the first half of 2012, cash remitted to the Group increased by 5 per cent to £726 million (2011: £690 million), with considerable amounts of cash remitted from all our business operations highlighting the improving balance of contributions from across the Group. Asia's remittances increased 20 per cent to £126 million (2011: £105 million), demonstrating its ongoing transition into a highly cash generative business as a result of significant growth and its focus on health and protection products. It is testament to the quality of Jackson's post-financial crisis expansion in variable annuities that it has remitted cash of £247 million while continuing to grow the business. The REALIC acquisition will be financed by Jackson's internal resources and the positive impact of this financially attractive acquisition will enable Jackson to increase its net remittance objective for Group from £200 million to £260 million in 2013 and beyond. The UK life operations have continued to make sizeable remittances at £230 million (2011: £265 million). M&G (including Prudential Capital) delivered net remittances of £123 million, reflecting their 'capital-lite' business model that facilitates a high dividend payout ratio from earnings.

Against the cumulative 2010 to 2013 net remittance objective of £3.8 billion, by 30 June 2012 over £2.7 billion has been remitted by business operations. We remain confident of achieving this target. Our confidence is underpinned by the strong underlying free surplus generation of our businesses which, by 30 June 2012, had generated a total of £4.7 billion against our 2010 to 2013 cumulative objective of £6.5 billion.

* Total Asia operating profit from long-term business and Eastspring Investments after development costs. The comparatives represent results as reported in the respective periods and excludes adjustment for altered US GAAP requirements for deferred acquisition costs as described in note B to the IFRS financial statements.
† Net remittances from Asia in 2010 included a one-off remittance of £130 million, representing the accumulation of historic distributable reserves.
‡ Net remittances from Jackson in 2011 included releases of excess surplus to Group.
§ In 2009, the net remittances from the UK included the £150 million arising from the proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis. The 2010 net remittances included an amount of £120 million representing the releases of surplus and net financing payments.
¶ Including Prudential Capital.

### Capital position, financing and liquidity

Despite the challenging investment market conditions, our liquidity, capital generation and solvency have continued to show resilience due to our ongoing capital discipline, the effectiveness of our hedging activities, our low direct Eurozone exposure, the minimal level of impairments and our comparatively low interest rate sensitivity.

The Group has maintained a strong capital position. At 30 June 2012, our IGD surplus is estimated at £4.2 billion (31 December 2011: £4.0 billion), generating very strong coverage of 2.7 times the requirement. All of our subsidiaries continue to hold strong capital positions at the local regulatory level. In particular, at 30 June 2012, the value of the estate of our UK with-profit funds is estimated at £6.1 billion (31 December 2011: £6.1 billion).

Furthermore, on a statutory (Pillar 1) basis the total credit default reserve for the UK shareholder annuity funds also contributes to protecting our capital position in excess of the IGD surplus. Notwithstanding the absence of defaults in the period, at 30 June 2012 we have maintained our credit default reserves at £2.1 billion, representing 35 per cent of the portfolio spread over swaps, compared with 33 per cent at 31 December 2011.

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

Our financing and liquidity position remained strong throughout the period. The next call on external financing is in relation to the US$750 million of Perpetual Subordinated Capital Securities, where the option to redeem early is exercisable from December 2014. Our central cash resources amounted to £1.2 billion at 30 June 2012, a strong position.

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

### Shareholders' funds

During the first six months of 2012, investment markets experienced considerable volatility with flat to moderate positive movements in global equity market indices over the period and further falls in long-term interest rates in the US, the UK and a number of Asian countries, most notably Hong Kong. Despite these effects the Group's EEV shareholders' funds increased by 5 per cent during the first half of 2012 to £20.6 billion (31 December 2011: £19.6 billion). On a per share basis EEV at the end of 30 June 2012 stood at 806 pence, up from 771 pence at 31 December 2011. IFRS shareholders' funds were 8 per cent higher at £9.3 billion (31 December 2011: £8.6 billion).

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

**Nic Nicandrou**
Chief Financial Officer

'The Group has maintained a strong capital position. At 30 June 2012, our IGD surplus is estimated at £4.2 billion, generating very strong coverage of 2.7 times the requirement.'

# Accelerating Asia

**Barry Stowe**
Chief Executive
Prudential Corporation Asia

'The growth prospects for Asia's long-term savings and protection markets remain very attractive and Prudential's Asia strategy continues to deliver excellent results across all metrics.'

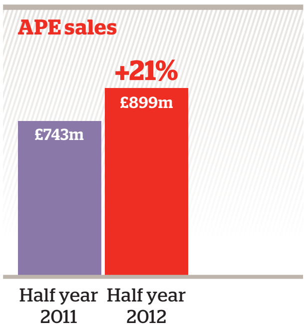
## Market overview

**The macroeconomic outlook for Asia remains positive although the IMF have recently lowered their GDP growth forecasts as the impacts of the debt crisis continue to affect the Asian economies. The Chinese economy is particularly significant in the region and expectations are that policy makers will engineer a soft landing.**

Asia's middle class continues to grow, with predictions that Asia-Pacific, excluding Japan, will have the world's second largest pool of wealth behind North America by 2016[1]. Rising incomes and increasing risk awareness will continue to be positive drivers for Asia's life insurance sector.

Recent regulatory developments that promote higher quality distribution and better service to customers are positive and typically create advantages for international companies that are already used to operating to these standards. The recently announced Financial Advisory Industry Review (FAIR) in Singapore is a good example of regulators reviewing industry practices to ensure that customers are receiving good value.

The competitive environment has remained largely stable over the past six months although there are some major European players looking to make strategic disposals in the region.




## Business performance

Prudential's strategy in Asia remains consistent and is focused on continuing to build quality agency and bank distribution with a product portfolio that emphasises regular premium savings and protection to meet a range of customer needs.

During the first half of 2012, average active agency manpower (excluding India) increased by 12 per cent compared to the same period last year. India's agency force continues to be restructured following the regulatory changes that came into effect on 1 September 2010. Bancassurance also continues to expand as we develop our capabilities in our newer bank markets such as Indonesia and Malaysia and leverage our already strong platforms in markets such as Hong Kong and Singapore. We have an excellent track record of delivering growth from long-established partners such as Standard Chartered Bank (SCB), where APE has grown by 42 per cent over the first half and newer partners such as United Overseas Bank (UOB) where the growth rate was 129 per cent.

Regular premium products generated 93 per cent of first half of 2012 APE compared to 90 per cent for the same period last year. Given the volatile investment environment we are continuing to see a sustained demand for participating products with these generating 35 per cent of total APE, up from 33 per cent for the first half of 2011. Sales of health and protection business continued to grow strongly, increasing by 25 per cent and accounting for 32 per cent of total APE, in line with last year.

Note
1 Source: Boston Consulting Group Global Wealth 2012.

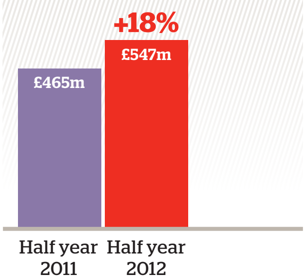


## Financial performance

| | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 899 | 743 | 21 | 743 | 21 |
| NBP | 547 | 465 | 18 | 468 | 17 |
| NBP margin (% APE) | 61% | 63% | | 63% | |
| Total IFRS operating profit[(i)(ii)] | 409 | 324 | 26 | 322 | 27 |
| Total EEV operating profit[(i)] | 872 | 774 | 13 | 778 | 12 |

Notes
(i) Operating profit from long-term operations excluding Eastspring Investments, development costs and Asia regional head office costs.
(ii) The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

**New business profit**




On 2 July, we announced that Prudential has received in-principle approval from Cambodia's Ministry of Economy and Finance to establish a wholly foreign-owned life insurance operation in the country. Although the Cambodian economy is relatively small at present, it has delivered strong GDP growth at a CAGR of 11 per cent over the past 10 years and we see that there are excellent opportunities to develop the life insurance industry.

Prudential continues to support a number of CSR activities in Asia, around the core themes of disaster relief, financial literacy and children. For example, during June, 65 Prudential volunteers from operations around the region spent a few days in Thailand's Fang district where they helped build and renovate homes for old people and a school, built a dam to protect the village from future floods, participated in an evacuation simulation exercise and spent valuable time with villagers and children.

## Financial performance

Prudential Asia remains on track to deliver its 2013 new business profit, IFRS operating profit and cash remittance targets despite the more challenging external market conditions seen during the first half of 2012 where, for example, the MSCI Asia Pacific Excluding Japan Index is volatile with most of the gains seen in the first quarter having been reversed in the second and interest rates remaining very low.

New business sales APE of £899 million for the first half of 2012 represent 21 per cent growth over first half 2011. Our continued momentum is demonstrated by the fact that the second quarter of 2012 APE growth was also 21 per cent higher than the same quarter last year. Prudential Asia has now delivered 12 consecutive quarters where the APE is higher than the equivalent quarter in the prior year and the average growth rate over this period has been 20 per cent.

# Accelerating Asia

**2013 financial objectives**

- Double 2009 value of IFRS life and asset management pre-tax operating profit
- Double 2009 value of new business profits
- Deliver £300 million of net cash remittance to the Group

New business profit of £547 million is 18 per cent higher than last year and the average new business profit margin was 61 per cent (2011: 63 per cent). The impacts of lower interest rates across the region accounted for a 2 point reduction in the overall margin as we use active economic assumptions. This was particularly evident in Hong Kong where the 150 basis points decline in long-term US$ yields since June last year has resulted in a 22 percentage point reduction in new business margin.

EEV operating profit from our in-force business of £325 million was up 5 per cent on prior period with the increase in the unwind that comes from a larger in-force book, being muted by lower interest rates. Experience variances were positive £12 million compared to negative £6 million last year with the improvement including a reduction in expense variances as most countries are reporting improvements in key expense ratios. Experience variances remain very small in the context of the total embedded value of our Asia life businesses.

Operating profit on an IFRS basis continues to grow strongly to £409 million, 26 per cent higher than last year and continues to be driven by the increasing scale of the in-force book, particularly the high proportion of health and protection business.

During the first half of 2012, shareholder-backed business policyholder liabilities have increased to £19.4 billion (31 December 2011: £18.3 billion). Our strong business momentum saw net insurance inflows of £0.9 billion (up 12 per cent on last year's equivalent amount of £0.8 billion).

Underlying free surplus generated by the in-force life business was 9 per cent higher at £345 million (2011: £316 million), reflecting the increasing scale of the business. Of this total, £162 million (2011: £129 million) was reinvested in new business at IRRs of over 20 per cent and payback of an average four years. The increase in the new business capital invested mainly reflects sales volume growth and higher reserving requirements associated with lower interest rates, particularly in Hong Kong. The overall cash generating capacity of the life business is clearly demonstrated by net remittances of £170 million to the Group during first half 2012.

Looking at individual countries:

| China | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales (Prudential's 50 per cent share) | 33 | 35 | (6) | 37 | (11) |

Market conditions in China during the first half of 2012 have been challenging as the economy continues to slow down and adjust to the global economic crisis.

CITIC-Prudential remains one of the leading foreign joint ventures in a market that remains dominated by domestic players. We have true multi-channel distribution with a high-quality agency force and a diverse range of national, regional and foreign bank partners covering many of the major cities and provinces in China's more developed eastern regions.

Prudential's 50 per cent share of sales for first half of 2012 were £33 million, 6 per cent lower than the prior period. During this period we focused our efforts on agent recruitment and on promoting regular premium business. Agency numbers have increased compared to the first half of last year, but productivity was lower principally due to lower case size. Bancassurance, which accounts for nearly half of the total sales, has also seen lower productivity from bank branches following the tightening of regulations that came into effect last year.

## Hong Kong

| | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 177 | 151 | 17 | 155 | 14 |

Prudential Hong Kong continues to deliver strong new business APE growth with an increase of 17 per cent over the prior period to £177 million. Prudential remains the only leading player in Hong Kong to have material agency and bank distribution.

During the first half of 2012, bank sales through SCB grew at a faster rate than agency and accounted for 49 per cent of total APE (2011: 43 per cent). This demonstrates the ongoing strengths of our bancassurance model, particularly the in-branch Financial Services Consultants whose APE growth was 34 per cent. We are continuing to increase the size of the agency and the number of new recruits was 25 per cent higher than the same period last year.

## India

| | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales (Prudential's 26 per cent share) | 53 | 47 | 13 | 42 | 26 |

The Indian life insurance market has been going through a significant period of change, particularly following the regulatory driven refocus on savings and protection products, which came into effect on 1 September 2010.

Although new business volumes remain lower than those before the regulatory change, it is encouraging to see new business volumes picking up. This is being driven principally by the bank channel where the proportion of new business during the first half of 2012 increased to 38 per cent from 17 per cent in the same period last year. Our joint venture with ICICI continues to be a leader in the private sector.

## Indonesia

| | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 206 | 158 | 30 | 154 | 34 |

The recent Nielsen Global Consumer Confidence Index reported Indonesia as the highest ranking country and this is a sign that the country's large domestic economy and expanding middle class is bolstering consumer optimism.

Prudential's strong new business APE growth of 30 per cent to £206 million has been primarily driven by the continued expansion of the agency force (now over 180,000) and improvements in productivity. Growth in the agency force is now being supplemented by the smaller but fast growing bancassurance channel where APE for the first half grew by 162 per cent over prior period with strong contributions from UOB, BII, Citibank and Permata.

# Accelerating Asia

| Korea | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 45 | 55 | (18) | 55 | (18) |

In Korea, we continue to balance growth and profitability and do not compete in the low margin, capital-intensive guaranteed return segment of the market. Work undertaken over the past 24 months to refocus the business is now showing good results and new business from our agency force grew 6 per cent over prior period. Sales via banks and brokers declined as consumers continue to focus on interest rate sensitive products, which we do not offer as the economics of these products are unattractive.

| Malaysia | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 98 | 91 | 8 | 92 | 7 |

Prudential remains a market leader in Malaysia with a highly productive agency force and growing bank distribution.

New business growth in Malaysia of 8 per cent to £98 million reflects the continued success of our agency channel with increases in headcount and activity rates. Our focus in the first half of 2012 on health and protection has driven a 28 per cent increase in APE for this product line and increased average new business profit margins significantly. We have continued to expand in the Takaful sector where we remain market leaders. New business sales from our bank partners UOB and SCB were up 75 per cent.

| Singapore | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 141 | 103 | 37 | 106 | 33 |

Singapore recorded an excellent first half with APE of £141 million up 37 per cent on prior period. The principal driver of growth was the bancassurance channel where we have a cross section of partners including UOB, SCB, Maybank and Singpost, enabling us to access a broad range of customers. Our agency channel continues to be one of Singapore's most productive and according to the latest available market statistics, we lead in terms of regular premium new business generated per agent[1].

Note
1 Source: Life Insurance Association of Singapore.

| Taiwan | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 88 | 59 | 49 | 58 | 52 |

Taiwan is mainly focused on bank distribution through our partnership with E.Sun and SCB, supplemented by direct marketing and worksite marketing activities which are growing fast. New business APE was up 49 per cent to £88 million with particularly strong results from SCB driven by new product launches.

| Others - Philippines, Thailand and Vietnam | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 58 | 44 | 32 | 44 | 32 |

In Vietnam, challenging economic conditions are reflected in lower agency activity rates. In Thailand, where we are a relatively small player with market share of 2 per cent, new business APE was 73 per cent higher than last year and we are encouraged by the prospects of our developing distribution capabilities. The Philippines delivered excellent growth of 50 per cent driven by successes with partnership distribution and increased agency activity and productivity.

**Barry Stowe**
Chief Executive
Prudential Corporation Asia

# Strengthening
# United States

**Mike Wells**
**President and Chief Executive Officer Jackson National Life Insurance Company**

'Jackson's strategy is focused on balancing value, sales, capital efficiency, balance sheet strength and strict pricing discipline for both variable and fixed annuities.'

## Market overview

**The United States is the world's largest retirement savings market. Each year, more of the 78 million baby boomers[1] reach retirement age, which is triggering a shift from savings accumulation to retirement income generation for more than US$10 trillion of accumulated wealth over the next decade[2].**

The US equity markets ended the first half of 2012 with strong gains despite a pullback from even higher levels earlier in the year. At 30 June 2012, the S&P 500 index was up 8.3 per cent since 31 December 2011. Market volatility has decreased slightly from 2011 year end levels. Rates on 10-year treasuries fell to historic lows, ending below 170 basis points at half year, while AA corporate spreads narrowed from 2011 year end levels.

Jackson's asset and liability management incorporates both equity and interest rate exposure on an aggregate basis in order to ensure that economic risk is hedged effectively within our established policy limits. Jackson continually adapts its hedging programme to current market conditions in order to ensure effective risk management. Jackson's hedging programme has performed well during the period, mitigating the impact of significant macroeconomic challenges and supporting our capital position on both economic and regulatory bases. Our approach to pricing and hedging is to adopt a conservative stance, which positions us well during periods of market dislocation. Policyholder behaviour in the first half of 2012 continued to trend in line with our pricing and reserving assumptions.

The uncertain environment continues to provide an advantage to companies with good financial strength ratings and a track record of financial discipline. Companies that were hardest hit by the market disruptions over the last few years still have to work to regain market share as customers and distributors seek product providers that offer consistency, stability and financial strength. Jackson has benefited from this flight to quality and heightened risk aversion.

Jackson's strategy is focused on balancing value, sales, capital efficiency, balance sheet strength and strict pricing discipline for both variable and fixed annuities. Thanks to our financial stability and innovative products, we continue to enhance our reputation as a high-quality and reliable business partner, with more advisers recognising the benefits of working with Jackson. A significant part of Jackson's sales comes through distributors who either did not previously sell Jackson's products or simply did not sell variable annuities (VA).

## Business performance

In March 2012, Jackson introduced its new variable annuity product, Elite Access, which has no guaranteed benefits and provides tax efficient access to alternative investments. The roll-out of this new product has benefited VA sales and has received a positive reaction from distributors, with over 90 per cent signing up to distribute this product. Single premium sales in the period since launch in March 2012 were £138 million. We look forward to continuing to roll it out across the business over the remainder of the year.

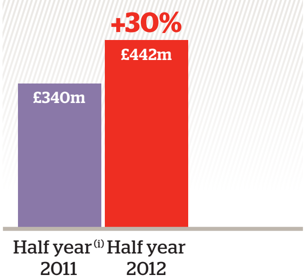
Notes
1 Source: US Census Bureau.
2 Source: McKinsey.

## Financial performance

| | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 719 | 672 | 7 | 688 | 5 |
| NBP | 442 | 458 | (3) | 470 | (6) |
| NBP margin (% APE) | 61% | 68% | | 68% | |
| Total IFRS operating profit[(i)] | 442 | 340 | 30 | 349 | 27 |
| Total EEV operating profit | 805 | 831 | (3) | 852 | (6) |

Note
(i) The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

**Total IFRS operating profit**




Although we do not target volume or market share, market conditions allowed Jackson's ranking to remain at third in variable annuity sales in the US through the first quarter of 2012 (latest information available), while increasing its market share to 12.3 per cent from 11.4 per cent for the full year 2011[1].

Total annuity net inflows of £4.3 billion during the first half of 2012 increased 7 per cent over the same period in 2011, benefiting from the launch of the Elite Access product. Jackson continues to adjust product pricing to respond to both market conditions and the competitive environment. These actions are taken in order to optimise the balance between growth, capital and profitability. Jackson was the second largest seller of individual annuities through the first quarter of 2012, with a market share of 9.2 per cent, up from third and a market share of 8.2 per cent for the full year 2011[2].

## Financial performance

IFRS pre-tax operating profit was £442 million during the first half of 2012, up 30 per cent from £340 million during the same period in 2011. This increase was primarily driven by higher fee income and lower deferred acquisition cost (DAC) amortisation as 2011 included £66 million of additional amortisation, representing the reversal of the benefit received in 2008 from the mean reversion formula. These increases were partially offset by lower spread income and higher expenses, net of deferrals.

At 30 June 2012, Jackson had £44 billion in separate account assets, averaging £8 billion higher than during the same period of 2011. The increase in separate account assets primarily reflects the impact of net inflows. This generated variable annuity separate account fee income of £408 million during the first half of 2012, up 25 per cent over the £327 million achieved during the first half of 2011.

Total spread income, including the expected return on shareholders' assets, was £384 million during the first half of 2012, compared to £416 million during the same period in 2011. This decrease was primarily due to declining interest rates and lower achieved spreads.

Notes
1 Sources: Morningstar Annuity Research Center (MARC) First Quarter 2012 Sales Report® and Fourth Quarter 2011 Sales Report®. © Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.
2 Sources: LIMRA U.S. Individual Annuities Sales Survey, First Quarter 2012 and Fourth Quarter 2011.

# Strengthening United States

**2013 financial objective**

- Deliver £200 million of net cash remittance to the Group

Acquisition costs during the first half of 2012 remained flat compared to the first half of 2011 despite the growth in sales, as a greater proportion of distributors are opting for asset-based commission. Following the introduction of new accounting guidance in 2012, which was applied retrospectively, acquisition costs are no longer fully deferrable, resulting in IFRS new business strain of £82 million in the first half of 2012, compared to £80 million in the amended first half of 2011.

DAC amortisation of £179 million decreased during the first half of 2012, compared to £241 million in the same period of 2011. This decrease is primarily a result of the negative prior year impact of the reversal of the benefit received in 2008 from the mean reversion formula. Partially offsetting this decrease was higher amortisation due to the higher earnings base in the first half of 2012.

Administration expenses increased by 24 per cent to £242 million during the first half of 2012 compared to £195 million in the same period of 2011, with the increase due primarily to higher asset-based commissions paid on the larger 2012 separate account balance. These asset-based commissions are classified as an administration expense.

Jackson continues to actively manage its investment portfolio to mitigate investment risk. Jackson did not have any defaults in the first half of 2012 or 2011. Net realised losses on debt securities amounted to £4 million in the first half of 2012 compared to gains of £79 million in the first half of 2011. In addition, we realised a loss net of recoveries of £8 million (2011: gains of £1 million) on credit-related sales of impaired bonds. Write-downs on debt securities were £25 million (2011: £14 million). Interest related gains during the period totalled £29 million (2011: £92 million), primarily due to sales of corporate debt.

The net unrealised gain position has improved to £2,522 million at 30 June 2012 from £2,057 million at 31 December 2011, due primarily to the continued decline in the US Treasury rates and tighter spreads. Gross unrealised losses improved to £157 million at 30 June 2012 from £246 million at 31 December 2011.

Jackson delivered APE retail sales of £700 million in the first half of 2012, representing a 5 per cent increase over the same period of 2011. In addition, with the modest institutional sales in the first half of 2012, total APE sales were £719 million, a 7 per cent increase over the same period in 2011. Jackson has achieved these sales levels while maintaining its pricing discipline, as it continued to write new business at aggregate internal rates of return (IRR) in excess of 20 per cent.

Variable annuity APE sales of £611 million through 30 June 2012 were only slightly higher than the same period in 2011. Excluding currency translation effects, the entire increase in sales was accounted for by sales of Elite Access, which totalled US$22 million out of total variable annuity APE sales of US$964 million (2011: US$953 million). In the second half of 2011 and the first half of 2012, Jackson implemented various product initiatives to optimise the balance between growth, capital and profitability. In line with this philosophy further initiatives will be undertaken as necessary to further optimise this balance.

Fixed annuity (FA) APE sales of £31 million were 35 per cent higher than the level of sales in the same period in 2011. Jackson ranked eighth in sales of traditional deferred fixed annuities through the first quarter of 2012, with a market share of 3.7 per cent, compared to thirteenth with a 2.1 per cent market share for the full year 2011[1].

Fixed index annuity (FIA) APE sales of £50 million in the first half of 2012 increased 19 per cent from the same period of 2011. Jackson ranked seventh in sales of fixed index annuities through the first quarter of 2012, with a market share of 4.9 per cent, up from eighth and a market share of 4.6 per cent in the full year 2011[2].

EEV basis new business profit of £442 million, was down 3 per cent on 2011 despite higher sales volumes. Total new business margin was 61 per cent, compared to 68 per cent achieved in 2011. The combination of a 150 basis point reduction in 10-year treasury yields and spread compression has caused an 11 point drag on the margin relative to the first half of 2011. Pricing actions and business mix have somewhat mitigated this reduction. Notwithstanding these effects, the overall profitability remains robust.

Notes
1 Sources: LIMRA U.S. Individual Annuities Sales Survey, First Quarter 2012 and Fourth Quarter 2011.
2 Sources: AnnuitySpecs.com's Indexed Sales & Market Report, 1Q2012 and 4Q2011; Copyright © 2012, AnnuitySpecs.com. All rights reserved.

The variable annuity new business margin of 66 per cent in 2012 decreased from 73 per cent in the equivalent period of 2011, primarily as a result of a lower assumed fund earned rate driven by the reduction in interest rates. Partially offsetting this was an increase in margin due to pricing actions taken over the past 15 months. The fixed indexed annuity new business margin decreased from 37 per cent in 2011 to 34 per cent in 2012, primarily driven by a reduction in the achieved spreads. The fixed annuity margin was similarly affected by spread compression, for a net decrease in the margin from 25 per cent in 2011 to 20 per cent in 2012.

Total EEV basis operating profit for the long-term business in 2012 was £805 million, compared to £831 million in 2011, reflecting small declines in both new and in-force business profits. Lower in-force profit was driven largely by lower unwind of discount, due to lower interest rates partially offset by the growth in the underlying book and a reduced positive net contribution from operating experience variances and assumption changes.

In the first half of 2012, Jackson's life in-force book generated £589 million of underlying free surplus (2011: £514 million) in line with the recent growth in the business. Some £180 million of which was reinvested to write £719 million of new business APE (2011: £135 million and £672 million, respectively). The increase in capital consumption year-on-year was caused predominantly by the differing business mix in 2012. Jackson wrote a higher proportion of general account business, which consumes greater levels of initial capital. In addition, the significant decrease in interest rates caused a large drop in the valuation interest rate used to set reserves, resulting in additional capital consumption compared to 2011.

Jackson's RBC level at the end of 2011 was 429 per cent. In the first half of 2012, capital generation has been positive, reflecting the strong operating performance, the modest level of impairments and other market value net related gains. With its strong capital formation, Jackson was able to remit £247 million to Group while supporting its balance sheet growth and growing total adjusted capital from year end 2011 levels.

## Acquisition of Reassure America Life Insurance Company (REALIC)

On 30 May 2012, Jackson National Life Insurance Company (JNLI), an indirect wholly-owned subsidiary of Prudential plc, entered into an agreement to buy SRLC America Holding Corp. (SRLC), a life insurance business, from Swiss Re. The primary operating subsidiary of SRLC is REALIC. Swiss Re will retain a portion of the SRLC business through reinsurance arrangements to be undertaken prior to closing. JNLI will pay US$621 million (£398 million) in cash for the business financed from its own resources. The price is subject to adjustment to reflect the actual value of SRLC according to its balance sheet at closing. This adjustment is not expected to exceed £60 million. The transaction is subject to regulatory approval and is expected to close in the third quarter of 2012. Jackson expects the transaction to be immediately accretive to its pre-tax earnings, while having a modest impact on its statutory capital position. The acquisition will diversify Jackson's earnings base by increasing the percentage of income derived from underwriting activities relative to Jackson's current spread and fee-based businesses. This bolt-on acquisition is in line with the Group's strategy and provides an opportunity to increase the scale of Jackson's life business.

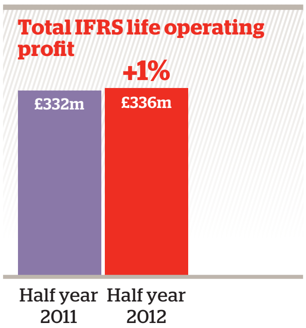
**Mike Wells**
President and Chief Executive Officer
Jackson National Life Insurance Company

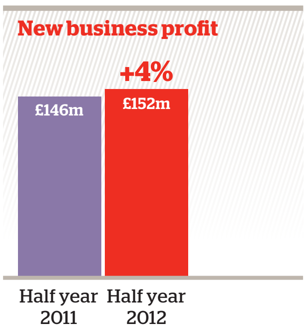
'In the second half of 2011 and the first half of 2012, Jackson implemented various product initiatives to optimise the balance between growth, capital and profitability.'

# Focusing
# United Kingdom

**Rob Devey**
Chief Executive
Prudential UK and Europe

‘Prudential competes selectively in the UK’s retirement savings and income market, with a focus on writing profitable new business combined with sustainable cash generation and capital preservation.’




## Market overview

**The UK is a mature life and pensions market, characterised by an ageing population and a concentration of wealth in the 45 to 74-year-old age group.**

Prudential UK's longevity experience, multi-asset investment capabilities, strong brand and financial strength mean that we are strongly positioned to help consumers translate their accumulated wealth into the provision of dependable retirement income through our range of market leading with-profits and annuity products.

Prudential competes selectively in the UK's retirement savings and income market, with a focus on writing profitable new business combined with sustainable cash generation and capital preservation, rather than pursuing top-line sales growth. We have improved our new business profitability in the first half of 2012, despite the challenging economic environment and competitive conditions that prevail in the UK marketplace.

## Business performance

Prudential UK has a strong individual annuity business, built on a robust pipeline of internal vestings from maturing individual and corporate pension policies. The internal vestings pipeline is supplemented by sales through intermediaries and strategic partnerships with third parties where Prudential is the recommended annuity provider for customers vesting their pensions at retirement.

Total APE sales for the first half of 2012 were £412 million (2011: £409 million), of which sales of individual annuities of APE £105 million were 22 per cent higher than for the first half of 2011.

Sales from internal vestings of £66 million, were 18 per cent higher than for the first half of 2011, due to a combination of an increase in the number of customers retiring and higher average fund values. Sales of external annuities of APE £39 million were 30 per cent higher compared to the same period last year, mainly due to an increase in with-profits annuity sales through intermediaries.

Onshore bonds sales of APE £106 million were up 26 per cent on the first half of 2011, including with-profits bond sales of APE £99 million, which increased by 36 per cent. Our PruFund range made up 77 per cent of with-profits bond sales. Against the first half of 2011, PruFund sales were 45 per cent higher, reflecting continued customer demand for products offering smoothed investment returns and the popularity of the reintroduced PruFund Protected Growth Fund. Although the demand for guarantees remains high, the growth in PruFund sales has been mainly in the form of non-guaranteed business.




| Financial performance | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| APE sales | 412 | 409 | 1 | 409 | 1 |
| NBP | 152 | 146 | 4 | 146 | 4 |
| NBP margin (% APE) | 37% | 36% | | 36% | |
| Total IFRS operating profit | 353 | 353 | – | 353 | – |
| Total EEV operating profit | 507 | 558 | (9) | 558 | (9) |

**37%**
New business margin (% APE)

Corporate pensions sales of APE £104 million were 29 per cent lower than the same period last year. Sales in the first half of 2011 were particularly high due to new defined contribution members joining our schemes following closure of a number of defined benefit schemes operated by existing clients. We continue to focus on securing new members and incremental business rather than new Corporate Pensions schemes. Prudential UK remains the largest provider of Additional Voluntary Contribution plans within the public sector where we now provide schemes for 68 of the 99 public sector authorities in the UK.

Sales of other products, principally individual pensions, PruProtect, PruHealth and offshore bonds of £70 million were 9 per cent higher than the first half of 2011. Individual pensions sales (including income drawdown) of APE £44 million were 10 per cent higher, reflecting the popularity of the reintroduced PruFund Growth Fund which has a range of optional capital guarantees offering a degree of security against potential market falls.

In the Wholesale market, Prudential UK's aim is to continue to participate selectively in bulk and back-book buyouts using our financial strength, superior investment track record, annuitant mortality risk assessment and servicing capabilities. In line with this opportunistic approach, we signed a single bulk annuity buy-in insurance agreement in the first half of 2012 of APE £27 million (2011: single deal APE £28 million). We will continue to maintain our focus on value and only participate in capital-efficient transactions that meet our return on capital and payback requirements.

## Financial performance

Total APE sales of £412 million were 1 per cent higher than the first half of 2011, principally due to higher sales of individual annuities and with-profits bonds which were partly offset by lower sales of corporate pensions. The new business margin including bulk annuities of 37 per cent in the first half of 2012 was up 1 per cent on the same period last year. The retail new business margin of 34 per cent was up 2 per cent compared to 2011. The negative impact on product margins of the lower economic assumptions driven by the lower interest rates was more than offset by a favourable business mix, with lower sales of corporate pensions and higher sales of individual annuities and with-profits bonds (which have a higher margin).

# Focusing
# United Kingdom

**2013 financial objective**

- Deliver £350 million of net cash remittance to the Group

New business profit increased by 4 per cent to £152 million (2011: £146 million), including the bulk annuity transaction. Retail new business profit at £130 million was 6 per cent above 2011 (£123 million), primarily driven by a changing business mix.

IFRS life operating profit is higher than the first half of 2011 at £336 million (2011: £332 million), with £146 million (2011: £154 million) from with-profits and the balance from shareholder-backed business. Commission received on Prudential-branded General Insurance products contributed £17 million to IFRS operating profits in 2012, £4 million lower than in the first half of 2011, as the book of business originally transferred to Churchill in 2002 is decreasing.

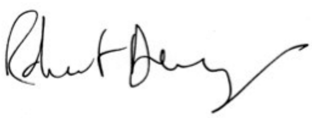
At half year 2010, we announced that the business had achieved its cost savings target of £195 million per annum. At the end of 2010, the business announced a number of cost-saving initiatives to reduce costs by a further £75 million per annum by the end of 2013. The business has made good progress towards this objective and remains on track to deliver these savings by the end of 2013.

EEV total operating profit of £507 million was 9 per cent lower than the first half of 2011, reflecting lower in-force profits, mainly due to the impact of lower interest rates on the unwind of the discount rate. EEV profit included £43 million from the change in the long-term tax rate assumption from 25 per cent to 24 per cent, compared with £46 million from the 1 per cent tax reduction in the first half of 2011.

Prudential UK writes with-profits annuity, with-profits bond and with-profits corporate and individual pensions business in its Life Fund, with other products backed by shareholder capital. The weighted average post-tax IRR on the shareholder capital allocated to new business in the UK was in excess of 20 per cent and the undiscounted payback period on that new business was three years.

Operating free surplus generated from the long-term in-force business in the UK amounted to £278 million (2011: £339 million). Of this total, £22 million (2011: £33 million) was reinvested in writing shareholder-backed business at attractive average IRRs. In the first half of 2011, operating free surplus benefited from a number of one-off items, including the change from the RPI to CPI inflation assumption in the valuation of pension scheme liabilities.

During the first half of 2012, Prudential UK remitted cash of £230 million to the Group, comprising £216 million from the annual with-profits transfer to shareholders which occurs in the second quarter each year, and £14 million from the shareholder-backed business. The business expects to generate £350 million per annum of sustainable cash remittances by 2013, supported by the strength of the with-profits business and surpluses arising from the large book of shareholder-backed annuities, maintained into the future by the pipeline of maturing individual and corporate pensions.



**Rob Devey**
Chief Executive
Prudential UK and Europe

# Optimising
# Asset management
# M&G

'M&G's continuing focus on investment performance, combined with its established distribution capabilities, has ensured that the business continued to attract new assets in a period of persistent volatility in world markets.'

Michael McLintock
Chief Executive
M&G



## Market overview

**M&G is the UK and European fund manager of the Prudential Group with responsibility for investments on behalf of both internal and external clients. M&G is an investment-led business whose aim is to generate superior long-term returns for its third-party investors and the internal funds of the Prudential Group.**

This is achieved by creating an environment that is attractive to talented investment professionals. Our investment performance has been strong in the face of continued macroeconomic instability. Over the three years to 30 June 2012, 27 retail funds representing approximately 84 per cent of retail funds under management (FUM), delivered first or second quartile investment performance. The performance of our actively managed external institutional fixed income mandates also remains very strong with all of the mandates meeting or outperforming their benchmarks over the three years to 30 June 2012.

In the retail market, M&G's aim is to operate a single fund range and to diversify the distribution base through a wide variety of channels and geographies. In recent years, this has resulted in significantly increased sales of UK-based funds in European and other international markets.

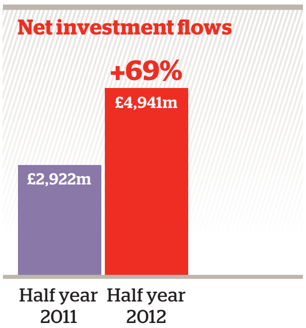
In the institutional marketplace, M&G's approach is to leverage capabilities developed primarily for Prudential's internal funds to create higher margin external business opportunities. This has allowed M&G to offer third-party clients, such as pension funds, an innovative range of specialist fixed income and real estate strategies, including private debt opportunities in leveraged finance and infrastructure investment.

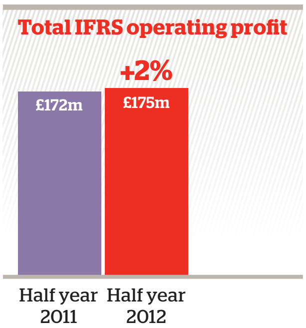
## Business performance

M&G's continuing focus on investment performance, combined with its established distribution capabilities, has ensured that the business continued to attract new assets in a period of persistent volatility in world markets. Net fund inflows during the first half of 2012 were over £4.9 billion, 69 per cent more than the £2.9 billion taken during the same period last year.

M&G's total FUM stands at £203.7 billion at the end of the first half of 2012 compared with £202.8 billion at the same point in 2011. Following the reduction in M&G's stake in its South African subsidiary, on a like-for-like basis, FUM have increased by 2 per cent since the end of June 2011. This reflects strong net sales rather than market movements; the FTSE All Share Index has, on average, been 4 per cent lower over the period. External FUM is up 1 per cent to £94.6 billion and now accounts for over 46 per cent of the total.

Even though demand across the industry for investment funds is subdued and volatility in capital markets remains high, M&G's strength in depth across all major asset classes has enabled it to continue to attract significant new funds and to increase market share.



# Optimising Asset management M&G

'M&G continues to provide capital-efficient profits and cash generation for the Prudential Group.'

| M&G | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| Gross investment inflows | 14,701 | 13,390 | 10 | 13,390 | 10 |
| Net investment inflows: | | | | | |
| Retail business | 4,274 | 2,796 | 53 | 2,796 | 53 |
| Institutional business | 667 | 126 | 429 | 126 | 429 |
| Total | 4,941 | 2,922 | 69 | 2,922 | 69 |
| Revenue | 351 | 329 | 7 | 329 | 7 |
| Other income | 3 | 1 | 200 | 1 | 200 |
| Staff costs | (120) | (125) | 4 | (125) | 4 |
| Other costs | (66) | (58) | (14) | (58) | (14) |
| Underlying profit before performance-related fees | 168 | 147 | 14 | 147 | 14 |
| Share of associate's results[(i)] | 6 | 13 | (54) | 13 | (54) |
| Performance-related fees | 1 | 12 | (92) | 12 | (92) |
| Operating profit from asset management operations | 175 | 172 | 2 | 172 | 2 |
| Operating profit from Prudential Capital | 24 | 27 | (11) | 27 | (11) |
| Total IFRS operating profit | 199 | 199 | – | 199 | – |
| Funds under management[(ii)] | 204bn | 203bn | – | 203bn | – |

Notes
(i) The 2012 figure represents M&G's 47 per cent proportionate share in the operating profit (including performance-related fees) of PPM South Africa following the divestment transaction in 2012. 100 per cent of operating profits were included in 2011.
(ii) Funds under management includes M&G's share of the assets managed by PPM South Africa at 47 per cent and 100 per cent for half year 2012 and half year 2011 respectively.

## Retail

Despite weak investor appetite for risk products, M&G's Retail business drew £4.3 billion of net inflows, a 53 per cent increase and a figure that exceeds the total annual net sales achieved in 2011. A relative slowdown in retail flows is, however, becoming evident: the second quarter's £1.9 billion of net new funds contrasted with £2.4 billion in the first three months of 2012.

In our core UK market, retail gross inflows were £6.4 billion over the first half and net inflows were £2.8 billion, representing an increase of 28 per cent on 2011 levels. M&G has been number 1 for gross and net retail sales in the UK over 14 consecutive quarters based on data to 31 March 2012[1]. The business has experienced strong flows in Europe with net sales of almost £2.2 billion, up 142 per cent on 2011 levels. M&G has been the top net selling cross-border group in Europe over the year to end-May 2012[2]. M&G-managed retail FUM sourced outside of the UK exceed £10.5 billion, an increase of 28 per cent on the end-2011 position.

It is a core pillar of M&G's business that it is able to benefit from changing investor preferences as a result of its diversified product offering. While the appetite for risk products is subdued, demand for M&G's retail fixed income fund range remains strong. The M&G Optimal Income Fund has been the sixth best cross-border fund for net sales across Europe over the 12 months to end-May 2012[3].

Some of M&G's equity funds have bucked the market trend, attracting healthy levels of net sales over the first half of the year. The M&G Global Dividend Fund in particular has been extremely popular with investors in both the UK and in continental Europe and is the tenth best cross-border fund for net sales across Europe over the 12 months to end-May 2012[3].

Notes
1 Source: Fundscape. (Q1 issue, May 2012). The Pridham Report. Fundscape LLP.
2 Source: Lipper FMI. (July 2012, data as at May 2012). SalesWatch. Thomson Reuters.
3 Source: Lipper FMI. (June 2012, data as at April 2012). SalesWatch. Thomson Reuters.

No fewer than 13 of M&G's retail funds, representing all of the main asset classes, each achieved net sales in excess of £20 million in the first half of 2012.

The £5.0 billion of net retail inflows in the UK and in mainland Europe were partially offset by a £0.7 billion net outflow from funds managed by M&G's associate entity in South Africa. These redemptions were entirely from the PPM South Africa Dividend Income Fund which was closed on 31 March 2012 ahead of the implementation of new tax legislation on 1 April 2012 which would have had a materially adverse impact on the treatment of the distributions made by the Fund to the Fund's investors. Fund flows into other retail funds of the South African business have been positive.

### Institutional

The Institutional business recorded net inflows over the first half of 2012 of £667 million. Investment performance by the business remains strong. Indeed, M&G's flagship institutional UK corporate bond fund, with over £4.1 billion of FUM as at 30 June 2012, has outperformed its benchmark[1] by 1.5 per cent a year over the five years to end-June 2012, a period which includes the onset of the credit crisis.

The quality of investment performance, coupled with an established reputation for innovation, has led to a strong pipeline of new business for the Institutional team.

M&G has accelerated its lending activities since the onset of the credit crisis to support organisations starved of traditional bank loans. The M&G UK Companies Financing Fund, M&G's loan facility for UK quoted companies, has now made total commitments of £835 million across 10 loans, two of which have been extended during 2012.

M&G's infrastructure equity investment unit, Infracapital, invested in a consortium (comprising Infracapital and other parties independent of Prudential) that in June signed an agreement to acquire a 90 per cent interest in Veolia Environnement S.A.'s UK regulated water business Veolia Water RegCo, which is the second largest regulated water-only company in the UK. The acquisition represents the first investment for Infracapital Fund II. The Fund recently completed its first close with £305 million of commitments from investors.

## Financial performance

The first half has seen further growth in profits and improvement in our operating margins. Total revenues for the first half of 2012 were £354 million (2011: £330 million). This represents an increase of 7 per cent. M&G also remains focused on cost control with a cost/income ratio[2] of 53 per cent over the half year, an improvement on the 2011 result of 55 per cent. The increased scale of the business following the growth in FUM over recent periods has generated operational efficiencies. Underlying profits at the half year rose to £168 million. This is an increase of 14 per cent compared with the 2011 position of £147 million.

Following the addition of performance-related fees and profit from our associate investment in South Africa, operating profit for the first half of 2012 was £175 million (2011: £172 million). The profit from the South Africa entity represents our proportionate share of its operating profit, which following the divestment transaction in the first quarter of 2012, reduced our ownership from 75 per cent at 2011 year end to 47 per cent. For 2011 and prior periods, the results of the South Africa entity were fully consolidated within our operating profit.

The M&G Group operating margin[2] for the period was 47 per cent, continuing the steady improvement achieved over the last four years and ahead of the 39 per cent for the full year to 31 December 2011.

M&G continues to provide capital-efficient profits and cash generation for the Prudential Group. This is in addition to the strong investment returns generated on the internally managed funds. M&G remits a substantial proportion of its post-tax profits to the Group and in the first half of 2012 paid £98 million to the parent company.

Notes
1 The benchmark for the Fund is the iBoxx Sterling Non Gilts Index.
2 Excluding performance-related fees, carried interest on private equity investment and profit from the PPM South Africa entity.

# Optimising Asset management M&G

## Prudential Capital

Prudential Capital manages the Group's balance sheet for profit by leveraging Prudential's market position. This business has three strategic objectives: to provide professional treasury services to the Prudential Group; to operate a first-class wholesale and capital markets interface; and to realise profitable opportunities within a tightly controlled risk framework. 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.

Markets have remained difficult and volatile in 2012, and as a result the business remains focused on liquidity across the Prudential Group, management of the existing asset portfolio and conservative levels of new investment. Development of new product and infrastructure has continued. This is helping to maintain the dynamism and flexibility necessary to ensure that the treasury and wholesale services remain robust in a period of increased regulatory change, and to identify and realise opportunities for profit within acceptable risk parameters.

Prudential Capital has a diversified earnings base derived from its portfolio of secured loans, debt investments and the provision of wholesale markets services. IFRS operating profit was £24 million in the first half of 2012 (2011: £27 million). In the first half of 2012 a total of £25 million was remitted to the Group.

**Michael McLintock**
Chief Executive
M&G

# Optimising
# Asset management
# Eastspring Investments

| Eastspring Investments | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| Gross investment inflows (excluding MMF) | 3,787 | 4,278 | (11) | 4,240 | (11) |
| Net investment flows (excluding MMF) | 426 | (12) | n/a | (32) | n/a |
| Money Market Funds (MMF) net flows | (103) | 383 | n/a | 278 | n/a |
| Total IFRS operating profit | 34 | 43 | (21) | 44 | (23) |
| Funds under management | 53.8bn | 52.5bn | 2 | 51.3bn | 5 |

**£53.8bn**
Funds under management



## Market overview

**Prudential's asset management business in Asia manages investments for Asia's third-party retail and institutional clients in addition to investments of Prudential's Asia, UK and US life companies.**

Markets remained challenging in the first half of 2012. Equity markets struggled to gain traction driven by poor investor sentiment in the face of weak macroeconomic signals. Fixed income and regular yield products remained in favour during this period.

### Eastspring Investments

In November 2011, Prudential announced that its Asia Fund Management operations would be rebranded Eastspring Investments. The new brand, which was officially launched in February 2012, will enable the business to establish a cohesive regional presence thereby penetrating the offshore segment more effectively. It also supports distribution to new markets beyond Asia and we have recently opened a US distribution office.

Separately, Eastspring Investments augmented its strong market positioning in Asia by expanding its geographic footprint to Indonesia.

## Business performance

Net third-party inflows of £426 million were driven by inflows to new funds in India and Taiwan, as well as higher net inflows in Singapore. Specifically, strong fundraising was seen in India for its fixed maturity plan range, while the Taiwan business saw a successful launch of the Emerging Asian Local Fixed Income Fund. In Singapore, Eastspring Investment's Monthly Income Plan continued to be one of the top three best-selling funds in the local onshore mutual funds market. The positive net flows were partially offset by redemptions from an institutional client in Korea.

Total funds under management of £53.8 billion were 2 per cent higher than a year ago, as net inflows were partially offset by unfavourable market and other movements

## Financial performance

IFRS profits of £34 million were 21 per cent below last year as a result of lower margins, reflecting a change in asset mix towards bonds and a higher proportion of institutional business, as well as increased costs as we continue to invest in the development of the Eastspring Investments platform.

# Optimising
# Asset management
# United States

| PPM America | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| Total IFRS operating profit | 2 | 3 | (33) | 3 | (33) |

## Market overview
PPM America (PPMA) manages assets for Prudential's US, UK and Asia affiliates. PPMA also provides other affiliated and unaffiliated institutional clients with investment services including collateralised debt obligations (CDOs), private equity funds, institutional accounts and mutual funds. PPMA's strategy is focused on managing existing assets effectively, maximising the benefits derived from synergies with our international asset management affiliates and leveraging investment management capabilities across the Prudential Group. PPMA also pursues third-party mandates on an opportunistic basis.

## Financial performance
IFRS operating profit in the first half of 2012 was £2 million, compared to £3 million in the same period in 2011.

At 30 June 2012, funds under management of £57 billion were as follows:

| | AER | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Half year 2012 | | | | Half year 2011 | | | |
| | US £bn | UK £bn | Asia £bn | Total £bn | US £bn | UK £bn | Asia £bn | Total £bn |
| Insurance | 33 | 15 | – | 48 | 31 | 15 | – | 46 |
| Unitised | 2 | 1 | 6 | 9 | 1 | 1 | 5 | 7 |
| Total funds under management | 35 | 16 | 6 | 57 | 32 | 16 | 5 | 53 |

| Curian | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| Gross investment flows | 845 | 863 | (2) | 885 | (5) |
| Revenue | 34 | 26 | 31 | 27 | 26 |
| Costs | (27) | (21) | (29) | (22) | (23) |
| Total IFRS operating profit | 7 | 5 | 40 | 5 | 40 |
| Total funds under management | 5.8bn | 4.3bn | 35 | 4.4bn | 32 |

## Market overview
Curian Capital, Jackson's registered investment adviser, provides innovative fee-based managed accounts and investment products to advisers through a sophisticated technology platform. Curian expands Jackson's access to advisers while also complementing Jackson's core annuity product lines with Curian's retail asset management products.

## Business performance

At 30 June 2012, Curian had total assets under management of £5.8 billion, compared to £4.7 billion at the end of 2011. Curian had gross investment inflows of £845 million in the first six months of 2012, slightly down from the same period in 2011. Curian's asset growth continues to benefit from its prior investment platform expansions and its significant expansion in 2012 of the firm's wholesaling team and new distribution territories.

## Financial performance

Curian reported an IFRS basis operating profit of £7 million during the first half of 2012 compared to £5 million in the same period last year.

## US Broker-dealer

**National Planning Holdings, Inc**

| | AER | | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| Revenue | 261 | 250 | 4 | 257 | 2 |
| Costs | (253) | (241) | (5) | (248) | (2) |
| Total IFRS operating profit | 8 | 9 | (11) | 9 | (11) |

## Market overview

National Planning Holdings, Inc. (NPH) is Jackson's affiliated independent broker-dealer network. The business is comprised of four broker-dealer firms, including INVEST Financial Corporation, Investment Centers of America, National Planning Corporation and SII Investments.

NPH continues to grow the average business and revenue per representative. By utilising high-quality, state-of-the-art technology, Jackson provides NPH's advisers with 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, as well as receiving valuable insights into the needs of financial advisers and their clients.

## Financial performance

NPH generated revenues of £261 million during the first half of the year, up from £250 million in the same period of 2011, on gross product sales of £5.2 billion. The network continues to achieve profitable results, with IFRS operating profit through 30 June 2012 of £8 million, broadly in line with the first half of 2011. At 30 June 2012, the NPH network had 3,651 registered advisers, up from 3,636 at 31 December 2011.

# Results summary

## International Financial Reporting Standards (IFRS) Basis Results*

### Statutory IFRS basis results

| | 2012 | 2011 | |
|---|---|---|---|
| | Half year | Half year† | Full year† |
| Profit after tax attributable to equity holders of the Company | £952m | £829m | £1,415m |
| Basic earnings per share | 37.5p | 32.7p | 55.8p |
| Shareholders' equity, excluding non-controlling interests | £9.3bn | £8.0bn | £8.6bn |

### Supplementary IFRS basis information

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year† | Full year† |
| Operating profit based on longer-term investment returns* | 1,162 | 1,028 | 2,027 |
| Short-term fluctuations in investment returns on shareholder-backed business | (32) | 93 | (220) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 87 | (7) | 21 |
| Gain on dilution of Group holdings | 42 | – | – |
| **Profit before tax attributable to shareholders** | 1,259 | 1,114 | 1,828 |
| Operating earnings per share* (reflecting operating profit based on longer-term investment returns after related tax and non-controlling interests) | 34.5p | 31.4p | 62.8p |

## European Embedded Value (EEV) Basis Results*

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Asia operations | 903 | 815 | 1,839 |
| US operations | 822 | 848 | 1,455 |
| UK operations: | | | |
| UK insurance operations | 507 | 558 | 893 |
| M&G | 199 | 199 | 357 |
| Other income and expenditure | (285) | (281) | (536) |
| RPI to CPI inflation measure change on defined benefit pension schemes | – | 45 | 45 |
| Restructuring and Solvency II implementation costs | (37) | (37) | (75) |
| **Operating profit based on longer-term investment returns*** | 2,109 | 2,147 | 3,978 |
| Short-term fluctuations in investment returns | 225 | (111) | (907) |
| Mark to market value movements on core borrowings | (113) | (74) | (14) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 103 | (8) | 23 |
| Effect of changes in economic assumptions | (371) | (111) | (158) |
| Gain on dilution of Group holdings | 42 | – | – |
| **Profit before tax (including actual investment returns)** | 1,995 | 1,843 | 2,922 |
| Operating earnings per share* (reflecting operating profit based on longer-term investment returns after related tax and non-controlling interests) | 60.7p | 61.5p | 115.7p |
| Shareholders' equity, excluding non-controlling interests | £20.6bn | £19.0bn | £19.6bn |

* See basis of preparation on following page.

†The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

| | 2012 | 2011 | |
|---|---|---|---|
| | Half year | Half year | Full year |
| **Dividends per share declared and paid in reporting period** | 17.24p | 17.24p | 25.19p |
| **Dividends per share relating to reporting period** | 8.4p | 7.95p | 25.19p |
| **Funds under management** | £363bn | £350bn | £351bn |
| **Insurance Groups Directive capital surplus (as adjusted)*** | £4.2bn | £4.1bn | £4.0bn |



*** Basis of preparation**

**Results bases**
The basis of preparation of the statutory IFRS basis results and supplementary IFRS basis information is consistent with that applied for the full year 2011 results and financial statements with the exception that the Group adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which accounted for insurance assets and liabilities under the previous GAAP of the UK Modified Statutory Basis substantially by reference to US GAAP measurement principles. The full impact of this change is described in note B to the IFRS financial statements.

The EEV basis results have been prepared in accordance with the European Embedded Value principles issued by the CFO Forum of European Insurance Companies in May 2004. Life insurance products are, by their nature, long-term and the profit on this business is generated over a significant number of years. Accounting under IFRS alone does not, in Prudential's opinion, fully reflect the value of future profit streams. Prudential considers that embedded value reporting provides investors with a measure of the future profit streams of the Group's in-force long-term businesses and is a valuable supplement to statutory accounts. There has been no change to the basis of presentation of the EEV results from the full year 2011 results and financial statements.

**Exchange translation – Actual Exchange Rate (AER) and Constant Exchange Rate (CER)**
The comparative results have been prepared using previously reported exchange rates (AER basis) except where otherwise stated. In particular, results on a CER basis are shown for the analysis of IFRS and EEV operating profit based on longer-term investment returns.

**Operating profit based on longer-term investment returns**
Consistent with previous reporting practice, the Group provides supplementary analysis of IFRS profit before tax attributable to shareholders and analyses its EEV basis results, so as to distinguish operating profit based on longer-term investment returns from other elements of total profit. On both the IFRS and EEV bases, operating earnings per share are calculated using operating profits based on longer-term investment returns, after related tax and non-controlling interests.

These profits exclude short-term fluctuations in investment returns and the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes. The operating profit based on longer-term investment returns for 2012 half year excludes the gain arising upon the divestment of the Group's holding in Prudential Portfolio Managers South Africa (Pty) Limited. The Group's agreement to acquire REALIC is subject to regulatory approval, accordingly operating profit does not include any impact on earnings from this acquisition.

Under the EEV basis, where additional profit and loss effects arise, operating profit based on longer-term investment returns also excludes the mark to market value movements on core borrowings and the effect of changes in economic assumptions.

After adjusting for related tax and non-controlling interests, the amounts excluded from operating profit based on longer-term investment returns are included in the calculation of basic earnings per share based on total profit attributable to the company's equity holders.

**Insurance Groups Directive capital surplus (as adjusted)**
The estimated surpluses shown for half year 2012 and half year 2011 are before allowing for the interim dividends for 2012 and 2011 respectively. The surplus for full year 2011 is before the 2011 final dividend.

# Financial review

## IFRS results

### IFRS basis operating profit based on longer-term investment returns

| | | AER | | CER | |
|---|---|---|---|---|---|
| | **Half year 2012** £m | **Half year 2011** note (i) £m | **Change** % | **Half year 2011** note (i) £m | **Change** % |
| Insurance business | | | | | |
| Long-term business: | | | | | |
| Asia | 409 | 324 | 26 | 322 | 27 |
| US | 442 | 340 | 30 | 349 | 27 |
| UK | 336 | 332 | 1 | 332 | 1 |
| Development expenses | (3) | (2) | (50) | (2) | (50) |
| **Long-term business profit** | 1,184 | 994 | 19 | 1,001 | 18 |
| UK general insurance commission | 17 | 21 | (19) | 21 | (19) |
| Asset management business: | | | | | |
| M&G (including Prudential Capital) | 199 | 199 | – | 199 | – |
| Eastspring Investments | 34 | 43 | (21) | 44 | (23) |
| Curian | 7 | 5 | 40 | 5 | 40 |
| US broker-dealer and asset management | 10 | 12 | (17) | 12 | (17) |
| | 1,451 | 1,274 | 14 | 1,282 | 13 |
| Other income and expenditure | (255) | (253) | (1) | (253) | (1) |
| RPI to CPI inflation measure change on defined benefit pension schemes[note (ii)] | – | 42 | – | 42 | – |
| Solvency II implementation costs | (27) | (27) | – | (27) | – |
| Restructuring costs | (7) | (8) | 13 | (8) | 13 |
| **Total IFRS basis operating profit based on longer-term investment returns** | 1,162 | 1,028 | 13 | 1,036 | 12 |

Notes

(i) The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

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

In the first half of 2012, the Group's IFRS operating profit based on longer-term investment returns was £1,162 million, an increase of 13 per cent from the first half of 2011.

In Asia, IFRS operating profit for long-term business increased by 26 per cent from £324 million in the first half of 2011 to £409 million in the first half of 2012. Profits from in-force business grew by 23 per cent between the two periods from £365 million to £449 million, reflecting an increasing contribution from health and protection business and the continued growth of the business in the region. New business strain has reduced from £41 million in the first half of 2011 to £40 million in the first half of 2012.

Hong Kong, Indonesia, Singapore and Malaysia, Prudential's largest markets in Asia, continue to see profits grow strongly, with operating profits from long-term business[1] up 27 per cent from £255 million in the first half of 2011 to £323 million in the first half of 2012. Indonesia continues to see strong organic growth, with operating profit[1] up 29 per cent from £95 million to £123 million. Hong Kong's operating profit[1] increased by 52 per cent to £47 million (2011: £31 million), reflecting the continued growth of the portfolio. Singapore increased by 29 per cent to £93 million (2011: £72 million)[1] and Malaysia's operating profit[1] at £60 million (2011: £57 million) increased by 5 per cent. Other territories contributed operating profits[1] of £69 million (2011: £44 million), an increase of 57 per cent, and have all made positive contributions to this metric.

The US long-term business operating profit increased by 30 per cent from £340 million in the first half of 2011 to £442 million in the first half of 2012. The strong performance is attributed to growth in fee income, up 25 per cent to £408 million, driven by the continued high sales of variable annuity business which has enhanced separate account balances. The operating profit in the first half of 2012 further benefited from absence of non-recurring DAC amortisation of £66 million recognised in the first half of 2011. Partially offsetting these increases are higher non-deferrable acquisition costs from the growing variable annuity business and reduced spread income.

In Prudential's UK business, total IFRS operating profit was £353 million, in line with same period last year (2011: £353 million). Long-term business generated £336 million (2011: £332 million). The with-profits business contributed £146 million, compared with £154 million in 2011, in line with reductions in policy bonus rates. Profit from UK general insurance commission continued to decline as expected at £17 million (2011: £21 million) as the business matures and in-force policy numbers fall.

Total operating profit for the first half of 2012 from M&G and Prudential Capital was £199 million, comparable to operating profit earned in the first half of 2011. The impact of strong net inflows in the first half of 2012 has been offset by the effect of lower average market levels in the period.

Eastspring Investments reported operating profits of £34 million, down by 21 per cent from the £43 million recognised in the first half of 2011. This reflects lower average margins on funds under management following a shift in business mix towards bonds and a higher proportion of institutional business, together with increased costs as the business develops the Eastspring Investments platform.

The charge for other income and expenditure has increased from £253 million in the first half of 2011 to £255 million in the first half of 2012.

A total of £27 million of Solvency II implementation costs were incurred in the first half of 2012 (2011: £27 million) as we continue to make progress in our preparedness to implement the new regime.

**Note**
1 Before non-recurring items.

# Financial review

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

| | AER | | | AER | | | CER | | |
|---|---|---|---|---|---|---|---|---|---|
| | Half year 2012 | | | Half year 2011 note (v) | | | Half year 2011 | | |
| | Operating profit £m | Average liability note (ii) £m | Margin note (i) bps | Operating profit £m | Average liability note (ii) £m | Margin note (i) bps | Operating profit £m | Average liability note (ii) £m | Margin note (i) bps |
| Spread income | 536 | 61,109 | 175 | 533 | 55,687 | 191 | 543 | 56,301 | 193 |
| Fee income | 509 | 74,795 | 136 | 423 | 68,435 | 124 | 429 | 69,062 | 124 |
| With-profits | 164 | 94,103 | 35 | 171 | 92,701 | 37 | 171 | 92,702 | 37 |
| Insurance margin | 420 | | | 345 | | | 347 | | |
| Margin on revenues | 704 | | | 638 | | | 635 | | |
| Expenses: | | | | | | | | | |
| Acquisition costs note (iii) | (972) | 2,030 | (48)% | (900) | 1,824 | (49)% | (911) | 1,840 | (50)% |
| Administration expenses | (555) | 135,904 | (82) | (497) | 124,122 | (80) | (500) | 125,363 | (80) |
| DAC adjustments note (iv) | 248 | | | 150 | | | 156 | | |
| Expected return on shareholder assets | 130 | | | 131 | | | 131 | | |
| Operating profit based on longer-term investment returns | 1,184 | | | 994 | | | 1,001 | | |

Notes

(i) Margin represents the operating return earned in the period as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus. The margin is on an annualised basis in which half year profits are annualised by multiplying by two.

(ii) For UK and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the period, as this is seen as a good proxy for average balances throughout the period. The calculation of average liabilities for Jackson is derived from month-end balances throughout the period as opposed to opening and closing balances only, and liabilities held in the general account for variable annuity living and death guaranteed benefits are excluded from the calculation of the average as no spread income is earned on these balances. These changes were introduced in full year 2011 and half year 2011 has been amended for consistency albeit impacts are minimal.

(iii) Acquisition cost ratio represents shareholder acquisition costs as a percentage of total APE.

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

(v) Starting from full year 2011 and following the reduction in 2010 of the Group's interest in the PruHealth and PruProtect businesses from 50 per cent to 25 per cent, the profits of these businesses have been shown as a single line in the insurance margin consistent with associate accounting principles. Half year 2011 results reflect this change.

**Spread income** earned in the first half of 2012 was £536 million, consistent with the amount received in the prior year of £533 million. The margin secured has fallen from 191 basis points in the first half of 2011 to 175 basis points in the first half of 2012 principally due to the anticipated spread compression in the US general account business, down from 262 basis points in 2011 to 238 basis points in 2012.

**Fee income** has increased by 20 per cent to £509 million, driven by the 9 per cent increase in the Group's average unit-linked liabilities, which principally reflects the £3.8 billion net inflows into Jackson's separate accounts as well as positive net flows in Asia's linked business in the first half of 2012. The fee income margin has increased from 124 basis points to 136 basis points in the first half of 2012 as Jackson contributes a greater proportion to the total, where the fee margin is higher.

**Insurance margin** has increased by 22 per cent to £420 million in the first half of 2012 driven by the continuing growth in the in-force book in Asia, which has a relatively high proportion of risk-based products and an increase in variable annuity guarantee fees in the US, in line with the growth in the business.

**Margin on revenues** principally comprises amounts deducted from premiums to cover acquisition costs and administration expenses. The margin has increased by 10 per cent from £638 million in first half of 2011 to £704 million in first half of 2012. This increase is driven by Asia and reflects higher premium income in the period.

**Acquisition costs** have increased in absolute terms to £972 million, broadly in line with the increased new business sales. Expressed as a percentage of new business APE, 2012 has seen a marginal decrease from 49 per cent in the first half of 2011 to 48 per cent in 2012.

**Administration expenses** have increased to £555 million, reflecting the growth of the business in the year.

**DAC adjustments** are a net benefit to the result as the deferral of current year's acquisition costs exceeds the amortisation of previously deferred costs. This net benefit increased from £150 million in the first half of 2011 to £248 million in the first half of 2012. This increase primarily arises in US, following a fall in DAC amortisation to more usual levels in 2012. 2011 included a £66 million charge for accelerated DAC amortisation, representing the reversal of the benefit received in 2008 from the mean reversion formula.

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

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | M&G note (i) | Eastspring Investments | PruCap | US | Total |
| Operating income note (i) | 354 | 96 | 59 | 142 | 651 |
| Operating profit based on longer-term investment returns | 175 | 34 | 24 | 17 | 250 |
| Average funds under management (FUM), including 47% proportional share of PPM South Africa | £200.6bn | | | | |
| Average funds under management (FUM), excluding PPM South Africa | £196.8bn | £52.1bn | | | |
| Margin based on operating income note (ii) | 36 bps | 37 bps | | | |
| Cost/income ratio note (iii) | 53% | 66% | | | |

| | Half year 2011 £m | | | | |
|---|---|---|---|---|---|
| | M&G note (i) | Eastspring Investments | PruCap | US | Total |
| Operating income note (i) | 330 | 98 | 55 | 125 | 608 |
| Operating profit based on longer-term investment returns | 172 | 43 | 27 | 17 | 259 |
| Average funds under management (FUM), including 100% share of PPM South Africa | £200.5 bn | | | | |
| Average funds under management (FUM), excluding PPM South Africa | £191.4 bn | £52.2bn | | | |
| Margin based on operating income note (ii) | 34 bps | 38 bps | | | |
| Cost/income ratio note (iii) | 55% | 59% | | | |

Notes

(i) Operating income is presented net of commissions and excludes performance-related fees, and for M&G carried interest on private equity investments. Following the divestment in the first half of 2012 of M&G's holding in PPM South Africa from 75 per cent to 47 per cent and its treatment from 2012 as an associate, M&G's operating income and expense no longer includes any element from PPM South Africa, with the share of associate's results being presented in a separate line. In order to avoid period on period distortion, in the table above the 2011 operating income, margin and cost/income ratio reflect the retrospective application of the basis of presentation for 2011 results.

(ii) Margin represents operating income as defined in note (i) above as a proportion of average funds under management (FUM), being the average of opening and closing FUM, excluding PPM South Africa. The margin is on an annualised basis in which the half year resultant figure is multiplied by two. For half year 2012, the opening balance of M&G's FUM has been adjusted to remove the proportional share of PPM South Africa divested following the change in treatment to associate at the beginning of the period.

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

M&G's asset management fee margin increased from 34 basis points in the first half of 2011 to 36 basis points in the first half of 2012. This reflects a shift in funds under management mix towards higher margin retail business which at 30 June 2012 represented 23 per cent of total funds under management, excluding PPM South Africa (31 December 2011: 21 per cent; 30 June 2011: 21 per cent). Retail margin fell by 1 basis point to 96 basis points as a result of a change in fund mix towards lower margin bond funds and channel diversification towards platform business. M&G continues to focus on cost control and the efficiencies created as the scale of the business grows. The benefit of this operational leverage is evident in the reduction in the cost/income ratio from 55 per cent in the first half of 2011 to 53 per cent in the first half of 2012.

At Eastspring Investments, fee margin declined from 38 basis points in the first half of 2011 to 37 basis points in the first half of 2012, with an increase in the funds under management mix towards institutional business including internal clients (68 per cent for 2012 compared to 62 per cent for 2011). The equity markets correction experienced in Asia and globally in the second half of 2011 has contributed to this asset mix shift. Institutional margins have remained stable across the periods. Lower operating income coupled with higher costs in 2012 as the business continues to invest in future growth opportunities have contributed to a higher cost/income ratio of 66 per cent in the first half of 2012 compared to 59 per cent in the first half of 2011.

# Financial review

## IFRS basis profit after tax

| | Half year 2012 £m | Half year 2011* £m |
|---|---|---|
| **Operating profit based on longer-term investment returns** | 1,162 | 1,028 |
| Short-term fluctuations in investment returns: | | |
| Insurance operations | (78) | 65 |
| Other operations | 46 | 28 |
| | (32) | 93 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 87 | (7) |
| Gain on dilution of Group holdings | 42 | – |
| **Profit before tax attributable to shareholders** | 1,259 | 1,114 |
| Tax charge attributable to shareholders' profit | (307) | (283) |
| Non-controlling interests | – | (2) |
| **Profit for the period attributable to equity holders of the Company** | 952 | 829 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

## IFRS basis profit after tax

The total profit before tax attributable to shareholders was £1,259 million in the first half of 2012, compared with £1,114 million in the first half of 2011. The improvement predominantly reflects the increase in operating profit based on longer-term investment returns.

In calculating the IFRS operating profit, we use longer-term investment return assumptions rather than actual investment returns arising in the year. The difference between actual investment returns recorded in the income statement and longer-term returns is shown in the analysis of profits as short-term fluctuations in investment returns.

### IFRS short-term fluctuations in investment returns

Short-term fluctuations in investment returns for our insurance operations comprise positive £42 million for Asia, negative £125 million for US operations and positive £5 million in the UK.

The positive short-term fluctuations of £42 million for our Asia operations include unrealised gains on the fixed interest and equity investments in Vietnam and Taiwan, including on the Group's investment in China Life insurance Company of Taiwan, offset by the impact of falling interest rates in Hong Kong.

Negative fluctuations of £125 million in our US operations mainly represent the net unrealised value movement on derivatives held to manage the Group's interest rate and equity exposures.

The positive short-term fluctuations of £5 million for our UK operations largely reflect the net effect of lower interest rates on shareholder-backed business.

Short-term fluctuations for other operations were positive £46 million representing net unrealised gains in the period on centrally held derivatives to manage foreign exchange and certain macroeconomic exposures of the Group and appreciation on Prudential Capital's bond portfolio.

### Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes of positive £87 million (2011: negative £7 million) mainly reflects the partial recognition of actuarial surplus in the Prudential Staff Pension Scheme following the results of the triennial valuation, further details of which are given in the pension fund section of this review.

### Gain on dilution of Group holdings

On 22 February 2012, M&G completed transactions to (i) exchange bonus share rights for equity holdings with the employees of PPM South Africa and (ii) the sale of a 10 per cent holding in the majority of the business to Thesele Group, a minority shareholder, for cash. Following these transactions M&G's majority holding in the business reduced from 75 per cent to 47 per cent. Under IFRS requirements, the divestment of M&G's holding in PPM South Africa is accounted for as the disposal of the 75 per cent holding and an acquisition of a 47 per cent holding at fair value resulting in a reclassification of PPM South Africa from a subsidiary to an associate. The transactions therefore give rise to a gain on dilution of £42 million, which has been excluded from the Group's IFRS operating profit based on longer-term investment returns.

### Effective tax rates

The effective rate of tax on operating profit based on longer-term investment returns was 25 per cent (2011: 22 per cent). The 2011 effective rate had benefited from utilising carried forward tax losses for which no deferred tax asset had been recognised.

The effective rate of tax at the total IFRS profit level was 24 per cent (2011: 25 per cent).

## EEV results

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

| | | AER | | CER | |
|---|---|---|---|---|---|
| | Half year 2012 £m | Half year 2011 £m | Change % | Half year 2011 £m | Change % |
| Insurance business: | | | | | |
| Asia | 872 | 774 | 13 | 778 | 12 |
| US | 805 | 831 | (3) | 852 | (6) |
| UK | 490 | 537 | (9) | 537 | (9) |
| Development expenses | (3) | (2) | 50 | (2) | 50 |
| **Long-term business profit** | 2,164 | 2,140 | 1 | 2,165 | (0) |
| UK general insurance commission | 17 | 21 | (19) | 21 | (19) |
| Asset management business: | | | | | |
| M&G (including Prudential Capital) | 199 | 199 | – | 199 | – |
| Eastspring Investments | 34 | 43 | (21) | 44 | (23) |
| Curian | 7 | 5 | 40 | 5 | 40 |
| US broker-dealer and asset management | 10 | 12 | (17) | 12 | (17) |
| | 2,431 | 2,420 | – | 2,446 | (1) |
| Other income and expenditure | (285) | (281) | 1 | (281) | 1 |
| RPI to CPI inflation measure change on defined benefit pension schemes[note] | – | 45 | | 45 | – |
| Solvency II implementation costs | (29) | (28) | (4) | (28) | (4) |
| Restructuring costs | (8) | (9) | 11 | (9) | 11 |
| **Total EEV basis operating profit** | 2,109 | 2,147 | (2) | 2,173 | (3) |

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

Despite the current macroeconomic environment, Prudential Group's total EEV basis operating profit based on longer-term investment returns was £2,109 million in the first half of 2012, compared to £2,147 million in the first half of 2011.

Long-term business profit generated by the Group was £2,164 million (2011: £2,140 million). This profit comprises:

- New business profit of £1,141 million (2011: £1,069 million);
- In-force profit of £1,026 million (2011: £1,073 million); and
- Negative £3 million for development expenses (2011: negative £2 million).

New business profit at £1,141 million was 7 per cent higher than last half year, reflecting an 11 per cent increase in new business APE. Group new business margin remained strong at 56 per cent albeit 3 percentage points lower than 2011. The considerably lower interest rates compared to the first half of 2011 (UK lower by 170 basis points, US lower by 150 basis points) has dampened our overall new business margins by an estimated 6 percentage points. The effect of this on the overall new business profit was more than compensated by higher sales volumes, pricing actions and business mix. The overall new business economics remain robust.

At 61 per cent, the new business margin for the Asia business was lower than the 63 per cent recorded in 2011, driven primarily by the impact of the low interest rates (particularly in Hong Kong) on assumed future returns. The US new business profit margin was 61 per cent (2011: 68 per cent), with the 150 basis points fall in 10-year Treasury yields since 30 June 2011 adversely impacting margins by 11 percentage points, offset by proactive pricing actions and business mix. The UK new business margin at 37 per cent was up 1 per cent compared to last half year (2011: 36 per cent), and includes the benefit of a single bulk annuity buy-in written in each period. Retail new business profit margins increased from 32 per cent to 34 per cent reflecting a change in product mix to include a greater proportion of sales of higher margin individual annuities and with-profits bonds.

# Financial review

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

The contribution to operating profit from life in-force business was £1,026 million (2011: £1,073 million) and comprises £764 million (2011: £825 million) from the unwind of the discount on the opening embedded value and other expected returns, and £262 million (2011: £248 million) from the effect of operating assumption changes, experience variances and other items. The unwind of discount and other expected returns is £61 million lower than the first half of 2011 with the growth in the business being offset by the effect on this profit measure of lower interest rates. The economic effects have adversely impacted the unwind and other expected returns by £110 million.

In the first half of 2012, at £872 million (2011: £774 million), Asia is the highest contributor to the Group's life profit, as it was in full year 2011. Included in this profit is £325 million of profit from in-force business (2011: £309 million). Operating assumption changes and experience variances netted to an overall small positive of £4 million for the first six months (2011: negative £24 million) with individual components remaining relatively modest.

US life in-force profit was lower at £363 million (2011: £373 million) reflecting the impact of lower interest rates as highlighted above. Jackson's actual performance continues to exceed that assumed with positive experience and operating assumptions of £165 million (2011: £170 million). Within these amounts, swap transactions undertaken from 2010 to more closely match the overall asset and liability duration contributed enhanced profits with an overall spread gain of £98 million (2011: £81 million).

UK life in-force profit was £338 million for the first six months of 2012 (2011: £391 million). Lower gilt yields led to a reduction in the contribution from the unwind of the discount on the opening embedded value and return on net worth relative to last half year by £44 million to £245 million. Disciplined management of the in-force book has enabled the business to continue to deliver returns beyond those anticipated, generating profits from experience and operating assumption changes of £93 million (2011: £102 million). Included in both half years are the beneficial effects on future profits arising from the reduction in UK corporation taxes enacted in both periods; in the first half of 2012 this amounted to £43 million, while in the first half of 2011 this amounted to £46 million.

Operating profit from the asset management business and other non-long-term businesses decreased slightly to £267 million, from £280 million in the first half of 2011.

Other income and expenditure totalled a net expense of £285 million, slightly higher than the £281 million incurred in the first half of 2011.

## EEV basis profit after tax and non-controlling interests

| | Half year 2012 £m | Half year 2011 £m |
|---|---|---|
| EEV basis operating profit based on longer-term investment returns | 2,109 | 2,147 |
| Short-term fluctuations in investment returns: | | |
| Insurance operations | 179 | (139) |
| Other operations | 46 | 28 |
| | 225 | (111) |
| Mark to market value movements on core borrowings | (113) | (74) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 103 | (8) |
| Effect of changes in economic assumptions | (371) | (111) |
| Gain on dilution of Group holdings | 42 | – |
| **Profit before tax** | 1,995 | 1,843 |
| Tax charge attributable to shareholders' profit | (554) | (572) |
| Non-controlling interests | – | (2) |
| **Profit after non-controlling interests** | 1,441 | 1,269 |

### EEV basis profit after tax and non-controlling interests

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

### EEV Short-term fluctuations in investment returns

Short-term fluctuations in investment returns for insurance operations of positive £179 million comprised of positive £216 million for Asia, negative £62 million for our US operations and positive £25 million in the UK.

For our Asia business, short-term fluctuations of positive £216 million (2011: negative £63 million) principally reflects unrealised bond and equity gains following market movements in the period, including a gain on the Group's investment in China Life Insurance Company of Taiwan.

In our US business, short-term fluctuations in investment returns were negative £62 million (2011: negative £91 million). This includes the net value movements on derivatives held to manage the Group's equity and interest rate exposures offset by the positive impact of market movements on the expected level of future fee income from the variable annuity separate accounts.

For our UK business, the short-term fluctuations in investment returns were positive £25 million (2011: positive £15 million). This arises principally because the actual return on the with-profits fund in the first half of 2012 of 3.2 per cent was higher than the longer-term assumed rate of 2.5 per cent.

### Mark to market value movements on core borrowings

The mark to market value movements on core borrowings of negative £113 million in the first half of 2012 reflects movements in the period of market interest rates and credit spreads on Prudential's borrowings.

### Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The shareholders' share of actuarial and other gains and losses on defined benefit pension schemes on the EEV basis comprises the IFRS charge attributable to shareholders, and the shareholders' share of movements in the scheme assets and liabilities attributable to the PAC with-profits fund. On the EEV basis there was a gain of £103 million (2011: charge of £8 million) mainly reflecting the partial recognition of actuarial surplus in the Prudential Staff Pension Scheme following the results of the triennial valuation, further details of which are given in the pension fund section of this review.

### Effect of changes in economic assumptions

The effect of changes in economic assumptions of negative £371 million, comprises negative £254 million for Asia, negative £79 million for the US and negative £38 million for the UK. These reflect the aggregate effects of the reduction in long-term yields and the associated decrease in risk discount rates.

The adverse changes in economic assumptions for Asia of £254 million primarily reflects the impact of reduced long-term yields on fund earned rates in Hong Kong and Vietnam, together with the effect of narrowing corporate bond spreads in Singapore.

# Financial review

## EEV basis profit after tax and non-controlling interests continued

In our US business, the economic effects have a positive effect on future fixed annuity spread profits which is more than offset by the negative effect on future variable annuity fee income.

In the UK, the negative £38 million arises principally on with-profits business, where the lower long-term returns applied at 30 June 2012 are assumed to reduce future policyholder bonuses with consequential adverse impact on the shareholders' transfer.

## Gain on dilution of Group holdings

On 22 February 2012, M&G completed transactions to (i) exchange bonus share rights for equity holdings with the employees of PPM South Africa and (ii) the sale of a 10 per cent holding in the majority of the business to Thesele Group, a minority shareholder, for cash. Following these transactions M&G's majority holding in the business reduced from 75 per cent to 47 per cent. Under IFRS requirements, the divestment of M&G's holding in PPM South Africa is accounted for as the disposal of the 75 per cent holding and an acquisition of a 47 per cent holding at fair value resulting in a reclassification of PPM South Africa from a subsidiary to an associate. As a consequence of the IFRS application, the transactions therefore give rise to a gain on dilution of £42 million, which has been excluded from the Group's EEV operating profit based on longer-term investment returns.

## Effective tax rates

The effective rate of tax on operating profit based on longer-term investment returns was consistent with 2011 at 27 per cent. The effective rate of tax at the total EEV profit level was 28 per cent (2011: 31 per cent), with the first half of 2011 being adversely impacted by a one-off adjustment in the US in respect of prior years.

## Earnings and dividends per share

### Earnings per share (EPS)

| | Half year 2012 pence | Half year 2011 pence |
|---|---|---|
| Basic EPS based on operating profit after tax and non-controlling interests | | |
| IFRS[note] | 34.5 | 31.4 |
| EEV | 60.7 | 61.5 |
| Basic EPS based on total profit after tax and non-controlling interests | | |
| IFRS[note] | 37.5 | 32.7 |
| EEV | 56.8 | 50.1 |

Note
The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.

### Dividend per share

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

In light of the continued strong performance of the business and the Group's focus on a growing dividend, the Board has approved an interim dividend of 8.4 pence per share (2011: 7.95 pence), representing an increase of 5.7 per cent over 2011.

The 2012 interim dividend of 8.4 pence per ordinary share will be paid on 27 September 2012 in sterling to shareholders on the principal register and the Irish branch register at 6.00pm BST on Friday, 24 August 2012 (Record Date), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm. Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 5 October 2012. The interim dividend will be paid on or about 4 October 2012 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte) Limited (CDP) at 5.00pm. Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 9 August 2012. The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG$, will be determined by CDP. The dividend will distribute an estimated £215 million of shareholders' funds.

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

The Board will maintain its focus on delivering a growing dividend, which will continue to be determined after taking into account our Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

# Financial review

## Movement on shareholders' funds

| | IFRS | | | EEV | | |
|---|---|---|---|---|---|---|
| | **Half year 2012** £m | **Half year 2011** note (a) £m | **Full year 2011** note (a) £m | **Half year 2012** £m | **Half year 2011** £m | **Full year 2011** £m |
| Operating profit based on longer-term investment returns | 1,162 | 1,028 | 2,027 | 2,109 | 2,147 | 3,978 |
| Items excluded from operating profit | 97 | 86 | (199) | (114) | (304) | (1,056) |
| **Total profit before tax** | 1,259 | 1,114 | 1,828 | 1,995 | 1,843 | 2,922 |
| Tax and non-controlling interests | (307) | (285) | (413) | (554) | (574) | (780) |
| **Profit for the period** | 952 | 829 | 1,415 | 1,441 | 1,269 | 2,142 |
| Exchange movements, net of related tax | (54) | (62) | (105) | (125) | (101) | (158) |
| Unrealised gains and losses on Jackson securities classified as available-for-sale note (b) | 196 | 109 | 349 | – | – | – |
| Dividends | (440) | (439) | (642) | (440) | (439) | (642) |
| New share capital subscribed | 14 | 15 | 17 | 14 | 15 | 17 |
| Other | 60 | 17 | 9 | 78 | 42 | 71 |
| **Net increase in shareholders' funds** | 728 | 469 | 1,043 | 968 | 786 | 1,430 |
| Shareholders' funds at beginning of the period | 8,564 | 7,521 | 7,521 | 19,637 | 18,207 | 18,207 |
| **Shareholders' funds at end of the period** | 9,292 | 7,990 | 8,564 | 20,605 | 18,993 | 19,637 |
| Comprising: | | | | | | |
| Long-term business | | | | | | |
| Free surplus note (c) | | | | 2,778 | 2,883 | 2,839 |
| Required capital | | | | 3,623 | 3,307 | 3,447 |
| Net worth | | | | 6,401 | 6,190 | 6,286 |
| Value of in-force | | | | 14,001 | 12,656 | 13,364 |
| Total | | | | 20,402 | 18,846 | 19,650 |
| Other business note (d) | | | | 203 | 147 | (13) |
| **Total** note (e) | | | | 20,605 | 18,993 | 19,637 |

Notes
(a) The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B to the IFRS financial statements.
(b) Net of related changes to deferred acquisition costs and tax.
(c) Free surplus for long-term business has fallen by £61 million from the £2.8 billion held at 31 December 2011. The £645 million free surplus generated by the long-term business (net of new business investment and market-related movements) in the period, has been used to pay £647 million to the holding company.
(d) Shareholders' funds for other than long-term business comprises:

| | 30 Jun 2012 £m | 30 Jun 2011 £m | 31 Dec 2011 £m |
|---|---|---|---|
| Asset management operations[note] | 1,888 | 1,860 | 1,783 |
| Holding company net borrowings | (2,258) | (2,364) | (2,188) |
| Other, net | 573 | 651 | 392 |
| **Total shareholders' funds for other business** | 203 | 147 | (13) |

Note
Including goodwill of £1,230 million for 30 June 2012, 30 June 2011 and 31 December 2011.

(e) EEV shareholders' funds excluding goodwill attributable to shareholders at 30 June 2012 is £19,138 million (30 June 2011: £17,524 million; 31 December 2011: £18,172 million).

## IFRS

Statutory IFRS basis shareholders' funds at 30 June 2012 were £9.3 billion. This compares to £8.6 billion at 31 December 2011 and represents an increase of £0.7 billion, equivalent to 8 per cent.

The movement primarily reflects the profit for the period after tax and non-controlling interests of £952 million and the increase in the level of net unrealised gains on Jackson's debt securities of £196 million from the position at 31 December 2011, offset by the payment of dividends of £440 million.

## EEV

On an EEV basis, which recognises the shareholders' interests in long-term business, shareholders' funds at 30 June 2012 were £20.6 billion, an increase of £1.0 billion from the 31 December 2011 level, equivalent to 5 per cent. This increased level of shareholders' funds primarily reflects the profit after tax of £1,441 million, offset by dividend payments of £440 million.

The shareholders' funds at 30 June 2012 relating to long-term business of £20.4 billion comprise £8.8 billion (up 4 per cent from 31 December 2011) for our Asia long-term business operations, £5.3 billion (up 3 per cent from 31 December 2011) for our US long-term business operations and £6.3 billion (up 4 per cent from 31 December 2011) for our UK long-term business operations.

# Financial review

## Free surplus and holding company cash flow

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

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| *Free surplus generation* | | | |
| Expected in-force cash flows (including expected return on net assets) | 1,271 | 1,218 | 2,335 |
| – Life operations | 1,080 | 1,010 | 1,972 |
| – Asset management operations | 191 | 208 | 363 |
| Changes in operating assumptions and experience variances | 132 | 139 | 168 |
| RPI to CPI inflation measure change on defined benefit pension schemes[note] | – | 33 | 33 |
| **Underlying free surplus generated in the period from in-force business** | 1,403 | 1,390 | 2,536 |
| Investment in new business | (364) | (297) | (553) |
| **Underlying free surplus generated in the period** | 1,039 | 1,093 | 1,983 |
| Market-related items | (156) | (44) | (531) |
| Gain on dilution of Group holdings | 42 | – | – |
| **Free surplus generated in the period from retained businesses** | 925 | 1,049 | 1,452 |
| Net cash remitted by the business units | (726) | (690) | (1,105) |
| Other movements and timing differences | (171) | (136) | (264) |
| **Total movement during the period** | 28 | 223 | 83 |
| **Free surplus at 1 January** | 3,421 | 3,338 | 3,338 |
| **Free surplus at end of period** | 3,449 | 3,561 | 3,421 |
| Comprised of: | | | |
| Free surplus relating to long-term insurance business | 2,778 | 2,883 | 2,839 |
| Free surplus of other insurance business | 13 | 48 | 29 |
| IFRS net assets of asset management businesses excluding goodwill | 658 | 630 | 553 |
| Total free surplus | 3,449 | 3,561 | 3,421 |

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

## Free surplus and holding company cash flow continued

### Overview

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

### Free surplus generation

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

The Group's free surplus at the end of the 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 items.

For asset management operations we have defined free surplus generation to be total post-tax IFRS profit for the period. The Group's free surplus generated also includes the general insurance commission earned during the period and excludes shareholders' other income and expenditure and centrally arising restructuring and Solvency II implementation costs.

During the first half of 2012 Prudential generated underlying free surplus from the in-force book of £1,403 million (2011: £1,390 million). 2011 benefited from a one-off credit of £33 million arising from a reduction in the liabilities of the Group's defined benefit pension schemes following the UK government's decision to change the basis of indexation from RPI to CPI, together with strong operating variances. Changes in operating assumptions and experience variances were £132 million in the first half of 2012 compared with £139 million in 2011. These variances included £1 million from Asia (2011: negative £29 million) and £14 million from the UK (2011: positive £60 million), where 2011 benefited from non-recurring items. The US continued to record strong positive variances of £117 million (2011: £108 million), which includes favourable spread experience in the period.

Underlying free surplus generated from in-force business has been used by our life businesses to invest in new business. Investment in new business has increased by 23 per cent to £364 million in the first half of 2012. This compares to a 11 per cent increase in sales and a 7 per cent increase in new business profits. The higher increase in capital consumed principally reflects a change in business mix in the US, with a higher proportion of more capital intensive general account business and a fall in interest rates which has led to a lower valuation rate used to set reserves in the US and Hong Kong on policy inception.

Market-related movements of negative £156 million in the first half of 2012 includes negative £168 million from the US, principally reflecting the valuation movements of derivatives, net of movements in reserves held for variable annuity guarantees given market movements in the period and negative £115 million in the UK. Offsetting these amounts are positive £80 million in Asia, reflecting in part the effects of lower bond yields in Taiwan and Vietnam and positive £47 million from our asset management business.

Free surplus also benefited by £42 million as a result of the divestment of M&G's holding in PPM South Africa from 75 per cent to 47 per cent.

# Financial review

## Value created through investment in new business by life operations

| | Half year 2012 £m | | | |
|---|---|---|---|---|
| | Asia insurance operations | US insurance operations | UK insurance operations | Group Total |
| Free surplus invested in new business | (162) | (180) | (22) | (364) |
| Increase in required capital | 48 | 151 | 44 | 243 |
| Net worth invested in new business | (114) | (29) | 22 | (121) |
| Value of in-force created by new business | 528 | 317 | 94 | 939 |
| Post-tax new business profit for the period | 414 | 288 | 116 | 818 |
| Tax | 133 | 154 | 36 | 323 |
| Pre-tax new business profit for the period | 547 | 442 | 152 | 1,141 |
| New business sales (APE) | 899 | 719 | 412 | |
| New business margins (% APE) | 61% | 61% | 37% | |
| Internal rate of return[note] | >20% | >20% | >20% | |

| | AER | | | |
|---|---|---|---|---|
| | Half year 2011 £m | | | |
| | Asia insurance operations | US insurance operations | UK insurance operations | Group Total |
| Free surplus invested in new business | (129) | (135) | (33) | (297) |
| Increase in required capital | 49 | 123 | 40 | 212 |
| Net worth invested in new business | (80) | (12) | 7 | (85) |
| Value of in-force created by new business | 430 | 310 | 101 | 841 |
| Post-tax new business profit for the period | 350 | 298 | 108 | 756 |
| Tax | 115 | 160 | 38 | 313 |
| Pre-tax new business profit for the period | 465 | 458 | 146 | 1,069 |
| New business sales (APE) | 743 | 672 | 409 | |
| New business margins (% APE) | 63% | 68% | 36% | |
| Internal rate of return[note] | >20% | >20% | >20% | |

## Value created through investment in new business by life operations continued

| | CER | | | |
|---|---|---|---|---|
| | Half year 2011 £m | | | |
| | Asia insurance operations | US insurance operations | UK insurance operations | Group Total |
| Free surplus invested in new business | (129) | (139) | (33) | (301) |
| Increase in required capital | 49 | 126 | 40 | 215 |
| Net worth invested in new business | (80) | (13) | 7 | (86) |
| Value of in-force created by new business | 433 | 319 | 101 | 853 |
| Post-tax new business profit for the period | 353 | 306 | 108 | 767 |
| Tax | 115 | 164 | 38 | 317 |
| Pre-tax new business profit for the period | 468 | 470 | 146 | 1,084 |
| New business sales (APE) | 743 | 688 | 409 | |
| New business margins (% APE) | 63% | 68% | 36% | |
| Internal rate of return[note] | >20% | >20% | >20% | |

Note
The internal rate of return (IRR) is equivalent to the discount rate at which the present value of the post-tax cash flows expected to be earned over the lifetime of the business written in shareholder-backed life funds is equal to the total invested capital to support the writing of the business. The capital included in the calculation of the IRR is equal to the amount required to pay acquisition costs and set up statutory reserves less premiums received, plus encumbered capital. The impact of the time value of options and guarantees is included in the calculation.

Overall, the Group wrote £2,030 million of sales on an APE basis in the first half of 2012 (2011: £1,824 million) generating a post-tax new business contribution to embedded value of £818 million (2011: £756 million). To support these sales, we invested £364 million of capital (2011: £297 million) equivalent to 26 per cent (2011: 21 per cent) of underlying free surplus generated by the life in-force and asset management businesses. The 2012 reinvestment rate of 26 per cent is trending back towards 2010 norms. A favourable business mix, together with other one-off factors, meant that 2011 had a reinvestment rate of 21 per cent, lower than the recent average.

In Asia, investment in new business was £162 million, a 26 per cent increase over the £129 million invested in the first half of 2011. This compares to a 21 per cent increase in new business sales (APE) in the period. For each £1 million of free surplus invested we generated £2.6 million of post-tax new business contribution to embedded value (2011: £2.7 million) the change being driven in part by the impact of lower interest rates on the level of reserves established on policy inception particularly in Hong Kong. The average free surplus undiscounted payback period for business written in the first half of 2012 was four years (2011: four years).

In the US, investment in new business was £180 million (2011: £135 million) and compares to a 7 per cent increase in APE new business sales in the period. For each £1 million of free surplus invested we generated £1.6 million of post-tax new business contribution to embedded value (2011: £2.2 million). This lower return reflects both a higher proportion of general account business being sold in the year and following falls in interest rates, a more punitive valuation interest rate used to establish liabilities upon policy inception. The average free surplus undiscounted payback period for business written in the first half of 2012 was two years (2011: two years).

In the UK, investment in new business was lower, at £22 million compared to £33 million in the same period last year. This investment generated APE sales which were comparable to prior year at £412 million in 2012 (2011: £409 million). For each £1 million of free surplus invested we generated £5.3 million of post-tax new business contribution to embedded value higher than the £3.3 million achieved in 2011 predominantly due to a change in business mix to an increased level of higher margin annuity business and with-profits business, which benefits from no capital investment by shareholders being required. Prudential competes selectively in the UK's retirement savings and income market, focusing on writing profitable new business, sustainable cash generation and capital preservation, rather than pursuing top-line sales growth. The average free surplus undiscounted payback period for shareholder-backed business written in the first half of 2012 was three years (2011: five years).

# Financial review

## Holding company cash flow

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| **Net cash remitted by business units** | | | |
| **UK net remittances to the Group** | | | |
| UK Life fund paid to the Group | 216 | 223 | 223 |
| Shareholder-backed business: | | | |
| Other UK paid to the Group | 14 | 42 | 116 |
| Group invested in UK | – | – | (42) |
| Total shareholder-backed business | 14 | 42 | 74 |
| **Total UK net remittances to the Group** | 230 | 265 | 297 |
| **US remittances to the Group** | 247 | 320 | 322 |
| **Asia net remittances to the Group** | | | |
| Asia paid to the Group: | | | |
| Long-term business | 170 | 147 | 289 |
| Other operations | 31 | 20 | 55 |
| | 201 | 167 | 344 |
| Group invested in Asia: | | | |
| Long-term business | – | (12) | (50) |
| Other operations | (75) | (50) | (88) |
| | (75) | (62) | (138) |
| **Total Asia net remittances to the Group** | 126 | 105 | 206 |
| **M&G remittances to the Group** | 98 | – | 213 |
| **PruCap remittances to the Group** | 25 | – | 67 |
| **Net remittances to the Group from business units** | 726 | 690 | 1,105 |
| Net interest paid | (136) | (135) | (282) |
| Tax received | 89 | 100 | 181 |
| Corporate activities | (70) | (70) | (139) |
| Solvency II costs | (31) | (36) | (56) |
| **Total central outflows** | (148) | (141) | (296) |
| **Operating holding company cash flow before dividend** note | 578 | 549 | 809 |
| Dividend paid | (440) | (439) | (642) |
| **Operating holding company cash flow after dividend** note | 138 | 110 | 167 |
| Issue of hybrid debt, net of costs | – | 340 | 340 |
| Repayment of subordinated debt | – | – | (333) |
| Hedge purchase cost (equity tail risks) | (48) | – | – |
| Other cash payments | (68) | (205) | (205) |
| Total holding company cash flow | 22 | 245 | (31) |
| Cash and short-term investments at beginning of period | 1,200 | 1,232 | 1,232 |
| Foreign exchange movements | – | (1) | (1) |
| **Cash and short-term investments at end of period** | 1,222 | 1,476 | 1,200 |

Note
Including central finance subsidiaries.

## Holding company cash flow

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

Operating holding company cash flow for the first half of 2012 before the shareholder dividend was £578 million, £29 million higher than 2011. After deducting the shareholder dividend the operating holding company cash flow was positive £138 million (2011: positive £110 million).

## Cash remittances to the Group from business units

As previously highlighted, the Group focuses on the generation of free surplus by each of the Group's business units and then determines the use of this surplus, balancing between financing new business growth, retaining surplus capital in operations to absorb the effect of market shocks and remitting funds to the Group to cover central outgoings, including the shareholder dividend.

The holding company received £726 million of net cash remittances from the business units in the first half of 2012, an increase of £36 million from the first half of 2011.

Asia continues to be cash positive, with its remittances to the Group in the first half of 2012 at £126 million (2011: £105 million). Asia remains on track to meet the £300 million net remittance objective in 2013.

Cash received from Jackson of £247 million for 2012 is lower than the £320 million remitted in the first half of 2011 as annual remittances return to a more sustainable level. This follows the exceptional release of excess surplus made in the prior year.

The UK insurance operations remitted £230 million in the first half of 2012 (2011: £265 million). Total shareholder-backed business net remittances in the first half of 2012 were £14 million (2011: £42 million). Cash from the annual with-profits transfer to shareholders reduced from £223 million to £216 million in 2012. The UK remains on track to deliver £350 million of cash to the Group in 2013.

M&G and PruCap collectively remitted £123 million in the first half of 2012, as the asset management businesses returned to the normal practice of remitting funds in both halves of the year.

In the course of 2009 and 2010, the Group raised certain financing contingent on future profits of the UK and Hong Kong life insurance operations which increased the cash remitted by business units by £245 million in aggregate. This was done in order to increase the financial flexibility of the Group during the investment market crisis. Since then principal and interest repayments have reduced the cash available to be remitted to the Group by these businesses. At the beginning of 2012 there was a remaining balance of £145 million to be paid. Based on current plans, payment of this amount will reduce the 2012 remittances from these businesses.

## Net central outflows and other movements

Net central outflows increased to £148 million in the first half of 2012 (2011: £141 million). Lower Solvency II spend in the first half of 2012 was offset by lower tax receipts in the same period.

After central costs, there was a net cash inflow before dividend of £578 million in the first half of 2012 compared to £549 million in the first half of 2011. The dividend paid was £440 million in the first half of 2012 compared to £439 million in the same period in 2011.

Outside of the normal recurring central cash flow items and in light of the heightened risks surrounding the Eurozone, we incurred £48 million for short-dated hedges to provide downside protection against severe equity market falls. We also incurred £68 million of other cash payments in the first half of 2012, representing payments to the UK tax authorities following the settlement reached in 2010 on historic tax issues. A final instalment of a similar amount will be paid in 2013.

The overall holding company cash and short-term investment balances at 30 June 2012 was broadly level with the balance held at the end of 2011 at £1.2 billion. The company seeks to maintain a central cash balance in excess of £1 billion.

# Financial review

## EEV balance sheet

### Summary

| | 30 Jun 2012 £m | 30 Jun 2011* £m | 31 Dec 2011* £m |
|---|---|---|---|
| Goodwill attributable to shareholders | 1,467 | 1,469 | 1,465 |
| Investments | 260,298 | 245,282 | 250,605 |
| Holding company cash and short-term investments | 1,222 | 1,476 | 1,200 |
| Other | 19,638 | 20,470 | 19,475 |
| Total assets | 282,625 | 268,697 | 272,745 |
| Less: liabilities | | | |
| Policyholder liabilities | 236,419 | 221,432 | 227,075 |
| Unallocated surplus of with-profits funds | 9,802 | 10,872 | 9,215 |
| | 246,221 | 232,304 | 236,290 |
| Less: shareholders' accrued interest in the long-term business | (11,313) | (11,003) | (11,073) |
| | 234,908 | 221,301 | 225,217 |
| Core structural borrowings of shareholders' financed operations (IFRS book value basis) | 3,596 | 3,998 | 3,611 |
| Other liabilities including non-controlling interest | 23,516 | 24,405 | 24,280 |
| Total liabilities and non-controlling interest | 262,020 | 249,704 | 253,108 |
| **EEV basis net assets** | 20,605 | 18,993 | 19,637 |
| Share capital and premium | 2,014 | 1,998 | 2,000 |
| IFRS basis shareholders' reserves | 7,278 | 5,992 | 6,564 |
| IFRS basis shareholders' equity | 9,292 | 7,990 | 8,564 |
| Additional EEV basis retained profit | 11,313 | 11,003 | 11,073 |
| **EEV basis shareholders' equity (excluding non-controlling interest)** | 20,605 | 18,993 | 19,637 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative component of EEV shareholders' funds for the IFRS basis shareholders' equity and the additional EEV basis retained profit have been adjusted for the retrospective application of the improvement as if the new accounting policy had always applied as described in note B to the IFRS financial statements. Total EEV shareholders' funds for the half year 2011 and full year 2011 are not altered by the change of IFRS policy.

## Financial instruments

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

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

## Policyholder liabilities and unallocated surplus of with-profits funds

| Shareholder-backed business | Half year 2012 £m Asia | US | UK | Total | Half year 2011 £m Total |
|---|---|---|---|---|---|
| At 1 January | 18,269 | 69,189 | 46,048 | 133,506 | 122,183 |
| Premiums | 1,938 | 7,303 | 2,018 | 11,259 | 10,782 |
| Surrenders | (949) | (2,083) | (1,307) | (4,339) | (4,142) |
| Maturities/Deaths | (98) | (451) | (1,170) | (1,719) | (1,626) |
| **Net cash flows** | 891 | 4,769 | (459) | 5,201 | 5,014 |
| Investment-related items and other movements | 497 | 1,906 | 1,507 | 3,910 | 2,832 |
| Foreign exchange translation differences | (233) | (600) | – | (833) | (1,453) |
| At 30 June | 19,424 | 75,264 | 47,096 | 141,784 | 128,576 |
| **With-profits funds** | | | | | |
| Policyholder liabilities | | | | 94,635 | 92,856 |
| Unallocated surplus | | | | 9,802 | 10,872 |
| **Total at 30 June** | | | | 104,437 | 103,728 |
| **Total policyholder liabilities including unallocated surplus at 30 June** | | | | 246,221 | 232,304 |

### Policyholder liabilities and unallocated surplus of with-profits funds

Policyholder liabilities relating to shareholder-backed business grew by £8.3 billion from £133.5 billion at 31 December 2011 to £141.8 billion at 30 June 2012.

The increase reflects positive net flows (premiums (net of charges) less surrenders, maturities and deaths) of £5.2 billion in the first half of 2012 (2011: £5.0 billion), driven by strong inflows in the US (£4.8 billion) and Asia (£0.9 billion). Net flows in Asia have increased by 11 per cent to £891 million in the first half of 2012 (2011: £803 million). Additionally, the rate of surrenders in Asia (expressed as a percentage of opening liabilities) was 5.2 per cent in the first half of 2012 which is broadly in line with the equivalent rate in the first half of 2011.

Other movements include negative foreign exchange movements of £833 million (2011: negative £1,453 million) together with positive investment-related and other items of £3,910 million. Investment-related and other items increased from £2,832 million in the first half of 2011 to £3,910 million in the first half of 2012 principally following improvements in the bond and equity markets during the period.

During the first half of 2012, the unallocated surplus, which represents the excess of assets over policyholder liabilities for the Group's with-profits funds on an IFRS basis, reduced by 10 per cent from £10.9 billion at 30 June 2011 to £9.8 billion at 30 June 2012.

# Financial review

## Shareholders' net borrowings and ratings

**Shareholders' net borrowings at 30 June 2012:**

| | 30 Jun 2012 £m | | | 31 Dec 2011 £m | | |
|---|---|---|---|---|---|---|
| | IFRS basis | Mark to market value | EEV basis | IFRS basis | Mark to market value | EEV basis |
| Perpetual subordinated Capital securities (Innovative Tier 1) | 1,808 | 47 | 1,855 | 1,823 | (10) | 1,813 |
| Subordinated notes (Lower Tier 2) | 830 | 140 | 970 | 829 | 120 | 949 |
| | 2,638 | 187 | 2,825 | 2,652 | 110 | 2,762 |
| Senior debt: | | | | | | |
| 2023 | 300 | 73 | 373 | 300 | 56 | 356 |
| 2029 | 249 | 33 | 282 | 249 | 21 | 270 |
| Holding company total | 3,187 | 293 | 3,480 | 3,201 | 187 | 3,388 |
| Prudential Capital | 250 | – | 250 | 250 | – | 250 |
| Jackson surplus notes (Lower Tier 2) | 159 | 26 | 185 | 160 | 17 | 177 |
| Total | 3,596 | 319 | 3,915 | 3,611 | 204 | 3,815 |
| Less: Holding company cash and short-term investments | (1,222) | – | (1,222) | (1,200) | – | (1,200) |
| Net core structural borrowings of shareholder-financed operations | 2,374 | 319 | 2,693 | 2,411 | 204 | 2,615 |

### Shareholders' net borrowings and ratings

The Group's core structural borrowings at 30 June 2012 totalled £3.6 billion on an IFRS basis, comparable to £3.6 billion at 31 December 2011.

After adjusting for holding company cash and short-term investments of £1,222 million, net core structural borrowings at 30 June 2012 were £2,374 million compared with £2,411 million at 31 December 2011. The decrease of £37 million represents the net fall in borrowings of £15 million, mainly reflecting the foreign exchange movements in the period, together with a £22 million rise in holding company cash and short-term investments.

In addition to its core structural borrowings set out above, Prudential also has in place an unlimited global commercial paper programme. As at 30 June 2012, we had issued commercial paper under this programme totalling £516 million, US$2,390 million, €317 million, CHF20 million and AU$12 million. The central treasury function also manages our £5 billion medium-term note (MTN) programme, covering both core and non-core borrowings. In April 2012 Prudential refinanced an existing internal £200 million issue under this programme. Under the programme at 30 June 2012 the outstanding subordinated debt was £835 million, US$1,300 million and €20 million and the senior debt outstanding was £250 million. In addition, Prudential's holding company has access to £2.1 billion of syndicated and bilateral committed revolving credit facilities, provided by 17 major international banks, expiring between 2013 and 2017. Apart from small drawdowns to test the process, these facilities have never been drawn, and there were no amounts outstanding at 30 June 2012. The commercial paper programme, the MTN programme and the committed revolving credit facilities are all available for general corporate purposes and to support the liquidity needs of Prudential's holding company and are intended to maintain a strong and flexible funding capacity.

Prudential manages the Group's core debt within a target level consistent with its current debt ratings. At 30 June 2012, the gearing ratio (debt, net of cash and short-term investments, as a proportion of EEV shareholders' funds plus net debt) was 10.3 per cent, compared with 10.9 per cent at 31 December 2011. Prudential plc has strong debt ratings from Standard & Poor's, Moody's and Fitch. Prudential's long-term senior debt is rated A+, A2 and A from Standard & Poor's, Moody's and Fitch, while short-term ratings are A-1, P-1 and F1 respectively.

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

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

## Financial position on defined benefit pension schemes

The Group currently operates three defined benefit schemes in the UK, of which by far the largest is the Prudential Staff Pension Scheme (PSPS) and two smaller schemes, Scottish Amicable (SAPS) and M&G.

Defined benefit schemes in the UK are generally required to be subject to a full actuarial valuation every three years, in order to assess the appropriate level of funding for schemes in relation to their commitments. The valuation of PSPS as at 5 April 2011, was finalised in the second quarter of 2012. The valuation demonstrated the scheme to be 111 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. Given the strength of the scheme, future funding (excluding expenses) has been reduced to the minimum level of contributions required under the scheme rules effective from July 2012. Excluding expenses, we estimate the actual cash contribution to the fund will fall to £6 million per annum from the £50 million per annum paid previously. The valuation basis under IAS 19 for the Group financial statements differs markedly from the full triennial actuarial valuation basis. The agreement to recognise contributions at the minimum level permitted means that the Group now recognises on its IFRS statement of financial position part of the surplus valued in accordance with IAS 19, which represents the amount which is recoverable through the reduced future contributions. At 30 June 2012 the total IAS 19 surplus, measured on an economic basis net of related tax relief, was £1,253 million (31 December 2011: £1,391 million), of which £147 million (2011: £nil) has been recognised by the Group.

The actuarial valuation of SAPS as at 31 March 2008 demonstrated the scheme to be 91 per cent funded. Based on this valuation and subsequent agreement with the Trustees, £13.1 million per annum of deficit funding is currently being paid into the scheme. The actuarial valuation of SAPS as at 31 March 2011 is currently being finalised, but we anticipate the current level of funding to continue, extending our commitment to pay deficit funding.

The actuarial valuation of the M&G pension scheme as at 31 December 2008 demonstrated the scheme to be 76 per cent funded. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period have been agreed with £14.1 million being paid in each of 2010 and 2011 half years and £9.3 million per annum for the subsequent three years. In 2011, the Group agreed with the Trustee to pay an additional funding of £1.2 million per annum from January 2012 until the conclusion of the actuarial valuation as at 31 December 2011, which is currently in progress.

As at 30 June 2012, on the Group IFRS statement of financial position, the shareholders' share of the net surplus for these UK schemes amounted to a £59 million surplus net of related tax relief (31 December 2011: £17 million net liability). The total share attributable to the PAC with-profits fund amounted to a net surplus of £92 million net of related tax relief (31 December 2011: £38 million net liability).

## Financial strength of the UK Long-term Fund

On a realistic valuation basis, with liabilities recorded on a market consistent basis, the free assets were valued at approximately £6.1 billion at 30 June 2012 (31 December 2011: £6.1 billion), before a deduction for the risk capital margin. The value of the shareholders' interest in future transfers from the UK with-profits fund is estimated at £2.1 billion (31 December 2011: £2.0 billion). The financial strength of PAC is rated AA by Standard & Poor's, Aa2 by Moody's and AA by Fitch Ratings.

Despite the continued volatility in financial markets, Prudential UK's with-profits fund performed relatively strongly achieving a 3.2 per cent pre-tax investment return for policyholder asset shares during the first half of 2012.

# Risk and capital management

**As a provider of financial services, including insurance, the management of risk lies at the heart of Prudential's business. As a result, effective risk management capabilities represent a key source of competitive advantage for the Group.**

The Group's risk framework includes the Group's appetite for risk exposures as well as our approach to risk management. Under this approach, Prudential continuously assesses the Group's top risks and monitors its risk profile against approved limits. Prudential's main strategies for managing and mitigating risk include asset liability management, using derivatives to hedge relevant market risks, and implementing reinsurance and corporate insurance programmes.

## A. Group risk appetite

Prudential defines and monitors aggregate risk limits based on financial and non-financial stresses for its earnings volatility, liquidity and capital requirements.

**Earnings volatility** – the objectives of the limits are to ensure that:

a the volatility of earnings is consistent with the expectations of stakeholders;
b the Group has adequate earnings (and cash flows) to service debt, 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 used to monitor the volatility of earnings are European Embedded Value (EEV) operating profit and International Financial Reporting Standards (IFRS) operating profit, although EEV and IFRS total profits are also considered.

**Liquidity** – the objective is to ensure that the Group is able to generate sufficient cash resources to meet financial obligations as they fall due in business as usual and stressed scenarios.

**Capital requirements** – the limits aim to ensure that:

a the Group meets its internal economic capital requirements;
b the Group achieves its desired target rating to meet its business objectives; and
c supervisory intervention is avoided.

The two measures used are the EU Insurance Groups Directive (IGD) capital requirements and internal economic capital requirements. In addition, capital requirements are monitored on both local statutory and future Solvency II regulatory bases.

Our risk appetite framework forms an integral part of our annual business planning cycle. The Group Risk Committee is responsible for reviewing the risks inherent in the Group's business plan and for providing the Board with input on the risk/reward trade offs implicit therein. This review is supported by our Group Risk function, which uses submissions by business units to calculate the Group's aggregated position (allowing for diversification effects between business units) relative to the limits contained within the risk appetite statements.

## B. 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.

| Category | Risk type | Definition |
|---|---|---|
| Financial risks | Market risk | • The risk of loss for the Group's business, or of adverse change in the financial situation, resulting, directly or indirectly, from fluctuations in the level or volatility of market prices of assets and liabilities. |
| | Credit risk | • The risk of loss for the Group's business or of adverse change in the financial position, resulting from fluctuations in the credit standing of issuers of securities, counterparties and any debtors in the form of default or other significant credit event (eg downgrade or spread widening). |
| | Insurance risk | • The risk of loss for the Group's business or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of a number of insurance risk drivers. This includes adverse mortality, longevity, morbidity, persistency and expense experience. |
| | Liquidity risk | • The risk of the Group being unable to generate sufficient cash resources or raise finance to meet financial obligations as they fall due in business as usual and stress scenarios. |
| Non-financial risks | Operational risk | • The risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events. |
| | Business environment risk | • Exposure to forces in the external environment that could significantly change the fundamentals that drive the business's overall strategy. |
| | 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 Group's capabilities. |

The key financial and non-financial risks and uncertainties faced by the Group, that have been considered by the Group Risk Committee, and our approaches to managing them, are described below.

### B.1 Financial risks

***a Market risk***

**(i) Equity risk**

In the UK business, most of Prudential's equity exposure is incurred in the with-profits fund, which includes a large inherited estate estimated at £6.1 billion as at 30 June 2012 (31 December 2011: £6.1 billion). This 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 Asia, Prudential's shareholder exposure to equities relates to revenue from unit-linked products and, from a capital perspective, to the effect of falling equity markets on the with-profits businesses.

In the US, where Jackson is a leading provider of variable annuities, there are risks associated with the guarantees inherent in these products. Jackson provides guaranteed minimum death benefits (GMDB) on substantially all policies in this class, guaranteed minimum withdrawal benefits (GMWB) on a significant proportion of the book, and guaranteed minimum income benefits (GMIB) on only 4 per cent. To protect the shareholders against the volatility introduced by these embedded options, Jackson uses both a comprehensive hedging programme and reinsurance. The GMIB is no longer offered, with existing coverage being reinsured.

In its variable annuity sales activities, Jackson focuses on meeting the needs of conservative and risk averse customers who are seeking reliable income in retirement, and who display little tendency to arbitrage their guarantees. These customers generally select conservative investment options. Jackson is able to meet the needs of these customers because of the strength of its operational platform.

It is Jackson's philosophy not to compete on price; rather, Jackson seeks to sell at a price sufficient to fund the cost incurred to hedge or reinsure its risks and to achieve an acceptable return for shareholders.

# Risk and capital management

Jackson uses a macro approach to hedging that covers the risks inherent across the US business. Within this macro approach Jackson makes use of the natural offsets that exist between the variable annuity guarantees and the fixed index annuity book, and then uses a combination of over-the-counter (OTC) options and exchange traded derivatives to hedge the remaining risk, considering significant market shocks and limiting the amount of capital Jackson is putting at risk. Internal positions are generally netted before any external hedge positions are considered. The hedging programme also covers the fees on variable annuity guarantees.

Jackson hedges the economics of its products rather than the accounting result. This means that Jackson accepts a degree of variability in its accounting results in order to ensure it achieves the appropriate economic result. Accordingly, while Jackson's hedges are effective on an economic basis, due to different accounting treatment for the hedges and some of the underlying hedged items on an IFRS basis, the reported income effect is more variable.

### (ii) Interest rate risk

Interest rate risk arises from Prudential's investments in long-term debt and fixed income securities, and 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.

In Asia, the exposure to interest rate risk arises from the guarantees of some non-unit-linked investment products. This exposure arises because it may not be possible to hold assets which will provide cash flows to match exactly those relating to policyholder liabilities. 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.

In the US, there is interest rate risk across the portfolio. The majority of Jackson's fixed annuity and life liabilities allow for an annual reset of the crediting rate, which provides for a greater level of discretion in determining the amount of interest rate risk to assume. The primary concerns with these liabilities relate to potential surrenders when rates increase and, in a low interest environment, the minimum guarantees required by state law. For variable annuities, interest rate changes will influence the level of reserves held for certain guaranteed benefits. With its large fixed annuity and fixed index annuity books, Jackson has natural offsets for its variable annuity interest-rate related risks. Jackson manages interest rate exposure through a combination of interest rate swaps and interest rate options.

In the UK, the investment policy for the shareholder-backed annuity business is to match the annuity payments with the cash flows from investments. As a result, assets and liabilities are closely matched by duration. The impact on profit of any residual cash flow mismatching can be adversely affected by changes in interest rates; therefore the mismatching position is regularly monitored. The guarantees of the with-profit business give rise to some interest rate discounting risk as falling rates may result in an increase in the cost of guarantees. Except for severe stress scenarios where shareholders' support may be required, this risk is borne by the with-profits fund.

### (iii) Foreign exchange risk

Prudential principally operates in the UK, the US and in Asia. The geographical diversity of its businesses means that Prudential 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 its 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 Prudential's consolidated financial statements when results are expressed in pounds sterling.

Prudential does not generally seek to hedge foreign currency revenues, as these are substantially retained locally to support the growth of the Group's business and meet local regulatory and market requirements. However, in cases where a surplus arising in an overseas operation supports Group capital or shareholders' interest, this exposure is hedged if it is economically optimal to do so. Currency borrowings, swaps and other derivatives are used to manage exposures.

### *b Credit risk*

In addition to business unit and Group-wide operational limits on credit risk, Prudential monitors closely its counterparty exposures at Group level, highlighting those that are large or of concern. Where appropriate, Prudential will reduce its exposure, purchase credit protection or make use of collateral arrangements to control its levels of credit risk.

The Group's balance sheet held the following total investments at 30 June 2012.

| | 30 Jun 2012 £bn | | | | 31 Dec 2011 £bn |
|---|---|---|---|---|---|
| | Participating funds | Unit-linked and variable annuities | Shareholder-backed | Total Group | Total Group |
| Debt securities | 58.9 | 9.1 | 60.3 | **128.3** | 124.5 |
| Equity | 23.4 | 66.0 | 1.1 | **90.5** | 87.3 |
| Property investments | 8.6 | 0.7 | 1.5 | **10.8** | 10.8 |
| Mortgage loans | 1.3 | – | 4.9 | **6.2** | 5.7 |
| Other loans | 1.6 | – | 2.2 | **3.8** | 4.0 |
| Deposits | 8.8 | 1.4 | 2.2 | **12.4** | 10.7 |
| Other investments | 4.7 | 0.1 | 3.5 | **8.3** | 7.6 |
| **Total** | 107.3 | 77.3 | 75.7 | **260.3** | 250.6 |

The table below presents the balances of investments related to shareholder-backed operations at 30 June 2012.

| | 30 Jun 2012 £bn | 31 Dec 2011 £bn |
|---|---|---|
| Shareholder-backed investments: | | |
| Asia life | **8.0** | 7.1 |
| UK life | **29.9** | 28.5 |
| US life | **34.4** | 34.0 |
| Other | **3.4** | 3.8 |
| Total | **75.7** | 73.4 |

Shareholders are not directly exposed to value movements on assets backing participating or unit-linked operations, with sensitivity mainly related to shareholder-backed operations.

### (i) Debt portfolio

The investments held by the shareholder-backed operations are predominantly debt securities, of which 95 per cent are rated, either externally or internally, as investment grade compared to 95 per cent at 31 December 2011.

The Group's total debt securities portfolio on an IFRS basis comprised the following at 30 June 2012:

| | 30 Jun 2012 £bn | | | | 31 Dec 2011 £bn |
|---|---|---|---|---|---|
| | Participating funds | Unit-linked and variable annuities* | Shareholder-backed | Total Group | Total Group |
| Insurance operations: | | | | | |
| UK | 48.5 | 6.1 | 25.3 | **79.9** | 78.0 |
| Jackson National Life Insurance Company | – | – | 27.1 | **27.1** | 27.0 |
| Asia long-term business | 10.4 | 3.0 | 6.0 | **19.4** | 17.7 |
| Other operations | – | – | 1.9 | **1.9** | 1.8 |
| **Total** | 58.9 | 9.1 | 60.3 | **128.3** | 124.5 |

* Jackson's variable annuity separate account assets comprise equity securities and portfolio holdings in unit trusts (including mutual funds), the majority of which are equity based.

### UK

The UK's debt portfolio on an IFRS basis is £79.9 billion as at 30 June 2012, including £48.5 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 is £6.1 billion in unit-linked funds where the shareholders' risk is limited, with the remaining £25.3 billion backing the shareholders' annuity business and other non-linked business (of which 76 per cent is rated AAA to A-, 22 per cent BBB and 2 per cent non-investment grade). The UK shareholder-backed portfolio did not experience any default losses in the first half of 2012.

# Risk and capital management

## US

At 30 June 2012 Jackson's fixed income debt securities portfolio consisted of:

| Summary | 30 Jun 2012 £m | 31 Dec 2011 £m |
|---|---|---|
| Corporate and government security and commercial loans: | | |
| Government | 2,107 | 2,163 |
| Publicly traded and SEC Rule 144A securities | 16,724 | 16,281 |
| Non-SEC Rule 144A securities | 3,263 | 3,198 |
| Total | 22,094 | 21,642 |
| Residential mortgage-backed securities (RMBS) | 2,282 | 2,591 |
| Commercial mortgage-backed securities (CMBS) | 2,129 | 2,169 |
| Other debt securities | 556 | 620 |
| **Total debt securities** | 27,061 | 27,022 |

Of the £20 billion of corporate debt, 95 per cent is investment grade. Concentration risk within the corporate debt portfolio is low, with the top ten holdings accounting for approximately 5 per cent of the portfolio. Jackson's largest sector exposures in the investment grade corporate debt portfolio are Utilities and Energy each at 14 per cent and 15 per cent, respectively. Jackson actively manages the portfolio and will reduce exposures as events dictate.

Within the RMBS portfolio of £2.3 billion, the portion guaranteed by US government sponsored agencies is 60 per cent. Another 19 per cent of the portfolio is non-agency prime and Alt-A investments with pre-2006/2007 vintages, where experience has been much more positive than later vintages. Jackson's exposure to the 2006/2007 vintages totals £268 million of which £263 million is invested in the senior part of the capital structure. The actual exposure to non-senior 2006/2007 Prime and Alt-A RMBS is only £5 million. The total RMBS portfolio has an average fair value price of 94 cents on the dollar.

The CMBS portfolio of £2.1 billion is performing strongly, with 36 per cent of the portfolio rated AAA and only 2 per cent rated below investment grade. The entire portfolio has an average credit enhancement level of 31 per cent. This level provides significant protection, since it means the underlying collateral has to incur a 31 per cent loss, net of recoveries, before Jackson's holding is at risk.

Jackson's debt securities experienced total credit-related losses in the first half of 2012 of £33 million (2011: charge of £13 million). This includes, in particular, IFRS write-downs of £25 million (2011: £14 million). Of this amount, £4 million (2011: £11 million) was in respect of the write-down of RMBS securities. In addition to the amounts for debt securities, in the first half of 2012 there were no write-downs on Jackson's commercial mortgage loan portfolio (2011: write-downs of £9.6 million). In 2012 and 2011 half year periods Jackson did not have any defaults in its debt securities portfolio.

The impairment process reflects a rigorous review of every bond and security in Jackson's portfolio. The Group's accounting policy requires Jackson to book full mark to market losses on impaired securities through its balance sheet. However, Jackson 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.

Jackson's net unrealised gains from debt securities was positive £2,522 million at 30 June 2012, compared to positive £2,057 million at 31 December 2011. The gross unrealised loss position was £157 million at 30 June 2012 (31 December 2011: £246 million). Gross unrealised losses on securities priced at less than 80 per cent of face value totalled £99 million at 30 June 2012 compared to £158 million at 31 December 2011.

## Asia

Asia's debt portfolio totalled £19.4 billion at 30 June 2012. Of this, approximately 69 per cent was in unit-linked and with-profits funds with minimal shareholders' risk. The remaining 31 per cent is shareholder exposure and is invested predominantly (86 per cent) in investment grade bonds. For Asia, the portfolio has performed very well, and did not experience any default losses in 2012.

## Asset management

The debt portfolio of the Group's asset management operations of £1.9 billion as at 30 June 2012 is principally related to Prudential Capital operations. Of this amount £1.6 billion was rated AAA to A- by S&P or Aaa by Moody's.

### (ii) Group sovereign debt exposure

Sovereign debt represented 15 per cent or £9.1 billion of the debt portfolio backing shareholder business at 30 June 2012 (31 December 2011: 16 per cent or £9.2 billion). 43 per cent of this was rated AAA and 91 per cent investment grade (31 December 2011: 43 per cent AAA, 94 per cent investment grade). At 30 June 2012, the Group's total holding in continental Europe shareholder sovereign debt fell from £690 million at 31 December 2011 to £566 million, principally due to a reduction in the level of German debt held from £598 million to £463 million. Of the total £566 million debt, 82 per cent was AAA rated (31 December 2011: 87 per cent AAA rated). Shareholder exposure to the Eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) is £45 million (31 December 2011: £44 million). The Group does not have any sovereign debt exposure to Greece, Portugal or Ireland.

The exposure of the Group's shareholder and with-profits funds to sovereign debt (including credit default swaps that are referenced to sovereign debt) at 30 June 2012 is as follows:

| | 30 Jun 2012 £m | | 31 Dec 2011 £m | |
|---|---|---|---|---|
| | Shareholder sovereign debt | With-profits sovereign debt | Shareholder sovereign debt | With-profits sovereign debt |
| Continental Europe | | | | |
| Italy | 44 | 54 | 43 | 52 |
| Spain | 1 | 36 | 1 | 33 |
| | 45 | 90 | 44 | 85 |
| Germany | 463 | 530 | 598 | 602 |
| Other Europe (principally Isle of Man and Belgium) | 58 | 47 | 48 | 62 |
| | 566 | 667 | 690 | 749 |
| United Kingdom | 3,323 | 2,303 | 3,254 | 2,801 |
| United States | 2,365 | 3,305 | 2,448 | 2,615 |
| Other, predominantly Asia | 2,888 | 341 | 2,850 | 332 |
| **Total** | 9,142 | 6,616 | 9,242 | 6,497 |

### (iii) Exposure to bank debt securities

Prudential expects that any second order sovereign credit exposures would most likely be concentrated in the banking sector. The Group's bank exposure is a function of its core investment business, as well as of the hedging and other activity undertaken to manage its various financial risks. Prudential relies on public information, such as the results of the July 2011 European Banking Authority stress tests to identify banks with large concentrations of indirect exposure and credit research sources.

Prudential has a range of controls and processes to manage credit exposure. In addition to the control frameworks that cover shareholder and policyholder credit risk within each Business Unit, the Group Credit Risk Committee oversees shareholder credit risk across the Group. The Committee receives comprehensive management information, including details of counterparty and invested credit exposure (including structured credit and loans), secured and unsecured cash balances, top 30 credit exposures, and an analysis of shareholder exposure by industry/country and rating. The Business Units and the Group Risk function also continually monitors the portfolio for emerging credit risks through various tools and processes.

Prudential actively mitigates the level of Group-wide credit risk (invested credit and counterparty) through a comprehensive system of hard limits, collateralisation agreements and centrally managed 'watch lists'.

Of the £60.3 billion of debt securities backing shareholder business, excluding holdings attributable to external holders of consolidated unit trusts, 3 per cent or £2.0 billion was in Tier 1 and Tier 2 hybrid bank debt. A further £2.7 billion was in the form of senior debt.

In terms of shareholder exposures to the bank debt of PIIGS, we held £299 million at 30 June 2012 (31 December 2011: £328 million). This comprised £137 million of covered bonds, £61 million senior debt, £3 million Tier 1 debt and £98 million Tier 2 debt. There was no direct exposure to Greek banks.

# Risk and capital management

The Group held the following direct exposures to bank debt securities of shareholder-backed business at 30 June 2012.

| | Bank debt securities – shareholder-backed business | | | | | | |
|---|---|---|---|---|---|---|---|
| | Senior debt | | | Subordinated debt | | | |
| | Covered £m | Senior £m | Total senior debt £m | Tier 2 £m | Tier 1 £m | Total subordinated debt £m | 30 Jun 2012 Total £m |
| Portugal | – | 26 | 26 | – | – | – | 26 |
| Ireland | – | 14 | 14 | – | – | – | 14 |
| Italy | – | 11 | 11 | 56 | – | 56 | 67 |
| Greece | – | – | – | – | – | – | – |
| Spain | 137 | 10 | 147 | 42 | 3 | 45 | 192 |
| | 137 | 61 | 198 | 98 | 3 | 101 | 299 |
| Austria | – | – | – | 10 | – | 10 | 10 |
| Belgium | – | – | – | – | – | – | – |
| France | 17 | 34 | 51 | 58 | 30 | 88 | 139 |
| Germany | – | 31 | 31 | 1 | – | 1 | 32 |
| Luxembourg | – | – | – | – | – | – | – |
| Netherlands | – | 11 | 11 | 89 | 66 | 155 | 166 |
| United Kingdom | 457 | 182 | 639 | 618 | 101 | 719 | 1,358 |
| **Total Europe** | 611 | 319 | 930 | 874 | 200 | 1,074 | 2,004 |
| United States | – | 1,434 | 1,434 | 382 | 1 | 383 | 1,817 |
| Other, predominantly Asia | 20 | 303 | 323 | 339 | 229 | 568 | 891 |
| **Total** | 631 | 2,056 | 2,687 | 1,595 | 430 | 2,025 | 4,712 |

In addition to the exposures held by the shareholder-backed business, the Group held the following bank securities at 30 June 2012 within its with-profits funds.

| | Bank debt securities – participating funds | | | | | | |
|---|---|---|---|---|---|---|---|
| | Senior debt | | | Subordinated debt | | | |
| | Covered £m | Senior £m | Total senior debt £m | Tier 2 £m | Tier 1 £m | Total subordinated debt £m | 30 Jun 2012 Total £m |
| Portugal | – | 7 | 7 | – | – | – | 7 |
| Ireland | 5 | – | 5 | – | – | – | 5 |
| Italy | – | 47 | 47 | 49 | – | 49 | 96 |
| Greece | – | – | – | – | – | – | – |
| Spain | 157 | 12 | 169 | 5 | 1 | 6 | 175 |
| | 162 | 66 | 228 | 54 | 1 | 55 | 283 |
| Austria | – | – | – | – | – | – | – |
| Belgium | – | – | – | – | – | – | – |
| France | 11 | 69 | 80 | 48 | 5 | 53 | 133 |
| Germany | – | 6 | 6 | – | – | – | 6 |
| Luxembourg | – | – | – | – | – | – | – |
| Netherlands | – | 133 | 133 | – | 4 | 4 | 137 |
| United Kingdom | 704 | 435 | 1,139 | 753 | 42 | 795 | 1,934 |
| **Total Europe** | 877 | 709 | 1,586 | 855 | 52 | 907 | 2,493 |
| United States | – | 1,720 | 1,720 | 202 | 36 | 238 | 1,958 |
| Other, predominantly Asia | 9 | 437 | 446 | 202 | 130 | 332 | 778 |
| **Total** | 886 | 2,866 | 3,752 | 1,259 | 218 | 1,477 | 5,229 |

### (iv) Other possible impacts of a Eurozone crisis

Other knock-on impacts of a Eurozone crisis may represent some risk to the Group, both in terms of financial market impact and potential operational issues. These third order exposures are intrinsically more difficult to quantify. However, as well as the monitoring routines noted above, Prudential has also developed tools to identify the Group's exposure to counterparties at risk (including contingent credit exposures), and has in place Group-wide processes to facilitate the management of such risks should they materialise.

In respect of operational risks, we believe we have strong investment operations, counterparty risk and change management capabilities that enable us to manage the transition to a new Eurozone regime if events require us to do so.

### (v) Loans

Of the total Group loans of £10 billion at 30 June 2012, the following are held by shareholder-backed operations.

| | 30 Jun 2012 £bn | | | 31 Dec 2011 £bn | | |
|---|---|---|---|---|---|---|
| | Mortgage loans | Other loans | Total | Mortgage loans | Other loans | Total |
| Asia insurance operations(i) | – | 0.4 | 0.4 | – | 0.4 | 0.4 |
| US insurance operations(ii) | 3.6 | 0.6 | 4.2 | 3.6 | 0.6 | 4.2 |
| UK insurance operations(iii) | 1.3 | – | 1.3 | 1.1 | – | 1.1 |
| Asset management operations(iv) | – | 1.2 | 1.2 | – | 1.3 | 1.3 |
| **Total loans held by shareholder-backed operations** | 4.9 | 2.2 | 7.1 | 4.7 | 2.3 | 7.0 |

Notes
(i) The majority of Asia insurance operations loans are commercial loans held by the Malaysian operation that are rated investment grade by two local rating agencies.
(ii) All commercial mortgage loans held by US insurance operations are collateralised by properties. 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. Jackson incurred no impairments on its commercial mortgage book (half year 2011: write downs of £9.6 million). Other loans represents policy loans.
(iii) The majority of mortgage loans held by UK insurance operations are mortgage loans collateralised by properties.
(iv) Relates to bridging loan finance managed by Prudential Capital.

### (vi) Counterparty credit risk

The 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, with the exception of some transactions in Asia, are conducted under standardised ISDA (International Swaps and Derivatives Association Inc) master agreements and the Group has collateral agreements between the individual Group entities and relevant counterparties in place under each of these market master agreements.

The Group's exposure to derivative counterparty credit risk is subject to the same framework of Group-wide operational limits and monitoring as its invested credit risk. Where appropriate, Prudential will reduce its exposure, purchase credit protection or make use of additional collateral arrangements to control its levels of counterparty credit risk.

### *c Insurance risk*

The processes of determining the price of Prudential's products and reporting the results of its long-term business operations require Prudential to make a number of assumptions. In common with other industry players, the profitability of Prudential'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.

Prudential continues to conduct rigorous research into longevity risk using data from its substantial annuity portfolio. The assumptions that Prudential makes about future expected levels of mortality are particularly relevant in its UK annuity business. The attractiveness of transferring longevity risk (via reinsurance and other external solutions) is regularly evaluated. These are used as risk management tools where it is appropriate and attractive to do so.

Prudential's persistency assumptions reflect recent experience for each relevant line of business, and any expectations of future persistency. Persistency risk is mitigated by appropriate training and sales processes and managed proactively post sale. 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.

# Risk and capital management

*d Liquidity risk*

The parent 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 the Group has £2.1 billion of undrawn committed facilities, expiring between 2013 and 2017. In addition, the Group has access to liquidity via the debt capital markets. Prudential also has in place an unlimited commercial paper programme and has maintained a consistent presence as an issuer in this market for the last decade. Liquidity uses and sources have been assessed at the Group and at a business unit level under base case and stressed assumptions. The liquidity resources available and the subsequent Liquidity Coverage Ratio have been assessed to be sufficient under both sets of assumptions.

### B.2 Non-financial risk

Prudential is exposed to operational, business environment and strategic risk in the course of running its businesses.

With regard to operational risk, the Group is dependent on processing a large number of complex transactions across numerous diverse products, and is subject to a number of different legal, regulatory and tax regimes. Prudential 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. This results in reliance upon the operational performance of these outsourcing partners.

Prudential's systems and processes incorporate controls that are designed to manage and mitigate the operational risks associated with its activities. The Prudential Group Governance Manual was developed to make a key contribution to the sound system of internal control that the Group is expected to maintain under the UK Corporate Governance Code and the Hong Kong Code on Corporate Governance Practices. Group Head Office and business units confirm that they have implemented the necessary controls to evidence compliance with the Manual.

The Group has an operational risk management framework in place that facilitates both the qualitative and quantitative analysis of operational risk exposures. The output of this framework, in particular management information on key operational risk and control assessments, scenario analysis, internal incidents and external incidents, is reported by the business units and presented to the Group Operational Risk Committee. This information also supports business decision-making and lessons-learned activities; the ongoing improvement of the control environment; and determination of the adequacy of Prudential's corporate insurance programme.

With regard to business environment risk, including the impacts of regulatory developments, the Group has a wide-ranging programme of active and constructive engagement with governments, policymakers and regulators in its key markets and with relevant international institutions. Such engagement is undertaken both directly and indirectly via trade associations. The Group has procedures in place to monitor and track political and regulatory developments and assess their potential impact on the Group. Where appropriate, the Group provides submissions and technical input to officials and others, either via submissions to formal consultations or through interactions with officials.

With regard to strategic risk, both business units and the Group Head Office are required to adopt a forward-looking approach to risk management by performing risk assessments as part of the annual strategic planning process. This supports the identification of potential threats and the initiatives needed to address them, as well as competitive opportunities. The impact on the underlying businesses and/or Group-wide risk profile is also considered to ensure that strategic initiatives are within the Group's risk appetite.

Solvency II represents a regulatory risk due to the uncertainty of what the rules will be when finalised, their potential impacts, and the timing of their introduction. The risks are that the Group may not be able to respond sufficiently quickly to the strategic implication of the change given levels of uncertainty around the content and timing; operational risk in terms of the scale and complexity of the delivery and uncertainty over timelines; and the additional capital that the Group may be required to hold. Solvency II is covered in more detail in the 'Capital management' section below.

### B.3 Risk factors

Our disclosures covering risk factors can be found at the end of this document.

## C. Capital management

### C.1 Regulatory capital (IGD)

Prudential is subject to the capital adequacy requirements of the European Union Insurance Groups Directive (IGD) as implemented by the Financial Services Authority (FSA) in the UK. The IGD capital adequacy requirements involve aggregating surplus capital calculated on a FSA consistent basis for 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.

Prudential's capital position remains strong. Prudential has 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. Prudential estimates that its IGD capital surplus is £4.2 billion at 30 June 2012 (before taking into account the 2012 interim dividend), with available capital covering its capital requirements 2.7 times. This compares to a capital surplus of £4.0 billion at the end of 2011 (before taking into account the 2011 final dividend).

The movements in the first half of 2012 mainly comprise:

- Net capital generation mainly through operating earnings (in-force releases less investment in new business, net of tax) of £0.9 billion;

offset by:

- Negative impact arising from market movements estimated at £0.1 billion;
- Final 2011 dividend of £0.4 billion; and
- External financing costs and other central costs, net of tax, of £0.2 billion.

Prudential continues to have further options available to manage available and required capital. These could take the form of increasing available capital (for example, through 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.

In addition to its strong capital position, on a statutory (Pillar 1) basis, the total credit reserve for the UK shareholder annuity funds also protects its capital position in excess of the IGD surplus. This credit reserve as at 30 June 2012 was £2.1 billion. This credit risk allowance represents 35 per cent of the bond portfolio spread over swap rates, compared to 33 per cent as at 31 December 2011.

### *Stress testing*

As at 30 June 2012, stress testing of our IGD capital position to various events has the following results:

- An instantaneous 20 per cent fall in equity markets from 30 June 2012 levels would reduce the IGD surplus by £0.55 billion;
- 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 £0.75 billion;
- A 100 basis points reduction (subject to a floor of zero) in interest rates would reduce the IGD surplus by £1.0 billion*; and
- Credit defaults of ten times the expected level would reduce IGD surplus by £0.65 billion.

* The impact of the 100 basis points reduction in interest rates is exacerbated by the current regulatory permitted practice used by Jackson, which values all interest rate swaps at book value rather than fair value for regulatory purposes. At 30 June 2012, removing the permitted practice would have increased reported IGD surplus by £0.4 billion. As at 30 June 2012, it is estimated that a 100 basis point reduction in interest rates (subject to a floor of zero) would have resulted in an IGD surplus of £4.0 billion, excluding the permitted practice.

During the first half of 2012, Prudential plc paid £48 million to enter into short-term (one year) options which offer some protection for the Group's IGD position against significant falls in equity markets. The benefit that would be expected from these hedges has been taken into account in the equity stress sensitivities shown above.

Prudential believes that the results of these stress tests, together with the Group's strong underlying earnings capacity, its established hedging programmes and its additional areas of financial flexibility, demonstrate that it is in a position to withstand significant deterioration in market conditions.

Prudential 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.

### C.2 Solvency II

The European Union (EU) is developing a new solvency framework for insurance companies, referred to as 'Solvency II'. The Solvency II Directive, which sets out the new framework, was formally approved by the Economic and Financial Affairs Council in November 2009 and is currently anticipated to be transposed into local regulations and take effect for supervisors from mid-2013, with implementation for firms currently scheduled from 1 January 2014. 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 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 are intended to 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.

Representatives from the European Parliament, the European Commission and the Council of the European Union are currently discussing the Omnibus II Directive which, once approved, will amend certain aspects of the original Solvency II Directive. The Omnibus II Directive is scheduled to be finalised in late 2012.

In addition the European Commission is continuing to develop, in consultation with stakeholders including industry, the detailed rules that will complement the high-level principles in the Solvency II Directive, referred to as 'implementing measures'. These are not currently expected to be finalised until early to mid-2013. Further guidance and technical standards are also being developed by the European Insurance and Occupational Pensions Authority. These are expected to be subject to a formal consultation and are unlikely to be finalised before mid-2013.

# Risk and capital management

There remains significant uncertainty regarding the outcome from this process. In particular, the Solvency II rules relating to the determination of the liability discount rate and to the treatment of US business remain unclear and Prudential's capital position is sensitive to these outcomes. With reference to the liability discount rate, solutions to remove artificial volatility from the balance sheet have been suggested by policymakers as the regulations continue to evolve. These solutions, along with transitional arrangements for the treatment of the US business, are continuing to be considered by policymakers as part of the process to reach agreement on the Omnibus II Directive. There is a risk that the effect of the final measures could be adverse for Prudential, including potentially that a significant increase in capital may be required to support its business and that Prudential may be placed at a competitive disadvantage to other European and non-European financial services groups. Prudential is actively participating in shaping the outcome through our involvement in industry bodies and trade associations, including the Chief Risk Officer and Chief Financial Officer Forums, together with the Association of British Insurers and Insurance Europe (formerly known as the Comité Européen des Assurances).

Having assessed the requirements of Solvency II, an implementation programme was initiated with dedicated teams to manage the required work across the Group. The activity of the local Solvency II teams is being coordinated centrally to achieve consistency in the understanding and application of the requirements. Prudential is continuing its preparations to adopt the regime when it eventually arrives and is undertaking in parallel an evaluation of the possible actions to mitigate its effects. Prudential regularly reviews its range of options to maximise the strategic flexibility of the Group. This includes consideration of optimising the Group's domicile as a possible response to an adverse outcome on Solvency II.

Over the coming months Prudential will be progressing its implementation plans and remain in regular contact with the FSA as it continues to engage in the 'pre application' stage of the approval process for the internal model.

### C.3 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.

Prudential optimises capital allocation across the Group by making use of 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 capital performance metrics is embedded into our decision-making processes for product design and product pricing.

Prudential capital performance metrics are based on economic capital, which provides a view of its capital requirements across the Group, allowing for realistic diversification benefits. Economic capital also provides valuable insights into its risk profile and is used both for risk measurement and capital management.

### C.4 Risk mitigation and hedging

Prudential manages its actual risk profile against its tolerance of risk. To do this, Prudential maintains risk registers that include details of the risks Prudential 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.

Prudential 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 manage insurance risk; implementing corporate insurance programmes to limit the impact of operational risks; and revising business plans where appropriate.

Section 3
# Financial results

# Index to Group financial results



* The additional financial information is not covered by the KPMG independent review opinion.

# Condensed consolidated income statement

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | Half year | Half year* | Full year* |
| Earned premiums, net of reinsurance | | 14,111 | 12,930 | 25,277 |
| Investment return | I | 8,762 | 7,750 | 9,360 |
| Other income | | 1,008 | 923 | 1,869 |
| Total revenue, net of reinsurance | | 23,881 | 21,603 | 36,506 |
| Benefits and claims and movement in unallocated surplus of with-profits funds, net of reinsurance | J | (19,850) | (17,590) | (29,289) |
| Acquisition costs and other expenditure | H | (2,592) | (2,665) | (5,120) |
| Finance costs: interest on core structural borrowings of shareholder-financed operations | | (140) | (140) | (286) |
| Total charges, net of reinsurance | | (22,582) | (20,395) | (34,695) |
| Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*† | | 1,299 | 1,208 | 1,811 |
| (Less) add tax (charge) credit attributable to policyholders' returns | | (40) | (94) | 17 |
| Profit before tax attributable to shareholders | C | 1,259 | 1,114 | 1,828 |
| Total tax charge attributable to policyholders and shareholders | K | (347) | (377) | (392) |
| Adjustment to remove tax charge (credit) attributable to policyholders returns | | 40 | 94 | (17) |
| Tax charge attributable to shareholders' returns | K | (307) | (283) | (409) |
| **Profit for the period** | | 952 | 831 | 1,419 |
| Attributable to: | | | | |
| Equity holders of the Company | | 952 | 829 | 1,415 |
| Non-controlling interests | | – | 2 | 4 |
| **Profit for the period** | | 952 | 831 | 1,419 |
| **Earnings per share (in pence)** | | | | |
| Based on profit attributable to the equity holders of the Company: | L | | | |
| Basic | | 37.5p | 32.7p | 55.8p |
| Diluted | | 37.5p | 32.6p | 55.7p |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

† This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders. This is principally because taxes borne by UK with-profits and unit-linked policies through adjustments to benefits are paid on the policyholders' behalf by the Company. These amounts are required to be included in the tax charge of the Company under IAS 12. Consequently, the profit before all taxes measure (which is determined after deducting the cost of policyholder benefits and movements in the liability for unallocated surplus of the PAC with-profits fund after adjusting for taxes borne by policyholders) is not representative of pre-tax profits attributable to shareholders.

**Dividends per share (in pence)**

| | Note | 2012 Half year | 2011 Half year | 2011 Full year |
|---|---|---|---|---|
| Dividends relating to reporting period: | M | | | |
| Interim dividend (2012 and 2011) | | 8.40p | 7.95p | 7.95p |
| Final dividend (2011) | | – | – | 17.24p |
| Total | | 8.40p | 7.95p | 25.19p |
| Dividends declared and paid in reporting period: | M | | | |
| Current year interim dividend | | – | – | 7.95p |
| Final dividend for prior year | | 17.24p | 17.24p | 17.24p |
| Total | | 17.24p | 17.24p | 25.19p |

# Condensed consolidated statement of comprehensive income

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | Half year | Half year* | Full year* |
| **Profit for the period** | | 952 | 831 | 1,419 |
| **Other comprehensive income:** | | | | |
| Exchange movements on foreign operations and net investment hedges: | | | | |
| Exchange movements arising during the period | | (53) | (57) | (37) |
| Related tax | | (1) | (5) | (68) |
| | | (54) | (62) | (105) |
| Unrealised valuation movements on securities of US insurance operations classified as available-for-sale: | | | | |
| Unrealised holding gains arising during the period | | 470 | 287 | 912 |
| Add back net losses/deduct net (gains) included in the income statement on disposal and impairment | | 12 | (50) | (101) |
| Total | U | 482 | 237 | 811 |
| Related change in amortisation of deferred income and acquisition costs | Q | (181) | (71) | (275) |
| Related tax | | (105) | (57) | (187) |
| | | 196 | 109 | 349 |
| **Other comprehensive income for the period, net of related tax** | | 142 | 47 | 244 |
| **Total comprehensive income for the period** | | 1,094 | 878 | 1,663 |
| Attributable to: | | | | |
| Equity holders of the Company | | 1,094 | 876 | 1,659 |
| Non-controlling interests | | – | 2 | 4 |
| **Total comprehensive income for the period** | | 1,094 | 878 | 1,663 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

# Condensed consolidated statement of changes in equity

| | | Period ended 30 June 2012 £m | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Note | Share capital | Share premium | Retained earnings | Translation reserve | Available-for-sale securities reserve | Shareholders' equity | Non-controlling interests | Total equity |
| **Reserves** | | | | | | | | | |
| Total comprehensive income for the period | | – | – | 952 | (54) | 196 | 1,094 | – | 1,094 |
| Dividends | | – | – | (440) | – | – | (440) | – | (440) |
| Reserve movements in respect of share-based payments | | – | – | 52 | – | – | 52 | – | 52 |
| Change in non-controlling interests arising principally from purchase and sale of property partnerships of PAC with-profits fund and other consolidated investment funds | | – | – | – | – | – | – | (9) | (9) |
| **Share capital and share premium** | | | | | | | | | |
| New share capital subscribed | | – | 14 | – | – | – | 14 | – | 14 |
| **Treasury shares** | | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | | – | – | 5 | – | – | 5 | – | 5 |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | – | – | 3 | – | – | 3 | – | 3 |
| Net increase (decrease) in equity | | – | 14 | 572 | (54) | 196 | 728 | (9) | 719 |
| At beginning of period: | | | | | | | | | |
| As previously reported | | 127 | 1,873 | 5,839 | 354 | 924 | 9,117 | 43 | 9,160 |
| Effect of change in accounting policy for deferred acquisition costs | B | – | – | (595) | (72) | 114 | (553) | – | (553) |
| After effect of change | | 127 | 1,873 | 5,244 | 282 | 1,038 | 8,564 | 43 | 8,607 |
| **At end of period** | | 127 | 1,887 | 5,816 | 228 | 1,234 | 9,292 | 34 | 9,326 |

# Condensed consolidated statement of changes in equity
continued

| | Note | Share capital | Share premium | Retained earnings | Translation reserve | Available-for-sale securities reserve | Shareholders' equity | Non-controlling interests | Total equity |
|---|---|---|---|---|---|---|---|---|---|
| | | Period ended 30 June 2011* £m | | | | | | | |
| **Reserves** | | | | | | | | | |
| Total comprehensive income for the period | | – | – | 829 | (62) | 109 | 876 | 2 | 878 |
| Dividends | | – | – | (439) | – | – | (439) | – | (439) |
| Reserve movements in respect of share-based payments | | – | – | 25 | – | – | 25 | – | 25 |
| **Share capital and share premium** | | | | | | | | | |
| New share capital subscribed | | – | 15 | – | – | – | 15 | – | 15 |
| **Treasury shares** | | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | | – | – | (10) | – | – | (10) | – | (10) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | – | – | 2 | – | – | 2 | – | 2 |
| Net increase (decrease) in equity | | – | 15 | 407 | (62) | 109 | 469 | 2 | 471 |
| At beginning of period: | | | | | | | | | |
| As previously reported | | 127 | 1,856 | 4,982 | 454 | 612 | 8,031 | 44 | 8,075 |
| Effect of change in accounting policy for deferred acquisition costs | B | – | – | (520) | (67) | 77 | (510) | – | (510) |
| After effect of change | | 127 | 1,856 | 4,462 | 387 | 689 | 7,521 | 44 | 7,565 |
| **At end of period** | | 127 | 1,871 | 4,869 | 325 | 798 | 7,990 | 46 | 8,036 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

| | Note | Year ended 31 December 2011* £m | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Share capital | Share premium | Retained earnings | Trans-lation reserve | Available-for-sale securities reserve | Share-holders' equity | Non-controlling interests | Total equity |
| **Reserves** | | | | | | | | | |
| Total comprehensive income for the year | | – | – | 1,415 | (105) | 349 | 1,659 | 4 | 1,663 |
| Dividends | | – | – | (642) | – | – | (642) | – | (642) |
| Reserve movements in respect of share-based payments | | – | – | 44 | – | – | 44 | – | 44 |
| Change in non-controlling interests arising principally from purchase and sale of property partnerships of the PAC with-profits fund and other consolidated investment funds | | – | – | – | – | – | – | (5) | (5) |
| **Share capital and share premium** | | | | | | | | | |
| New share capital subscribed | | – | 17 | – | – | – | 17 | – | 17 |
| **Treasury shares** | | | | | | | | | |
| Movement in own shares in respect of share-based payment plans | | – | – | (30) | – | – | (30) | – | (30) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | – | – | (5) | – | – | (5) | – | (5) |
| Net increase (decrease) in equity | | – | 17 | 782 | (105) | 349 | 1,043 | (1) | 1,042 |
| At beginning of year: | | | | | | | | | |
| As previously reported | | 127 | 1,856 | 4,982 | 454 | 612 | 8,031 | 44 | 8,075 |
| Effect of change in accounting policy for deferred acquisition costs | B | – | – | (520) | (67) | 77 | (510) | – | (510) |
| After effect of change | | 127 | 1,856 | 4,462 | 387 | 689 | 7,521 | 44 | 7,565 |
| **At end of year** | | 127 | 1,873 | 5,244 | 282 | 1,038 | 8,564 | 43 | 8,607 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

# Condensed consolidated statement of financial position
## Assets

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | 30 Jun | 30 Jun* | 31 Dec* |
| Intangible assets attributable to shareholders: | | | | |
| Goodwill | P | 1,467 | 1,469 | 1,465 |
| Deferred acquisition costs and other intangible assets | Q | 4,333 | 4,060 | 4,234 |
| Total | | 5,800 | 5,529 | 5,699 |
| Intangible assets attributable to with-profits funds: | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | | 178 | 169 | 178 |
| Deferred acquisition costs and other intangible assets | | 84 | 93 | 89 |
| Total | | 262 | 262 | 267 |
| Total | | 6,062 | 5,791 | 5,966 |
| Other non-investment and non-cash assets: | | | | |
| Property, plant and equipment | | 798 | 705 | 748 |
| Reinsurers' share of insurance contract liabilities | | 1,703 | 1,334 | 1,647 |
| Deferred tax assets | K | 2,179 | 2,120 | 2,276 |
| Current tax recoverable | | 308 | 384 | 546 |
| Accrued investment income | | 2,713 | 2,460 | 2,710 |
| Other debtors | | 1,827 | 1,638 | 987 |
| Total | | 9,528 | 8,641 | 8,914 |
| Investments of long-term business and other operations: | | | | |
| Investment properties | | 10,822 | 10,965 | 10,757 |
| Investments accounted for using the equity method | | 112 | 71 | 70 |
| Financial investments†: | | | | |
| Loans | S | 9,981 | 9,017 | 9,714 |
| Equity securities and portfolio holdings in unit trusts | | 90,542 | 91,037 | 87,349 |
| Debt securities | T | 128,269 | 117,213 | 124,498 |
| Other investments | | 8,143 | 6,121 | 7,509 |
| Deposits | | 12,429 | 10,858 | 10,708 |
| Total | | 260,298 | 245,282 | 250,605 |
| Properties held for sale | | – | 394 | 3 |
| Cash and cash equivalents | | 6,737 | 8,589 | 7,257 |
| **Total assets** | N | 282,625 | 268,697 | 272,745 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

† Included within financial investments are £5,273 million, £8,744 million and £7,843 million of lent securities as at 30 June 2012, 30 June 2011 and 31 December 2011, respectively.

# Condensed consolidated statement of financial position
## Equity and liabilities

| | Note | 2012 £m 30 Jun | 2011 £m 30 Jun* | 2011 £m 31 Dec* |
|---|---|---|---|---|
| **Equity** | | | | |
| Shareholders' equity | | 9,292 | 7,990 | 8,564 |
| Non-controlling interests | | 34 | 46 | 43 |
| Total equity | | 9,326 | 8,036 | 8,607 |
| **Liabilities** | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) | Y | 236,419 | 221,432 | 227,075 |
| Unallocated surplus of with-profits funds | Y | 9,802 | 10,872 | 9,215 |
| Total | | 246,221 | 232,304 | 236,290 |
| Core structural borrowings of shareholder-financed operations: | | | | |
| Subordinated debt | | 2,638 | 3,044 | 2,652 |
| Other | | 958 | 954 | 959 |
| Total | V | 3,596 | 3,998 | 3,611 |
| Other borrowings: | | | | |
| Operational borrowings attributable to shareholder-financed operations | W | 2,804 | 2,912 | 3,340 |
| Borrowings attributable to with-profits operations | W | 955 | 1,440 | 972 |
| Other non-insurance liabilities: | | | | |
| Obligations under funding, securities lending and sale and repurchase agreements | | 2,563 | 4,537 | 3,114 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | | 3,778 | 3,203 | 3,840 |
| Deferred tax liabilities | K | 3,913 | 3,936 | 3,929 |
| Current tax liabilities | | 627 | 876 | 930 |
| Accruals and deferred income | | 641 | 585 | 736 |
| Other creditors | | 2,989 | 2,599 | 2,544 |
| Provisions | | 411 | 587 | 529 |
| Derivative liabilities | | 3,452 | 2,385 | 3,054 |
| Other liabilities | | 1,349 | 1,299 | 1,249 |
| Total | | 19,723 | 20,007 | 19,925 |
| Total liabilities | | 273,299 | 260,661 | 264,138 |
| **Total equity and liabilities** | N | 282,625 | 268,697 | 272,745 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

# Condensed consolidated statement of cash flows

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | Half year | Half year* | Full year* |
| **Cash flows from operating activities** | | | | |
| Profit before tax *(being tax attributable to shareholders' and policyholders' returns)*note (i) | | 1,299 | 1,208 | 1,811 |
| Non-cash movements in operating assets and liabilities reflected in profit before taxnote (ii) | | (939) | 875 | 162 |
| Other itemsnote (iii) | | (172) | 122 | (235) |
| Net cash flows from operating activities | | 188 | 2,205 | 1,738 |
| **Cash flows from investing activities** | | | | |
| Net cash flows from purchases and disposals of property, plant and equipment | | (108) | (42) | (114) |
| Acquisition of subsidiaries, net of cash balancenote (iv) | | – | (41) | (53) |
| Change to Group's holdings, net of cash balancenote (iv) | | 23 | – | – |
| Net cash flows from investing activities | | (85) | (83) | (167) |
| **Cash flows from financing activities** | | | | |
| Structural borrowings of the Group: | | | | |
| Shareholder-financed operations: | V | | | |
| Issue of subordinated debt, net of costs | | – | 340 | 340 |
| Redemption of subordinated debt | | – | – | (333) |
| Interest paid | | (139) | (137) | (286) |
| With-profits operations:note (vi) | W | | | |
| Interest paid | | (4) | (4) | (9) |
| Equity capital: | | | | |
| Issues of ordinary share capital | | 14 | 15 | 17 |
| Dividends paid | | (440) | (439) | (642) |
| Net cash flows from financing activities | | (569) | (225) | (913) |
| Net (decrease) increase in cash and cash equivalents | | (466) | 1,897 | 658 |
| Cash and cash equivalents at beginning of period | | 7,257 | 6,631 | 6,631 |
| Effect of exchange rate changes on cash and cash equivalents | | (54) | 61 | (32) |
| Cash and cash equivalents at end of period | | 6,737 | 8,589 | 7,257 |

* The Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the 2011 comparative results and related notes have been adjusted from those previously published for the retrospective application of the improvement as if the new accounting policy had always applied, as described in note B.

Notes

(i) This measure is the formal profit before tax measure under IFRS but it is not the result attributable to shareholders.

(ii) The adjusting items to profit before tax included within non-cash movements in operating assets and liabilities reflected in profit before tax are as follows:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| Other non-investment and non-cash assets | (1,261) | (869) | (999) |
| Investments | (9,341) | (6,984) | (8,854) |
| Policyholder liabilities (including unallocated surplus) | 10,782 | 8,530 | 10,874 |
| Other liabilities (including operational borrowings) | (1,119) | 198 | (859) |
| Non-cash movements in operating assets and liabilities reflected in profit before tax | (939) | 875 | 162 |

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

(iv) There were no acquisitions for half year 2012. The acquisition of subsidiaries in half year and full year 2011 related to the outflows from the PAC with-profits fund's purchases of venture investments. The change to Group's holding for half year 2012 relates to the dilution of the Group's holding in PPM South Africa during the period from 75 per cent to 47 per cent. As a result of the dilution, PPM South Africa was deconsolidated as a subsidiary and treated as an associate. See note G for additional details.

(v) Structural borrowings of shareholder-financed operations comprise core debt of the parent company, PruCap bank loan 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.

(vi) Structural borrowings of with-profits operations relate solely to the £100 million 8.5 per cent undated subordinated guaranteed bonds which contribute to the solvency base of the Scottish Amicable Insurance Fund (SAIF), a ring-fenced sub-fund of the PAC with-profits fund. Cash flows in respect of other borrowings of with-profits funds, which principally relate to consolidated investment funds, are included within cash flows from operating activities.

# Notes on the IFRS basis results

## A: Basis of preparation and audit status

These condensed consolidated interim financial statements for the six months ended 30 June 2012 have been prepared in accordance with IAS 34, 'Interim Financial Reporting' as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). The Group's policy for preparing this interim financial information is to use the accounting policies adopted by the Group in its last consolidated financial statements, as updated by any changes in accounting policies it intends to make in its next consolidated financial statements as a result of new or amended IFRSs that are applicable or available for early adoption for the next annual financial statements and other policy improvements. EU-endorsed IFRSs may differ from IFRSs issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 30 June 2012, there were no unendorsed standards effective for the period ended 30 June 2012 affecting the condensed consolidated financial statements of the Group, and there were no differences between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the Group.

The IFRS basis results for the 2012 and 2011 half years are unaudited. Except for the effect of the adoption of altered US GAAP reporting requirements for Group IFRS reporting as explained in note B, the 2011 full year IFRS basis results have been derived from the 2011 statutory accounts. The auditors have reported on the 2011 statutory accounts which have been delivered to the Registrar of Companies. The auditors' report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

The accounting policies applied by the Group in determining the IFRS basis results in this report are the same as those previously applied in the Group's consolidated financial statements for the year ended 31 December 2011, except for the adoption of altered US GAAP reporting requirements for Group IFRS report as described below.

## B: Adoption of altered US GAAP reporting requirements for Group IFRS reporting in 2012

### Background

In October 2010, the Emerging Issues Trust Force of the US Financial Accounting Standards Board issued update No 2010-26 on 'Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts' (the 'Update'). The Update was issued to address perceived diversity by companies preparing financial statements in accordance with US GAAP as regards the types of acquisition costs being deferred. Under US GAAP, costs that can be deferred and amortised are those that 'vary with and are primarily related to the acquisition of insurance contracts'. The Update requires insurers to capitalise only those incremental costs directly relating to acquiring a contract for financial statements for reporting periods beginning after 15 December 2011. All other indirect acquisition expenses are required to be charged to the income statements as incurred expenses. Accordingly, the main impact of the Update is to disallow insurers from deferring costs that are not directly related to successful sales.

The Group's IFRS accounting policies include that under IFRS 4, 'Insurance Contracts', insurance assets and liabilities other than those for UK regulated with-profits funds, are measured using the GAAP basis applied prior to IFRS adoption in 2005. On this basis insurance assets and liabilities are measured under the UK Modified Statutory Basis (MSB) which was codified by the Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers (ABI) in 2003. The MSB requires the deferral of acquisition costs and, in the first instance, the use of a gross premium valuation basis of liability measurement unless a net premium valuation basis is required by the regulator. However, the SORP also permits the use of local GAAP subject to the requirement for adjustments to be made to ensure sufficient consistency of measurement under the UK GAAP framework under which the SORP was developed.

In applying this overarching basis, the Group has chosen to apply US GAAP for measuring the insurance assets and liabilities of Jackson. In addition, for the Group's operations in India, Japan, Taiwan and Vietnam, where the local GAAP basis would not be appropriate as the start point for deriving MSB insurance asset and liabilities, the measurement has been determined substantially by reference to US GAAP requirements.

For half year 2012, the Group has the option to either continue with its current basis of measurement or improve its accounting policy under IFRS 4 to acknowledge the issuance of the Update. Prudential has chosen to improve its accounting policy in 2012 to apply the US GAAP update, on a retrospective basis, to the results of Jackson and the four Asia operations.

The half year and full year 2011 comparatives in these condensed consolidated interim financial statements have been adjusted accordingly for the retrospective application of this Update.

## Effect of change in accounting policy

(a) The effect of the change in accounting policy for deferred acquisition costs (DAC) on the income statement, earnings per share, comprehensive income, changes in equity and statement of financial position is shown in the tables below.

### Condensed consolidated income statement

| | Half year 2012 £m | | | Half year 2011 £m | | | Full year 2011 £m | | |
|---|---|---|---|---|---|---|---|---|---|
| | Under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy |
| Total revenue, net of reinsurance | 23,881 | – | 23,881 | 21,603 | – | 21,603 | 36,506 | – | 36,506 |
| Acquisition costs and other expenditure | (2,520) | (72) | (2,592) | (2,615) | (50) | (2,665) | (5,005) | (115) | (5,120) |
| Total other charges, net of reinsurance | (19,990) | – | (19,990) | (17,730) | – | (17,730) | (29,575) | – | (29,575) |
| Profit before tax *(being tax attributable to shareholders' and policyholders' returns)* | 1,371 | (72) | 1,299 | 1,258 | (50) | 1,208 | 1,926 | (115) | 1,811 |
| (Less) Add tax (charge) credit attributable to policyholders' returns | (40) | – | (40) | (94) | – | (94) | 17 | – | 17 |
| Profit before tax attributable to shareholders | 1,331 | (72) | 1,259 | 1,164 | (50) | 1,114 | 1,943 | (115) | 1,828 |
| Total tax charge attributable to policyholders and shareholders | (371) | 24 | (347) | (395) | 18 | (377) | (432) | 40 | (392) |
| Adjustment to remove tax charge (credit) attributable to policyholders' returns | 40 | – | 40 | 94 | – | 94 | (17) | – | (17) |
| Tax charge attributable to shareholders' returns | (331) | 24 | (307) | (301) | 18 | (283) | (449) | 40 | (409) |
| **Profit for the period** | 1,000 | (48) | 952 | 863 | (32) | 831 | 1,494 | (75) | 1,419 |
| Profit for the period attributable to equity holders of the Company | 1,000 | (48) | 952 | 861 | (32) | 829 | 1,490 | (75) | 1,415 |
| **Earnings per share (in pence)** | | | | | | | | | |
| Based on profit attributable to the equity holders of the Company: | | | | | | | | | |
| Basic | 39.4p | (1.9)p | 37.5p | 34.0p | (1.3)p | 32.7p | 58.8p | (3.0)p | 55.8p |
| Diluted | 39.4p | (1.9)p | 37.5p | 33.9p | (1.3)p | 32.6p | 58.7p | (3.0)p | 55.7p |

# Notes on the IFRS basis results continued

## B: Adoption of altered US GAAP reporting requirements for Group IFRS reporting in 2012 continued

### Condensed consolidated statement of comprehensive income and statement of changes in equity

| | Half year 2012 £m | | | Half year 2011 £m | | | Full year 2011 £m | | |
|---|---|---|---|---|---|---|---|---|---|
| | Under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy |
| Profit for the period | 1,000 | (48) | 952 | 863 | (32) | 831 | 1,494 | (75) | 1,419 |
| Exchange movements on foreign operations and net investment hedges, net of related tax | (56) | 2 | (54) | (75) | 13 | (62) | (100) | (5) | (105) |
| Unrealised valuation movements on securities of US insurance operations classified as available-for-sale | 482 | – | 482 | 237 | – | 237 | 811 | – | 811 |
| Related change in amortisation of deferred income and acquisition costs | (211) | 30 | (181) | (97) | 26 | (71) | (331) | 56 | (275) |
| Related tax | (94) | (11) | (105) | (49) | (8) | (57) | (168) | (19) | (187) |
| Total | 177 | 19 | 196 | 91 | 18 | 109 | 312 | 37 | 349 |
| Total comprehensive income for the period | 1,121 | (27) | 1,094 | 879 | (1) | 878 | 1,706 | (43) | 1,663 |
| Total comprehensive income for the period attributable to equity holders of the Company | 1,121 | (27) | 1,094 | 877 | (1) | 876 | 1,702 | (43) | 1,659 |
| Net increase in shareholders' equity | 755 | (27) | 728 | 470 | (1) | 469 | 1,086 | (43) | 1,043 |
| At beginning of period | 9,117 | (553) | 8,564 | 8,031 | (510) | 7,521 | 8,031 | (510) | 7,521 |
| **At end of period** | 9,872 | (580) | 9,292 | 8,501 | (511) | 7,990 | 9,117 | (553) | 8,564 |

### Condensed Consolidated Statement of Financial Position

| | 30 Jun 2012 £m | | | 30 Jun 2011 £m | | | 31 Dec 2011 £m | | |
|---|---|---|---|---|---|---|---|---|---|
| | Under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy |
| **Assets** | | | | | | | | | |
| Deferred acquisition costs and other intangible assets attributable to shareholders | 5,207 | (874) | 4,333 | 4,829 | (769) | 4,060 | 5,069 | (835) | 4,234 |
| Total other assets | 278,292 | – | 278,292 | 264,637 | – | 264,637 | 268,511 | – | 268,511 |
| Total assets | 283,499 | (874) | 282,625 | 269,466 | (769) | 268,697 | 273,580 | (835) | 272,745 |
| **Liabilities** | | | | | | | | | |
| Deferred tax liabilities | 4,207 | (294) | 3,913 | 4,194 | (258) | 3,936 | 4,211 | (282) | 3,929 |
| Total other liabilities | 269,386 | – | 269,386 | 256,725 | – | 256,725 | 260,209 | – | 260,209 |
| Total liabilities | 273,593 | (294) | 273,299 | 260,919 | (258) | 260,661 | 264,420 | (282) | 264,138 |
| **Equity** | | | | | | | | | |
| Shareholders' equity | 9,872 | (580) | 9,292 | 8,501 | (511) | 7,990 | 9,117 | (553) | 8,564 |
| Non-controlling interests | 34 | – | 34 | 46 | – | 46 | 43 | – | 43 |
| Total equity | 9,906 | (580) | 9,326 | 8,547 | (511) | 8,036 | 9,160 | (553) | 8,607 |

(b) The effect of the change in accounting policy for deferred acquisition costs on the Group's supplementary analysis of profit is shown in the table below.

**Segment disclosure – income statement**

| | Half year 2012 £m | | | Half year 2011 £m | | | Full year 2011 £m | | |
|---|---|---|---|---|---|---|---|---|---|
| | Under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy | As reported under previous basis | Effect of change | Under new policy |
| **Operating profit based on longer-term investment returns** | | | | | | | | | |
| Asia insurance operations note (i) | 411 | (5) | 406 | 324 | (2) | 322 | 704 | – | 704 |
| US insurance operations note (ii) | 491 | (49) | 442 | 368 | (28) | 340 | 694 | (43) | 651 |
| Other operations | 314 | – | 314 | 366 | – | 366 | 672 | – | 672 |
| Total | 1,216 | (54) | 1,162 | 1,058 | (30) | 1,028 | 2,070 | (43) | 2,027 |
| Short-term fluctuations in investment returns on shareholder-backed business | (14) | (18) | (32) | 113 | (20) | 93 | (148) | (72) | (220) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 87 | – | 87 | (7) | – | (7) | 21 | – | 21 |
| Gain on dilution of Group holdings | 42 | – | 42 | – | – | – | – | – | – |
| **Profit before tax attributable to shareholders** | 1,331 | (72) | 1,259 | 1,164 | (50) | 1,114 | 1,943 | (115) | 1,828 |
| Basic EPS based on operating profit based on longer-term investment returns after tax and non-controlling interests | 36.0p | (1.5)p | 34.5p | 32.2p | (0.8)p | 31.4p | 63.9p | (1.1)p | 62.8p |
| Basic EPS based on total profit after tax and non-controlling interests | 39.4p | (1.9)p | 37.5p | 34.0p | (1.3)p | 32.7p | 58.8p | (3.0)p | 55.8p |

**Notes on the effect of the change in the accounting policy on operating profit based on longer-term investment returns**

(i) Asia insurance operations

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| | Effect of change | Effect of change | Effect of change |
| New business | | | |
| Acquisition costs on new contracts not able to be deferred | (5) | (10) | (16) |
| Business in force at beginning of period | | | |
| Reduction in amortisation on reduced DAC balance | – | 8 | 16 |
| Total | (5) | (2) | – |

(ii) US insurance operations

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| | Effect of change | Effect of change | Effect of change |
| New business | | | |
| Acquisition costs on new contracts not able to be deferred | (82) | (80) | (156) |
| Business in force at beginning of period | | | |
| Reduction in amortisation on reduced DAC balance | 33 | 52 | 113 |
| Total | (49) | (28) | (43) |

# Notes on the IFRS basis results continued

## C: Segment disclosure – income statement

| | Note | 2012 £m Half year | 2011 £m Half year* | 2011 £m Full year* |
|---|---|---|---|---|
| **Asia operations** | | | | |
| Insurance operations | E(i) | 409 | 324 | 709 |
| Development expenses | | (3) | (2) | (5) |
| Total Asia insurance operations after development expenses | | 406 | 322 | 704 |
| Eastspring Investments | | 34 | 43 | 80 |
| Total Asia operations | | 440 | 365 | 784 |
| **US operations** | | | | |
| Jackson (US insurance operations) | E(ii) | 442 | 340 | 651 |
| Broker-dealer and asset management | | 17 | 17 | 24 |
| Total US operations | | 459 | 357 | 675 |
| **UK operations** | | | | |
| UK insurance operations: | | | | |
| Long-term business | E(iii) | 336 | 332 | 683 |
| General insurance commission[note (i)] | | 17 | 21 | 40 |
| Total UK insurance operations | | 353 | 353 | 723 |
| M&G | | 199 | 199 | 357 |
| Total UK operations | | 552 | 552 | 1,080 |
| **Total segment profit** | | 1,451 | 1,274 | 2,539 |
| **Other income and expenditure** | | | | |
| Investment return and other income | | 5 | 5 | 22 |
| Interest payable on core structural borrowings | | (140) | (140) | (286) |
| Corporate expenditure | H | (120) | (118) | (219) |
| Total | | (255) | (253) | (483) |
| RPI to CPI inflation measure change on defined benefit pension schemes[note (ii)] | | – | 42 | 42 |
| Solvency II implementation costs | | (27) | (27) | (55) |
| Restructuring costs[note (iii)] | | (7) | (8) | (16) |
| Operating profit based on longer-term investment returns | | 1,162 | 1,028 | 2,027 |
| Short-term fluctuations in investment returns on shareholder-backed business | F | (32) | 93 | (220) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes[note (iv)] | | 87 | (7) | 21 |
| Gain on dilution of Group holdings | G | 42 | – | – |
| **Profit before tax attributable to shareholders** | | 1,259 | 1,114 | 1,828 |

| | Note | 2012 Half year | 2011 Half year* | 2011 Full year* |
|---|---|---|---|---|
| Basic EPS based on operating profit based on longer-term investment returns after tax and non-controlling interests | L | 34.5p | 31.4p | 62.8p |
| Basic EPS based on total profit after tax and non-controlling interests | L | 37.5p | 32.7p | 55.8p |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

Notes
(i) UK operations transferred its general insurance business to Churchill Insurance in 2002. General insurance commission represents the net commission receivable net of expenses for Prudential-branded general insurance products as part of this arrangement.
(ii) During the first half of 2011 the Group altered its inflation measure basis for future statutory increases to pension payments for certain tranches of its UK defined benefit pension schemes. This reflected the UK government's decision to replace the basis of indexation from Retail Price Index (RPI) with Consumer Price Index (CPI). This resulted in a credit to the operating profit before tax in half year and full year 2011 of £42 million.
(iii) Restructuring costs are incurred in the UK and represent one-off expenses incurred in securing expense savings.
(iv) For the 2011 comparatives, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes comprises the aggregate effect of actual less expected returns on scheme assets, experience gains and losses, the effect of changes in assumptions and altered provisions for deficit funding, where relevant. For half year 2012, these items also apply. However, the shareholders' share of actuarial and other gains and losses on defined benefit pension schemes also includes £51 million for the effect of partial recognition of surplus of the main Prudential Staff Pension Scheme (PSPS). This credit arises from altered funding arrangement following the 5 April 2011 triennial valuation. Additional details are provided in note X.

## Determining operating segments and performance measure of operating segments

The Group's operating segments determined in accordance with IFRS 8, 'Operating Segments', are as follows:

Insurance operations
- Asia
- US (Jackson)
- UK

Asset management operations
- M&G (including Prudential Capital)
- Eastspring Investments
- US broker-dealer and asset management (including Curian)

The Group's operating segments are also its reportable segments with the exception of Prudential Capital which has been incorporated into the M&G operating segment for the purposes of segment reporting.

The performance measure of operating segments utilised by the Company 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 half year 2012, this measure excluded a gain arising upon the dilution of the Group's holding in PPM South Africa. Operating earnings per share is calculated on operating profit based on longer-term investment returns, after tax and non-controlling interests.

Segment results that are reported to the Group Executive Committee 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 the Asia Regional Head Office.

Except in the case of the assets backing the UK annuity business, unit-linked and US variable annuity separate account liabilities, operating profit based on longer-term investment returns for shareholder-financed business is determined on the basis of expected longer-term investment returns. In the case of assets backing the UK annuity business, unit-linked and US variable annuity separate account liabilities, the basis of determining operating profit based on longer-term investment returns is as follows:

- Assets backing UK annuity business liabilities. 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. Variations between actual and best estimate expected impairments are recorded as a component of short-term fluctuations in investment returns.
- Assets backing unit-linked and US variable annuity business separate account liabilities. For such business, the policyholder unit liabilities are directly reflective of the asset value movements. Accordingly, the operating results based on longer-term investment returns reflect the current period value movements in unit liabilities and the backing assets.

In the case of other shareholder-financed business, the measurement of operating profit based on longer-term investment returns 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 of life businesses exclusive of the effects of short-term fluctuations in market conditions. In determining the profit on this basis, the following key elements are applied to the results of the Group's shareholder-financed operations.

# Notes on the IFRS basis results
continued

## C: Segment disclosure – income statement continued

### (a) Debt and equity-type securities

Longer-term investment returns for both debt and equity-type securities comprise longer-term actual income receivable (interest/dividend income) for the period and longer-term capital returns.

In principle, for debt securities, the longer-term capital returns comprise two elements. The first element is a risk margin reserve (RMR) based charge for the expected level of defaults for the period, which is determined by reference to the credit quality of the portfolio. The difference between impairment losses in the reporting period and the RMR charge to the operating result is reflected in short-term fluctuations in investment returns. The second element is for the 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 distinction between impairment losses and interest-related realised gains and losses is in practice relevant to a significant extent is Jackson. Jackson has used the ratings by Nationally Recognised Statistical Ratings Organisations (NRSRO) or ratings resulting from the regulatory ratings detail issued by the National Association of Insurance Commissioners (NAIC) developed by external third parties such as PIMCO or BlackRock Solutions to determine the average annual RMR. Further details of the RMR charge, as well as the amortisation of interest-related realised gains and losses, for Jackson are shown in note F(iii).

For debt securities backing non-linked shareholder-financed business of the UK insurance operations (other than the annuity business) and of the Asia insurance operations, the realised gains and losses are principally interest related. Accordingly, all realised gains and losses to date for these operations are being amortised over the period to the date those securities would otherwise have matured, with no explicit RMR charge.

At 30 June 2012, the level of unamortised interest-related realised gains and losses related to previously sold bonds for the Group was a net gain of £443 million (30 June 2011: £390 million; 31 December 2011: £462 million).

For equity-type securities, the longer-term rates of return are estimates of the long-term trend investment return for income and capital having regard to past performance, current trends and future expectations. Equity-type securities held for shareholder-financed operations other than the UK annuity business, unit-linked and US variable annuity are of significance for the US and Asia insurance operations. Different rates apply to different categories of equity-type securities.

As at 30 June 2012, the equity-type securities for US insurance non-separate account operations amounted to £1,017 million (30 June 2011: £862 million; 31 December 2011: £902 million). For these operations, the longer-term rates of return for income and capital applied in half year 2012 are as follows:

| | 2012 | 2011 | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Equity-type securities such as common and preferred stock and portfolio holdings in mutual funds | 5.6% to 6.2% | 7.1% to 7.5% | 5.9% to 7.5% |
| Other equity-type securities such as investments in limited partnerships and private equity funds | 7.6% to 8.2% | 9.1% to 9.5% | 7.9% to 9.5% |

For Asia insurance operations, investments in equity securities held for non-linked shareholder-financed operations amounted to £741 million as at 30 June 2012 (30 June 2011: £449 million; 31 December 2011: £590 million). Of this balance, £106 million (30 June 2011: £122 million; 31 December 2011: £88 million) related to the Group's 7.74 per cent (30 June 2011: 8.66 per cent; 31 December 2011: 7.37 per cent) stake in China Life Insurance Company of Taiwan. This £106 million (30 June 2011: £122 million; 31 December 2011: £88 million) investment is in the nature of a trade investment for which the determination of longer-term investment returns is on the basis as described in note (e) below. For the investments representing the other equity securities which had period end balances of £635 million (30 June 2011: £327 million; 31 December 2011: £502 million), the rates of return applied in half year 2012 and 2011 ranged from 1.0 per cent to 13.8 per cent, with the rates applied varying by territory.

The longer-term rates of return discussed above for equity-type securities are determined after consideration by the Group's in-house economists of long-term expected real government bond returns, equity risk premium and long-term inflation. These rates are broadly stable from period to period but may be different between countries, reflecting, for example, differing expectations of inflation in each territory. The assumptions are for returns expected to apply in equilibrium conditions. The assumed rates of return do not reflect any cyclical variability in economic performance and are not set by reference to prevailing asset valuations.

**(b) US variable and fixed index annuity business**

The following value movements for Jackson's variable and fixed index annuity business are excluded from operating profit based on longer-term investment returns:

- Fair value movements for equity-based derivatives;
- Fair value movements for embedded derivatives for Guaranteed Minimum Withdrawal Benefit (GMWB) 'not for life' and fixed index annuity business, and Guaranteed Minimum Income Benefit (GMIB) reinsurance (see note);
- Movements in accounts carrying value of Guaranteed Minimum Death Benefit (GMDB) and GMWB 'for life' liabilities, for which, under the 'grandfathered' US GAAP applied under IFRS for Jackson's insurance assets and liabilities, the measurement basis gives rise to a muted impact of current period market movements;
- Fee assessments and claim payments, in respect of guarantee liabilities; and
- Related changes to amortisation of deferred acquisition costs for each of the above items.

***Note: US operations – embedded derivatives for variable annuity guarantee features***

The GMIB liability, which is fully reinsured, subject to a deductible and annual claim limits, is accounted for in accordance with FASB ASC Subtopic 944-80 Financial Services – Insurance – Separate Accounts (formerly SOP 03-1) under IFRS using 'grandfathered' US GAAP. As the corresponding reinsurance asset is net settled, it is considered to be a derivative under IAS 39, 'Financial Instruments: Recognition and Measurement', and the asset is therefore recognised at fair value. As the GMIB benefit is economically reinsured the mark to market element of the reinsurance asset is included as a component of short-term fluctuations in investment returns.

**(c) Other derivative value movements**

Generally, derivative value movements are excluded from operating results based on longer-term investment returns (unless those derivative value movements broadly offset changes in the accounting value of other assets and liabilities included in operating profit). The principal example of non-equity based derivatives (for example interest rate swaps and swaptions) whose value movements are excluded from operating profit arises in Jackson. Non-equity based 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 the income statement), product liabilities (for which US GAAP accounting as 'grandfathered' under IFRS 4 does not fully reflect the economic features being hedged), and the interest rate exposure attaching to equity-based embedded derivatives.

**(d) Other 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 is broadly equivalent in the income statement, and operating profit based on longer-term investments returns is not distorted. In these circumstances, there is no need for the movement in the liability to be bifurcated between the elements that relate 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 (ie after allocated investment return and change for policyholder benefits) the operating result reflects longer-term market returns.

Examples where such bifurcation is necessary are:

***(i) Asia***

Vietnam 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 policyholders' 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 supplementary analysis of profit before tax attributable to policyholders.

# Notes on the IFRS basis results
continued

## C: Segment disclosure – income statement continued

### Non-participating business
Bifurcation for the effect of determining the movement in the carrying value of liabilities to be 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 FASB ASC subtopic 944-80, Financial Services – Insurance – Separate Accounts (formerly SOP 03-1), 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.

***(ii) UK shareholder-backed annuity business***
The operating result based on longer-term investment returns reflects the impact of value movements on policyholder liabilities for annuity business in PRIL and the PAC non-profit sub-fund after adjustments to allocate the following elements of the movement to the category of 'short-term fluctuations in investment returns' in the Group's supplementary analysis of profit:

(i) The impact on credit risk provisioning of actual upgrades and downgrades during the period; and
(ii) Credit experience compared to assumptions.

Credit experience reflects the impact of defaults and other similar experience, such as asset exchanges arising from debt restructuring by issuers that include effectively an element of permanent impairment of the security held. Negative experience compared to assumptions is included within short-term fluctuations in investment returns without further adjustment. This is to be contrasted with positive experience where surpluses are retained in short-term allowances for credit risk for IFRS reporting purposes.

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 due to portfolio rebalancing to align more closely with management benchmark.

### (e) 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 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 economic substance of the arrangements.

### Additional segmental analysis of revenue
The additional segmental analyses of revenue from external customers excluding investment return and net of outward reinsurance premiums are as follows:

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Intra-group | Total |
| Revenue from external customers: | | | | | |
| Insurance operations | 3,871 | 7,063 | 3,374 | – | 14,308 |
| Asset management | 136 | 357 | 462 | (154) | 801 |
| Unallocated corporate | – | – | 10 | – | 10 |
| Intra-group revenue eliminated on consolidation | (42) | (36) | (76) | 154 | – |
| Total | 3,965 | 7,384 | 3,770 | – | 15,119 |

| | Half year 2011 £m | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Intra-group | Total |
| Revenue from external customers: | | | | | |
| Insurance operations | 3,568 | 6,664 | 2,872 | (10) | 13,094 |
| Asset management | 129 | 332 | 448 | (152) | 757 |
| Unallocated corporate | – | – | 2 | – | 2 |
| Intra-group revenue eliminated on consolidation | (41) | (35) | (86) | 162 | – |
| Total | 3,656 | 6,961 | 3,236 | – | 13,853 |

| | Full year 2011 £m | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Intra-group | Total |
| Revenue from external customers: | | | | | |
| Insurance operations | 7,307 | 12,516 | 5,740 | – | 25,563 |
| Asset management | 290 | 653 | 923 | (323) | 1,543 |
| Unallocated corporate | – | – | 40 | – | 40 |
| Intra-group revenue eliminated on consolidation | (93) | (68) | (162) | 323 | – |
| Total | 7,504 | 13,101 | 6,541 | – | 27,146 |

Total Group revenue by type from external customers comprises:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Earned premiums, net of reinsurance | 14,111 | 12,930 | 25,277 |
| Fee income from investment contract business and asset management (presented as 'Other income') | 1,008 | 923 | 1,869 |
| Total revenue from external customers | 15,119 | 13,853 | 27,146 |

In their capacity as fund managers to fellow Prudential Group subsidiaries, M&G, Eastspring Investments and the US asset management businesses generate fees for investment management and related services. These services are charged at appropriate arm's length prices, typically priced as a percentage of funds under management. Intra-group fees included within asset management revenue were earned by the following asset management segment:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Intra-group revenue generated by: | | | |
| M&G | 76 | 76 | 162 |
| Eastspring Investments | 42 | 41 | 93 |
| US broker-dealer and asset management (including Curian) | 36 | 35 | 68 |
| Total intra-group fees included within asset management segment | 154 | 152 | 323 |

At half year 2011, a further £10 million of intra-group revenue was recorded between UK insurance operations.

Revenue from external customers of Asia, US and UK insurance operations shown above are net of outwards reinsurance premiums of £85 million, £38 million and £67 million respectively (half year 2011: £79 million, £37 million and £62 million respectively; full year 2011: £226 million, £72 million and £131 million respectively).

# Notes on the IFRS basis results
continued

## D: Profit before tax – asset management operations

The profit included in the income statement in respect of asset management operations is as follows:

| | 2012 £m | | | | 2011 £m | |
|---|---|---|---|---|---|---|
| | M&G | US | Eastspring Investments note (iv) | Half year Total | Half year Total | Full year Total |
| Revenue (excluding revenue of consolidated investment funds and NPH broker-dealer fees) | 607 | 142 | 138 | 887 | 802 | 1,583 |
| Revenue of consolidated investment funds note (i) | (24) | – | – | (24) | 18 | 9 |
| NPH broker-dealer fees note (i) | – | 215 | – | 215 | 207 | 405 |
| Gross revenue* | 583 | 357 | 138 | 1,078 | 1,027 | 1,997 |
| Charges (excluding charges of consolidated investment funds and NPH broker-dealer fees) | (298) | (125) | (104) | (527) | (534) | (1,147) |
| Charges of consolidated investment funds note (i) | 24 | – | – | 24 | (18) | (9) |
| NPH broker-dealer fees note (i) | – | (215) | – | (215) | (207) | (405) |
| Gross charges | (274) | (340) | (104) | (718) | (759) | (1,561) |
| **Profit before tax** | 309 | 17 | 34 | 360 | 268 | 436 |
| Comprising: | | | | | | |
| Operating profit based on longer-term investment returns note (ii) | 199 | 17 | 34 | 250 | 259 | 461 |
| Short-term fluctuations in investment returns note (iii) | 41 | – | – | 41 | 13 | (29) |
| Shareholder's share of actuarial gains and losses on defined benefit pension schemes | 27 | – | – | 27 | (4) | 4 |
| Gain on dilution of Group holdings note G | 42 | – | – | 42 | – | – |
| **Profit before tax** | 309 | 17 | 34 | 360 | 268 | 436 |

* For half year 2012 gross revenue includes the Group's share of results from the associate PPM South Africa. In prior years, PPM South Africa was treated as a subsidiary and accounted for accordingly.

Notes

(i) Under IFRS, disclosure details of segment revenue are required. The segment revenue of the Group's asset management operations are required to include two items that are for amounts which, reflecting their commercial nature, are also wholly reflected as charges within the income statement. After allowing for these charges, there is no effect on profit from these two items which are:

(a) Investment funds managed on behalf of third parties and are consolidated under IFRS in recognition of the control arrangements for the funds. The gains and losses of these funds are non-recourse to M&G and the Group; and

(b) NPH broker-dealer fees which represent commissions received, which are then paid on to the writing brokers on sales of investment products.

The presentation in the table above shows the amounts attributable to these two items so that the underlying revenue and charges can be seen.

(ii) M&G operating profit based on longer-term investment returns:

| | **2012 Half year £m** | **2011† Half year £m** | **2011† Full year £m** |
|---|---|---|---|
| Asset management fee income | 351 | 329 | 662 |
| Other income | 3 | 1 | 4 |
| Staff costs | (120) | (125) | (270) |
| Other costs | (66) | (58) | (134) |
| Underlying profit before performance-related fees | 168 | 147 | 262 |
| Share of associate results | 6 | 13 | 26 |
| Performance-related fees | 1 | 12 | 13 |
| Operating profit from asset management operations | 175 | 172 | 301 |
| Operating profit from Prudential Capital | 24 | 27 | 56 |
| Total M&G operating profit based on longer-term investment returns | 199 | 199 | 357 |

† Following the divestment in the first half of 2012 of M&G's holding in PPM South Africa from 75 per cent to 47 per cent and its treatment from 2012 as an associate, M&G's operating income and expense no longer include any element from PPM South Africa, with the share of associate's results being presented in a separate line. The table above reflects the retrospective application of this basis of presentation for half year 2011 and full year 2011 results. Total profit remains the same.

The difference between the fees and other income shown above in respect of asset management operations, and the revenue figure for M&G shown (excluding consolidated investment funds) in the main table primarily relates to total revenue of Prudential Capital (including short-term fluctuations) of £99 million (half year 2011: £71 million; full year 2011: £96 million) and commissions which have been netted off in arriving at the fee income of £351 million (half year 2011: £329 million; full year 2011: £662 million) in the table above. The difference in the presentation of commission is aligned with how management reviews the business.

(iii) Short-term fluctuations in investment returns for M&G are primarily in respect of unrealised value movements on Prudential Capital's bond portfolio.

(iv) Included within Eastspring Investments revenue and charges are £41 million of commissions (half year 2011: £30 million; full year 2011: £44 million).

# Notes on the IFRS basis results
continued

## E: Key assumptions, estimates and bases used to measure insurance assets and liabilities

### i Asia insurance operations
In half year 2012, IFRS operating profit based on longer-term investment returns for Asia insurance operations included a net £17 million credit arising from a small number of items that are not anticipated to reoccur in future periods (half year 2011: £25 million; full year 2011: £38 million).

### ii US insurance operations
**Amortisation of deferred acquisition costs**
Under the Group's basis of applying IFRS 4, the insurance assets and liabilities of Jackson's traditional life business are accounted for under US GAAP. In line with industry practice, Jackson applies the mean reversion technique method for amortisation of deferred acquisition costs which dampens the effects of short-term market movements on expected gross profits against which deferred acquisition costs are amortised. To the extent that the mean reversion methodology does not fully dampen the effects of market returns there is a charge or credit for accelerated or decelerated amortisation. For half year 2012, reflecting the positive market returns in the period, there was a credit for decelerated amortisation of £25 million (half year 2011: charge for accelerated amortisation of £66 million; full year 2011: charge for accelerated amortisation of £190 million, as explained in note Q).

### iii UK insurance operations
**Annuity business: allowance for credit risk**
For IFRS reporting, the results for UK shareholder-backed annuity business are particularly sensitive to the allowances made for credit risk. The allowance is reflected in the deduction from the valuation rate of interest 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:

(a) the expected level of future defaults;
(b) the credit risk premium that is required to compensate for the potential volatility in default levels;
(c) the liquidity premium that is required to compensate for the lower liquidity of corporate bonds relative to swaps; and
(d) the mark to market risk premium that is required to compensate for the potential volatility in corporate bond spreads (and hence market values) at the time of sale.

The sum of (c) and (d) is often referred to as 'liquidity premium'.

The allowance for credit risk comprises (i) an amount for long-term best estimate defaults and (ii) additional provisions for credit risk premium, downgrade resilience and short-term defaults.

The weighted components of the bond spread over swap rates for shareholder-backed fixed and linked annuity business for PRIL at 30 June 2012, 30 June 2011 and 31 December 2011, based on the asset mix at the relevant balance sheet date are shown below.

| | 30 June 2012 bps | | |
|---|---|---|---|
| | Pillar 1 regulatory basis | Adjustment from regulatory to IFRS basis | IFRS |
| Bond spread over swap rates note (i) | 191 | – | 191 |
| Credit risk allowance: | | | |
| Long-term expected defaults note (ii) | 16 | – | 16 |
| Additional provisions note (iii) | 50 | (23) | 27 |
| Total credit risk allowance | 66 | (23) | 43 |
| Liquidity premium | 125 | 23 | 148 |

| | 30 June 2011 bps | | |
|---|---|---|---|
| | Pillar 1 regulatory basis | Adjustment from regulatory to IFRS basis | IFRS |
| Bond spread over swap rates note (i) | 151 | – | 151 |
| Credit risk allowance: | | | |
| Long-term expected defaults note (ii) | 16 | – | 16 |
| Additional provisions note (iii) | 51 | (25) | 26 |
| Total credit risk allowance | 67 | (25) | 42 |
| Liquidity premium | 84 | 25 | 109 |

| | 31 December 2011 bps | | |
|---|---|---|---|
| | Pillar 1 regulatory basis | Adjustment from regulatory to IFRS basis | IFRS |
| Bond spread over swap rates note (i) | 201 | – | 201 |
| Credit risk allowance: | | | |
| Long-term expected defaults note (ii) | 15 | – | 15 |
| Additional provisions note (iii) | 51 | (24) | 27 |
| Total credit risk allowance | 66 | (24) | 42 |
| Liquidity premium | 135 | 24 | 159 |

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 2009 and the definition of the credit rating used is the second highest credit rating published by Moody's, Standard and Poor's and Fitch.
(iii) Additional provisions comprise credit risk premium, which is derived from Moody's data from 1970 to 2009, an allowance for a 1-notch downgrade of the portfolio subject to credit risk and an additional allowance for short-term defaults.

The 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 aims to establish liabilities that are closer to 'best estimate'.

# Notes on the IFRS basis results
continued

## E: Key assumptions, estimates and bases used to measure insurance assets and liabilities continued

**Movement in the credit risk allowance for PRIL in the six months ended 30 June 2012**
The movement in the first half of 2012 of the average basis points allowance for PRIL on IFRS basis is as follows:

| | Pillar 1 regulatory basis bps | IFRS bps |
|---|---|---|
| | Total | Total |
| Total allowance for credit risk at 31 December 2011 | 66 | 42 |
| Credit rating changes | 2 | 1 |
| Asset trading | – | – |
| Asset mix (effect of market value movements) | – | – |
| New business and other | (2) | – |
| Total allowance for credit risk at 30 June 2012 | 66 | 43 |

For half year 2011 and other prior periods, favourable credit experience was retained in short-term allowances for credit risk on both the Pillar 1 and IFRS bases. From full year 2011 onwards the methodology applied is to continue to retain such surplus experience in the IFRS credit provisions but not for Pillar 1.

Overall the movement has led to the credit allowance for Pillar 1 purposes to be 35 per cent (30 June 2011: 45 per cent; 31 December 2011: 33 per cent) of the bond spread over swap rates. For IFRS purposes it represents 22 per cent (30 June 2011: 28 per cent; 31 December 2011: 20 per cent) of the bond spread over swap rates.

The reserves for credit risk allowance at 30 June 2012 for the UK shareholder annuity fund were as follows:

| | Pillar 1 regulatory basis £bn | IFRS £bn |
|---|---|---|
| | Total | Total |
| PRIL | 1.9 | 1.2 |
| PAC non-profit sub-fund | 0.2 | 0.1 |
| **Total - 30 June 2012** | 2.1 | 1.3 |
| Total – 31 December 2011 | 2.0 | 1.3 |
| Total – 30 June 2011 | 1.8 | 1.1 |

## F: Short-term fluctuations in investment returns on shareholder-backed business

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year* | Full year* |
| Insurance operations: | | | |
| Asia note (ii) | 42 | 14 | (92) |
| US note (iii) | (125) | 7 | (167) |
| UK notes (iv) | 5 | 44 | 159 |
| Other operations: | | | |
| Economic hedge value movement note (v) | (15) | – | – |
| Other note (vi) | 61 | 28 | (120) |
| Total note (i) | (32) | 93 | (220) |

Notes

(i) General overview of defaults
The Group did not experience any defaults on its shareholder-backed debt securities portfolio in half year 2012 and 2011.

(ii) Asia insurance operations
The fluctuations for Asia insurance operations of positive £42 million in half year 2012 (half year 2011: £14 million; full year 2011: negative £(92) million) include a £13 million unrealised gain (half year 2011: £26 million; full year 2011: unrealised loss £(14) million) on the Group's 7.74 per cent stake (30 June 2011: 8.66 per cent; 31 December 2011: 7.37 per cent) in China Life Insurance Company of Taiwan.

(iii) US insurance operations
The short-term fluctuations in investment returns for US insurance operations comprise the following items:

| | 2012 Half year £m | 2011 Half year* £m | 2011 Full year* £m |
|---|---|---|---|
| Short-term fluctuations relating to debt securities | | | |
| Charges in the period: | | | |
| Defaults | – | – | – |
| Losses on sales of impaired and deteriorating bonds | (16) | (2) | (32) |
| Bond write downs | (25) | (14) | (62) |
| Recoveries/reversals | 8 | 3 | 42 |
| Total charges in the period note (a) | (33) | (13) | (52) |
| Less: Risk margin charge included in operating profit based on longer-term investment returns note (b) | 38 | 35 | 70 |
| | 5 | 22 | 18 |
| Interest-related realised gains (losses): | | | |
| Arising in the period | 29 | 92 | 158 |
| Less: Amortisation of gains and losses arising in current and prior years to operating profit based on longer-term investment returns | (44) | (43) | (84) |
| | (15) | 49 | 74 |
| Related change to amortisation of deferred acquisition costs | 2 | (9) | (3) |
| Total short-term fluctuations related to debt securities | (8) | 62 | 89 |
| Derivatives (other than equity-related): market value movement (net of related change to amortisation of deferred acquisition costs) note (c) | 179 | 29 | 554 |
| Net equity hedge results (net of related change to amortisation of deferred acquisition costs) note (d) | (320) | (107) | (788) |
| Equity-type investments: actual less longer-term return (net of related change to amortisation of deferred acquisition costs) note C | 22 | 28 | – |
| Other items (net of related change to amortisation of deferred acquisition costs) | 2 | (5) | (22) |
| Total | (125) | 7 | (167) |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

The short-term fluctuations shown in the table above are stated net of the related change to amortisation of deferred acquisition costs of £80 million (half year 2011: £68 million; full year 2011: £287 million). See note Q.

# Notes on the IFRS basis results
continued

## F: Short-term fluctuations in investment returns on shareholder-backed business continued

Notes

(a) The charges on the debt securities of Jackson comprise the following:

| | Defaults £m | Bond write downs £m | Losses on sale of impaired and deteriorating bonds £m | Recoveries/ reversals £m | 2012 Half year Total £m | 2011 Half year Total £m | 2011 Full year Total £m |
|---|---|---|---|---|---|---|---|
| Residential mortgage-backed securities: | | | | | | | |
| Prime (including agency) | – | (1) | (1) | 3 | 1 | (10) | (25) |
| Alt-A | – | – | (2) | 3 | 1 | (1) | (1) |
| Sub-prime | – | (3) | – | – | (3) | – | – |
| Total residential mortgage-backed securities | – | (4) | (3) | 6 | (1) | (11) | (26) |
| Corporate debt securities | – | – | (13) | 1 | (12) | (2) | (14) |
| Other | – | (21) | – | 1 | (20) | – | (12) |
| Total | – | (25) | (16) | 8 | (33) | (13) | (52) |

(b) The risk margin reserve (RMR) charge for longer-term credit-related losses included in operating profit based on longer-term investment returns for half year 2012 is based on an average annual RMR of 27 basis points (half year 2011: 25 basis points; full year 2011: 25 basis points) on average book values of US$44.2 billion (half year 2011: US$44.5 billion; full year 2011: US$44.4 billion) as shown below:

| | Half year 2012 | | | |
|---|---|---|---|---|
| | | | Annual expected loss* | |
| Moody's rating category (or equivalent under NAIC ratings of MBS) | Average book value US$m | RMR % | US$m | £m |
| A3 or higher | 21,149 | 0.11 | (23) | (15) |
| Baa1, 2 or 3 | 20,655 | 0.26 | (54) | (34) |
| Ba1, 2 or 3 | 1,616 | 1.11 | (18) | (11) |
| B1, 2 or 3 | 560 | 2.97 | (17) | (11) |
| Below B3 | 174 | 3.77 | (6) | (4) |
| Total | 44,154 | 0.27 | (118) | (75) |
| Related change to amortisation of deferred acquisition costs (see opposite) | | | 18 | 11 |
| Risk margin reserve charge to operating profit for longer-term credit related losses | | | 100 | (64) |

| | Half year 2011 | | | |
|---|---|---|---|---|
| | | | Annual expected loss* | |
| Moody's rating category (or equivalent under NAIC ratings of MBS) | Average book value US$m | RMR % | US$m | £m |
| A3 or higher | 21,283 | 0.08 | (16) | (10) |
| Baa1, 2 or 3 | 20,729 | 0.27 | (55) | (34) |
| Ba1, 2 or 3 | 1,826 | 1.02 | (19) | (12) |
| B1, 2 or 3 | 425 | 3.01 | (13) | (8) |
| Below B3 | 221 | 3.87 | (9) | (6) |
| Total | 44,484 | 0.25 | (112) | (70) |
| Related change to amortisation of deferred acquisition costs (see opposite) | | | 22 | 14 |
| Risk margin reserve charge to operating profit for longer-term credit related losses | | | (90) | (56) |

* Annual expected loss: Charge for the half year 2012 was £(38) million (half year 2011: £(35) million).

| Moody's rating category (or equivalent under NAIC ratings of MBS) | Full year 2011 Average book value US$m | RMR % | Annual expected loss US$m | £m |
|---|---|---|---|---|
| A3 or higher | 21,255 | 0.08 | (17) | (11) |
| Baa1, 2 or 3 | 20,688 | 0.26 | (54) | (34) |
| Ba1, 2 or 3 | 1,788 | 1.04 | (19) | (11) |
| B1, 2 or 3 | 474 | 3.01 | (14) | (9) |
| Below B3 | 211 | 3.88 | (8) | (5) |
| Total | 44,416 | 0.25 | (112) | (70) |
| Related change to amortisation of deferred acquisition costs (see below) | | | 22 | 14 |
| Risk margin reserve charge to operating profit for longer-term credit related losses | | | (90) | (56) |

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

(c) The gain of £179 million (half year 2011: gain of £29 million; full year 2011: gain of £554 million) is principally for the value movement of non-equity free-standing derivatives held to manage interest rate exposures and for the GMIB reinsurance asset that is considered to be a derivative under IAS 39.

Under IAS 39, unless hedge accounting is applied, value movements on derivatives are recognised in the income statement. For the derivatives programme attaching to the general account business, the 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.

(d) The amount of £(320) million (half year 2011: £(107) million; full year 2011: £(788) million) relates to the net equity hedge accounting effect of the equity-based derivatives and associated guarantee liabilities of Jackson's variable and fixed index annuity business. The details of the value movements excluded from operating profit based on longer-term investment returns are as described in note C. The principal movements are for (i) value for free-standing and GMWB 'not for life' embedded derivatives, (ii) accounting values for GMDB and GMWB 'for life' guarantees, (iii) fee assessments and claim payments in respect of guarantee liabilities and (iv) related changes to DAC amortisation. In half year 2012, the charge of £(320) million principally reflects fair value movements on free-standing futures contracts and short-dated options. The movements included within the net equity hedge result included the effect of lower interest rates for which the movement was particularly significant in 2011. The value movements on derivatives held to manage this and any other interest rate exposure are included in the £179 million (half year 2011: £29 million; full year 2011: £554 million) described above in note (c).

In addition to the items discussed above, for US insurance operations, included within the statement of comprehensive income is an increase in net unrealised gains on debt securities classified as available-for-sale of £482 million (half year 2011: £237 million; full year 2011: £811 million). 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 U.

(iv) UK insurance operations
The short-term fluctuations gain for UK insurance operations of £5 million (half year 2011: £44 million; full year 2011: £159 million) reflects net investment gains arising in the period on fixed income assets backing the capital of the annuity business.

(v) Economic hedge value movement
This item represents the value movement in the half year 2012 on short-dated hedge contracts to provide downside protection against severe UK equity market falls.

(vi) Other
Short-term fluctuations of other operations, in addition to the previously discussed economic hedge value movement, were positive £61 million (half year 2011: positive £28 million; full year 2011: negative £(120) million) representing unrealised value movements on investments, including centrally held swaps to manage foreign exchange and certain macroeconomic exposures of the Group.

# Notes on the IFRS basis results
continued

## G: Changes to Group's holdings

### PPM South Africa

On 22 February 2012, M&G completed transactions to (i) exchange bonus share rights for equity holdings with the employees of PPM South Africa and (ii) the sale of a 10 per cent holding in the majority of the business to Thesele Group, a minority shareholder, for cash. Following these transactions M&G's majority holding in the business reduced from 75 per cent to 47 per cent. Under IFRS requirements, the divestment is accounted for as the disposal of the 75 per cent holding and an acquisition of a 47 per cent holding at fair value resulting in a reclassification of PPM South Africa from a subsidiary to an associate. As a consequence of the IFRS application, the transactions give rise to a gain on dilution of £42 million. This amount is accounted for in the Group's half year 2012 supplementary analysis of profit as a gain on dilution of holdings which is excluded from the Group's IFRS operating profit based on longer-term investment returns. The cash outflow arising from this change to the Group's holdings, as shown in the condensed consolidated statement of cash flows, was £23 million, representing cash and cash equivalents no longer consolidated net of the cash proceeds received.

## H: Acquisition costs and other expenditure

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year* | Full year* |
| Acquisition costs incurred | 1,192 | 1,106 | 2,264 |
| Acquisition costs deferred less amortisation of acquisition costs | (327) | (218) | (520) |
| Administration costs and other expenditure | 1,746 | 1,764 | 3,524 |
| Movements in amounts attributable to external unit holders | (19) | 13 | (148) |
| Total acquisition costs and other expenditure | 2,592 | 2,665 | 5,120 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

The acquisition costs as shown on the table above relate to policy acquisition costs. Acquisition costs from business combinations are included within other expenditure.

Included within total acquisition costs and other expenditure is depreciation of £44 million (half year 2011: £45 million; full year 2011: £95 million).

The total amounts for acquisition costs and other expenditure shown above includes corporate expenditure shown in note C (Segment disclosure – income statement). The charge for corporate expenditure comprises:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Group head office | 86 | 88 | 168 |
| Asia regional office: | | | |
| Gross costs | 45 | 48 | 86 |
| Recharges to Asia operations | (11) | (18) | (35) |
| | 34 | 30 | 51 |
| Total | 120 | 118 | 219 |

## I: 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 Group, irrespective of whether the return is attributable to shareholders, to policyholders or to 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.

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| **Asia operations** | | | |
| Policyholders' returns: | | | |
| Assets backing unit-linked liabilities | 296 | 208 | (812) |
| With-profits business | 423 | 404 | 756 |
| | 719 | 612 | (56) |
| Shareholders' returns | 333 | 178 | 341 |
| Total | 1,052 | 790 | 285 |
| **US operations** | | | |
| Policyholders' returns: | | | |
| Assets held to back (separate account) unit-linked liabilities | 2,095 | 1,530 | (869) |
| Shareholders' returns: | | | |
| Realised gains and losses (including impairment losses on available-for-sale bonds) | (331) | 81 | (238) |
| Value movements on derivative hedging programme for general account business | 252 | 93 | 841 |
| Interest/dividend income and value movements on other financial instruments for which fair value movements are booked in the income statement | 638 | 570 | 1,714 |
| | 559 | 744 | 2,317 |
| Total | 2,654 | 2,274 | 1,448 |
| **UK operations** | | | |
| Policyholders' returns: | | | |
| Scottish Amicable Insurance Fund (SAIF) | 289 | 303 | 321 |
| Assets held to back unit-linked liabilities | 534 | 657 | 208 |
| With-profits fund (excluding SAIF) | 3,000 | 2,808 | 4,094 |
| | 3,823 | 3,768 | 4,623 |
| Shareholders' returns: | | | |
| Prudential Retirement Income Limited (PRIL) | 772 | 555 | 2,153 |
| Other business | 461 | 342 | 956 |
| | 1,233 | 897 | 3,109 |
| Total | 5,056 | 4,665 | 7,732 |
| **Unallocated corporate** | | | |
| Shareholders' returns | – | 21 | (105) |
| **Group Total** | | | |
| Policyholders' returns | 6,637 | 5,910 | 3,698 |
| Shareholders' returns | 2,125 | 1,840 | 5,662 |
| Total | 8,762 | 7,750 | 9,360 |

# Notes on the IFRS basis results
continued

## I: Allocation of investment return between policyholders and shareholders continued

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 per cent)). 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 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 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 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.

### Shareholders' returns

For shareholder-backed non-participating business of the UK (comprising PRIL and other non-linked non-participating business) and of the Asia 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 and 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 shareholders' 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 majority of the investments held to back the US general account 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.

## J: 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:

| | Half year 2012 £m | | | |
|---|---|---|---|---|
| | Asia | US | UK | Total |
| Claims incurred | (1,587) | (2,499) | (5,057) | (9,143) |
| Increase in policyholder liabilities | (2,109) | (6,410) | (1,600) | (10,119) |
| Movement in unallocated surplus of with-profits funds(note) | 137 | – | (725) | (588) |
| | (3,559) | (8,909) | (7,382) | (19,850) |

| | Half year 2011 £m | | | |
|---|---|---|---|---|
| | Asia | US | UK | Total |
| Claims incurred | (1,460) | (2,647) | (4,838) | (8,945) |
| Increase in policyholder liabilities | (1,827) | (5,465) | (713) | (8,005) |
| Movement in unallocated surplus of with-profits funds(note) | 52 | – | (692) | (640) |
| | (3,235) | (8,112) | (6,243) | (17,590) |

| | Full year 2011 £m | | | |
|---|---|---|---|---|
| | Asia | US | UK | Total |
| Claims incurred | (2,955) | (4,678) | (10,103) | (17,736) |
| Increase in policyholder liabilities | (2,950) | (7,973) | (1,655) | (12,578) |
| Movement in unallocated surplus of with-profits funds(note) | 540 | – | 485 | 1,025 |
| | (5,365) | (12,651) | (11,273) | (29,289) |

**Note**

The unallocated surplus of with-profits funds represents the excess of assets of with-profits funds over policyholder and other liabilities of the funds. The surplus is therefore sensitive to the measurement basis of the assets and liabilities. The movements on unallocated surplus of with-profits funds also reflect the impact of market fluctuations of investment values backing the surplus. The Asia movement principally arises in the Hong Kong branch operation.

# Notes on the IFRS basis results
continued

## K: Tax

### i Tax charge
The total tax charge comprises:

| Tax charge | Half year 2012 £m Current tax | Deferred tax | Total | Half year 2011* £m Total | Full year 2011* £m Total |
|---|---|---|---|---|---|
| UK tax | (98) | 14 | (84) | (85) | (20) |
| Overseas tax | (294) | 31 | (263) | (292) | (372) |
| Total tax charge | (392) | 45 | (347) | (377) | (392) |

The current tax charge of £392 million includes £8 million for half year 2012 (half year 2011: charge of £8 million; full year 2011: charge of £16 million) in respect of the tax charge for Hong Kong. The Hong Kong current tax charge is calculated as 16.5 per cent for all periods on either (i) 5 per cent of the net insurance premium or (ii) the estimated assessable profits, depending on the nature of the business written.

The total tax charge comprises tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders as shown below:

| Tax charge | Half year 2012 £m Current tax | Deferred tax | Total | Half year 2011* £m Total | Full year 2011* £m Total |
|---|---|---|---|---|---|
| Tax (charge) credit to policyholders' returns | (137) | 97 | (40) | (94) | 17 |
| Tax charge attributable to shareholders' returns | (255) | (52) | (307) | (283) | (409) |
| Total tax charge | (392) | 45 | (347) | (377) | (392) |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

The principal reason for the reduction in the tax charge attributable to policyholders' returns compared to the six-month period ended June 2011 is due to a reduction in the value of unrealised gains on investments which results in a decrease in the policyholders' deferred tax charge. An explanation of the tax charge attributable to shareholders is shown in note (iii) opposite.

### ii Deferred tax

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

| | 30 June 2012 £m | | 30 June 2011* £m | | 31 December 2011* £m | |
|---|---|---|---|---|---|---|
| | Deferred tax assets | Deferred tax liabilities | Deferred tax assets | Deferred tax liabilities | Deferred tax assets | Deferred tax liabilities |
| Unrealised gains and losses on investments | 206 | (1,629) | 319 | (1,654) | 297 | (1,566) |
| Balances relating to investment and insurance contracts | 22 | (969) | 17 | (745) | 13 | (667) |
| Short-term timing differences | 1,820 | (1,307) | 1,374 | (1,524) | 1,513 | (1,687) |
| Capital allowances | 12 | (8) | 18 | (13) | 15 | (9) |
| Unused tax losses | 119 | – | 392 | – | 438 | – |
| Total | 2,179 | (3,913) | 2,120 | (3,936) | 2,276 | (3,929) |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

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 Group often apply separate rules to trading and capital profits and losses. The distinction between temporary differences that arise from items of either a trading or capital nature may affect the recognition of deferred tax assets. Accordingly, for the 2012 half year results and financial position at 30 June 2012, the possible tax benefit of approximately £156 million (30 June 2011: £106 million; 31 December 2011: £158 million), which may arise from capital losses valued at approximately £0.7 billion (30 June 2011: £0.5 billion; 31 December 2011: £0.7 billion), is sufficiently uncertain that it has not been recognised. In addition, a potential deferred tax asset of £122 million (30 June 2011: £ 241 million; 31 December 2011: £147 million), which may arise from tax losses and other potential temporary differences totalling £0.5 billion (30 June 2011: £1.0 billion; 31 December 2011: £0.6 billion) is sufficiently uncertain that it has not been recognised. Of these, losses of £116 million will expire within the next 10 years. The remaining losses have no expiry date.

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

As part of the Finance Act 2011, the UK government enacted a corporation tax rate change to 25 per cent with effect from 1 April 2012. However in March 2012, the UK government announced a revised tax rate change to 24 per cent which was effective from 1 April 2012 after being substantively enacted on 26 March 2012 by a resolution under the Provisional Collection of Taxes Act 1968. Additionally, the reduction in the UK corporation tax rate to 23 per cent from 1 April 2013 was substantively enacted on 3 July 2012 in the 2012 Finance Bill, however this has no effect on half year 2012 financial results.

The subsequent proposed phased rate changes to 22 per cent are expected to have the effect of reducing the UK with-profits and shareholder-backed business elements of the net deferred tax balances at 30 June 2012 by £55 million.

The UK government has announced that there will be substantial changes to the rules relating to the taxation of life insurance companies, which will be effective 1 January 2013. The effects of these changes are not reflected in the financial statements for the period ended 30 June 2012 as the 2012 Finance Act had not been enacted at the balance sheet date. Based on the Finance (No.4) Bill, the new regime is not expected to have a material impact on the Group's net assets.

# Notes on the IFRS basis results continued

## K: Tax continued

### iii Reconciliation of tax charge on profit attributable to shareholders for continuing operations

| | Half year 2012 £m (except for tax rates) | | | | |
|---|---|---|---|---|---|
| | Asia insurance operations | US insurance operations | UK insurance operations | Other operations | Total |
| Profit before tax attributable to shareholders: | | | | | |
| Operating profit based on longer-term investment returns note (iii) | 406 | 442 | 353 | (39) | 1,162 |
| Short-term fluctuations in investment returns | 42 | (125) | 5 | 46 | (32) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 9 | 78 | 87 |
| Gain on dilution of Group holdings | – | – | – | 42 | 42 |
| Total | 448 | 317 | 367 | 127 | 1,259 |
| Expected tax rate: note (i) | | | | | |
| Operating profit based on longer-term investment returns note (iii) | 24% | 35% | 24.5% | 24.5% | 28% |
| Short-term fluctuations in investment returns | 24% | 35% | 24.5% | 24.5% | 69% |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 24.5% | 24.5% | 24.5% |
| Gain on dilution of Group holdings | – | – | – | 24.5% | 24.5% |
| Expected tax (charge) credit based on expected tax rates: | | | | | |
| Operating profit based on longer-term investment returns note (iii) | (97) | (155) | (86) | 10 | (328) |
| Short-term fluctuations in investment returns | (10) | 44 | (1) | (11) | 22 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (2) | (19) | (21) |
| Gain on dilution of Group holdings | – | – | – | (10) | (10) |
| Total | (107) | (111) | (89) | (30) | (337) |
| Variance from expected tax charge: note (ii) | | | | | |
| Operating profit based on longer-term investment returns note (iii) | 19 | 40 | 12 | (28) | 43 |
| Short-term fluctuations in investment returns | (13) | – | (6) | (4) | (23) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | – | – | – |
| Gain on dilution of Group holdings | – | – | – | 10 | 10 |
| Total | 6 | 40 | 6 | (22) | 30 |
| Actual tax (charge) credit: | | | | | |
| Operating profit based on longer-term investment returns note (iii) | (78) | (115) | (74) | (18) | (285) |
| Short-term fluctuations in investment returns | (23) | 44 | (7) | (15) | (1) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (2) | (19) | (21) |
| Gain on dilution of Group holdings | – | – | – | – | – |
| Total | (101) | (71) | (83) | (52) | (307) |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | 19% | 26% | 21% | (46)% | 25% |
| Total profit | 23% | 22% | 23% | 41% | 24% |

| | Half year 2011* £m (except for tax rates) | | | | |
|---|---|---|---|---|---|
| | Asia insurance operations | US insurance operations | UK insurance operations | Other operations | Total |
| Profit before tax attributable to shareholders: | | | | | |
| Operating profit based on longer-term investment returns note (iii) | 322 | 340 | 353 | 13 | 1,028 |
| Short-term fluctuations in investment returns | 14 | 7 | 44 | 28 | 93 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (2) | (5) | (7) |
| Total | 336 | 347 | 395 | 36 | 1,114 |
| Expected tax rate: note (i) | | | | | |
| Operating profit based on longer-term investment returns note (iii) | 24% | 35% | 26.5% | 26.5% | 29% |
| Short-term fluctuations in investment returns | 22% | 35% | 26.5% | 26.5% | 26% |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 26.5% | 26.5% | 26.5% |
| Expected tax (charge) credit based on expected tax rates: | | | | | |
| Operating profit based on longer-term investment returns note (iii) | (77) | (119) | (94) | (3) | (293) |
| Short-term fluctuations in investment returns | (3) | (2) | (12) | (7) | (24) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 1 | 1 | 2 |
| Total | (80) | (121) | (105) | (9) | (315) |
| Variance from expected tax charge: note (ii) | | | | | |
| Operating profit based on longer-term investment returns note (iii) | 39 | 19 | 5 | 1 | 64 |
| Short-term fluctuations in investment returns | (33) | – | 1 | – | (32) |
| Total | 6 | 19 | 6 | 1 | 32 |
| Actual tax (charge) credit: | | | | | |
| Operating profit based on longer-term investment returns note (iii) | (38) | (100) | (89) | (2) | (229) |
| Short-term fluctuations in investment returns | (36) | (2) | (11) | (7) | (56) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 1 | 1 | 2 |
| Total | (74) | (102) | (99) | (8) | (283) |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | 12% | 29% | 25% | 15% | 22% |
| Total profit | 22% | 29% | 25% | 22% | 25% |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

# Notes on the IFRS basis results
continued

## K: Tax continued

| | Full year 2011* £m (except for tax rates) | | | | |
|---|---|---|---|---|---|
| | Asia insurance operations | US insurance operations | UK insurance operations | Other operations | Total |
| Profit (loss) before tax attributable to shareholders: | | | | | |
| Operating profit based on longer-term investment returns[note (iii)] | 704 | 651 | 723 | (51) | 2,027 |
| Short-term fluctuations in investment returns | (92) | (167) | 159 | (120) | (220) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 18 | 3 | 21 |
| Total | 612 | 484 | 900 | (168) | 1,828 |
| Expected tax rate:[note (i)] | | | | | |
| Operating profit based on longer-term investment returns[note (iii)] | 24% | 35% | 27% | 27% | 29% |
| Short-term fluctuations in investment returns | 20% | 35% | 27% | 27% | 30% |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 27% | 27% | 26.5% |
| Expected tax (charge) credit based on expected tax rates: | | | | | |
| Operating profit based on longer-term investment returns[note (iii)] | (169) | (228) | (195) | 14 | (578) |
| Short-term fluctuations in investment returns | 18 | 58 | (43) | 32 | 65 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (5) | (1) | (6) |
| Total | (151) | (170) | (243) | 45 | (519) |
| Variance from expected tax charge:[note (ii)] | | | | | |
| Operating profit based on longer-term investment returns[note (iii)] | 47 | 43 | 5 | 50 | 145 |
| Short-term fluctuations in investment returns | (20) | – | 8 | (24) | (36) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | 1 | – | 1 |
| Total | 27 | 43 | 14 | 26 | 110 |
| Actual tax (charge) credit: | | | | | |
| Operating profit based on longer-term investment returns[note (iii)] | (122) | (185) | (190) | 64 | (433) |
| Short-term fluctuations in investment returns | (2) | 58 | (35) | 8 | 29 |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (4) | (1) | (5) |
| Total | (124) | (127) | (229) | 71 | (409) |
| Actual tax rate: | | | | | |
| Operating profit based on longer-term investment returns | 17% | 28% | 26% | 125% | 21% |
| Total profit | 20% | 26% | 25% | 42% | 22% |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

Notes

(i) Expected tax rates for profit (loss) attributable to shareholders

- The expected tax rates shown in the table above reflect the corporation tax rates generally applied to taxable profits of the relevant country jurisdictions.
- For Asia operations the expected tax rates reflect the corporation 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.

(ii) For 2012 and 2011, the principal variances arise from a number of factors, including:

(a) Asia long-term operations
For half year 2012 and 2011, profits in certain countries which are not taxable, along with utilising brought forward tax losses on which no deferred tax assets were previously recognised, partly offset by the inability to fully recognise deferred tax assets on losses being carried forward.

(b) Jackson
For half year 2012 and 2011, the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business.

(c) UK insurance operations
For half year 2012 and 2011, the effect of the reduction in the UK corporation tax rate on deferred tax liabilities and the different tax bases of UK life business. Additionally, for 2011 this is partially offset by routine revisions to prior period tax returns.

(d) Other operations
For half year 2012 and 2011 the effect of the reduction in UK corporation tax rate on deferred tax assets and revisions to prior period tax returns. For full year 2011 the settlement of outstanding issues with HMRC at an amount below that previously provided, partly offset by prior year adjustments arising from the revisions of prior period tax returns.

(iii) Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses. Related tax charges are determined on the basis of current taxation legislation.

# Notes on the IFRS basis results continued

## L: Supplementary analysis of earnings per share

| | Half year 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Before tax note C £m | Tax note K £m | Non-controlling interests £m | Net of tax and non-controlling interests £m | Basic earnings per share | Diluted earnings per share |
| Based on operating profit based on longer-term investment returns | 1,162 | (285) | – | 877 | 34.5p | 34.5p |
| Short-term fluctuations in investment returns on shareholder-backed business | (32) | (1) | – | (33) | (1.3)p | (1.3)p |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 87 | (21) | – | 66 | 2.6p | 2.6p |
| Gain on dilution of Group holdings | 42 | – | – | 42 | 1.7p | 1.7p |
| Based on profit for the period | 1,259 | (307) | – | 952 | 37.5p | 37.5p |

| | Half year 2011* | | | | | |
|---|---|---|---|---|---|---|
| | Before tax note C £m | Tax note K £m | Non-controlling interests £m | Net of tax and non-controlling interests £m | Basic earnings per share | Diluted earnings per share |
| Based on operating profit based on longer-term investment returns | 1,028 | (229) | (2) | 797 | 31.4p | 31.3p |
| Short-term fluctuations in investment returns on shareholder-backed business | 93 | (56) | – | 37 | 1.5p | 1.5p |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | (7) | 2 | – | (5) | (0.2)p | (0.2)p |
| Based on profit for the period | 1,114 | (283) | (2) | 829 | 32.7p | 32.6p |

| | Full year 2011* | | | | | |
|---|---|---|---|---|---|---|
| | Before tax note C £m | Tax note K £m | Non-controlling interests £m | Net of tax and non-controlling interests £m | Basic earnings per share | Diluted earnings per share |
| Based on operating profit based on longer-term investment return | 2,027 | (433) | (4) | 1,590 | 62.8p | 62.7p |
| Short-term fluctuations in investment returns on shareholder-backed business | (220) | 29 | – | (191) | (7.6)p | (7.6)p |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 21 | (5) | – | 16 | 0.6p | 0.6p |
| Based on profit for the year | 1,828 | (409) | (4) | 1,415 | 55.8p | 55.7p |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

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

The weighted average number of shares for calculating earnings per share:

| | 2012 | 2011 | |
|---|---|---|---|
| | **Half year** (in millions) | **Half year** (in millions) | **Full year** (in millions) |
| Weighted average number of shares for calculation of: | | | |
| Basic earnings per share | 2,536 | 2,533 | 2,533 |
| Diluted earnings per share | 2,539 | 2,539 | 2,538 |

## M: Dividends

| | 2012 | 2011 | |
|---|---|---|---|
| **Dividends per share (in pence)** | **Half year** | **Half year** | **Full year** |
| Dividends relating to reporting period: | | | |
| Interim dividend (2012 and 2011) | 8.40p | 7.95p | 7.95p |
| Final dividend (2011) | – | – | 17.24p |
| Total | 8.40p | 7.95p | 25.19p |
| Dividends declared and paid in reporting period: | | | |
| Current year interim dividend | – | – | 7.95p |
| Final dividend for prior year | 17.24p | 17.24p | 17.24p |
| Total | 17.24p | 17.24p | 25.19p |

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

The 2012 interim dividend of 8.40 pence per ordinary share will be paid on 27 September 2012 in sterling to shareholders on the principal register and the Irish branch register at 6.00pm BST on Friday, 24 August 2012 (the 'Record Date'), and in Hong Kong dollars to shareholders on the Hong Kong branch register at 4.30pm Hong Kong time on the Record Date (HK Shareholders). Holders of US American Depositary Receipts (US Shareholders) will be paid their dividends in US dollars on or about 5 October 2012. The interim dividend will be paid on or about 4 October 2012 in Singapore dollars to shareholders with shares standing to the credit of their securities accounts with The Central Depository (Pte) Limited (CDP) at 5.00pm Singapore time on the Record Date (SG Shareholders). The dividend payable to the HK Shareholders will be translated using the exchange rate quoted by the WM Company at the close of business on 9 August 2012. The exchange rate at which the dividend payable to the SG Shareholders will be translated into SG$, will be determined by CDP. The dividend will distribute an estimated £215 million of shareholders' equity.

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

# Notes on the IFRS basis results
continued

## N: Statement of financial position – analysis of Group position by segment and business type

### i Group statement of financial position analysis

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

| | 2012 £m | | | | | | | | 2011 £m | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Insurance operations | | | | | | | | | |
| By operating segment | UK | US | Asia | Total insurance operations | Asset management operations | Unallocated to a segment (central operations) | Intra-group eliminations | 30 Jun Group Total | 30 Jun* Group Total | 31 Dec* Group Total |
| **Assets** | | | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | | | |
| Goodwill note P | – | – | 237 | 237 | 1,230 | – | – | 1,467 | 1,469 | 1,465 |
| Deferred acquisition costs and other intangible assets note Q | 109 | 3,203 | 987 | 4,299 | 15 | 19 | – | 4,333 | 4,060 | 4,234 |
| Total | 109 | 3,203 | 1,224 | 4,536 | 1,245 | 19 | – | 5,800 | 5,529 | 5,699 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | 178 | – | – | 178 | – | – | – | 178 | 169 | 178 |
| Deferred acquisition costs and other intangible assets | 6 | – | 78 | 84 | – | – | – | 84 | 93 | 89 |
| Total | 184 | – | 78 | 262 | – | – | – | 262 | 262 | 267 |
| Total | 293 | 3,203 | 1,302 | 4,798 | 1,245 | 19 | – | 6,062 | 5,791 | 5,966 |
| Deferred tax assets note K | 243 | 1,633 | 95 | 1,971 | 110 | 98 | – | 2,179 | 2,120 | 2,276 |
| Other non-investment and non-cash assets note (i) | 5,437 | 1,536 | 1,053 | 8,026 | 1,104 | 4,079 | (5,860) | 7,349 | 6,521 | 6,638 |
| Investments of long-term business and other operations: | | | | | | | | | | |
| Investment properties | 10,786 | 25 | 11 | 10,822 | – | – | – | 10,822 | 10,965 | 10,757 |
| Investments accounted for using the equity method | 70 | – | – | 70 | 42 | – | – | 112 | 71 | 70 |
| Financial investments: | | | | | | | | | | |
| Loans note S | 3,435 | 4,168 | 1,171 | 8,774 | 1,207 | – | – | 9,981 | 9,017 | 9,714 |
| Equity securities and portfolio holdings in unit trusts | 34,036 | 43,874 | 12,553 | 90,463 | 79 | – | – | 90,542 | 91,037 | 87,349 |
| Debt securities note T | 79,900 | 27,061 | 19,433 | 126,394 | 1,875 | – | – | 128,269 | 117,213 | 124,498 |
| Other investments | 4,683 | 2,634 | 703 | 8,020 | 72 | 51 | – | 8,143 | 6,121 | 7,509 |
| Deposits | 11,105 | 228 | 1,041 | 12,374 | 55 | – | – | 12,429 | 10,858 | 10,708 |
| Total investments | 144,015 | 77,990 | 34,912 | 256,917 | 3,330 | 51 | – | 260,298 | 245,282 | 250,605 |
| Properties held for sale | – | – | – | – | – | – | – | – | 394 | 3 |
| Cash and cash equivalents | 2,554 | 293 | 1,927 | 4,774 | 1,580 | 383 | – | 6,737 | 8,589 | 7,257 |
| **Total assets** | 152,542 | 84,655 | 39,289 | 276,486 | 7,369 | 4,630 | (5,860) | 282,625 | 268,697 | 272,745 |

| By operating segment | 2012 £m Insurance operations UK | US | Asia | Total insurance operations | Asset management operations | Unallocated to a segment (central operations) | Intra-group eliminations | 30 Jun Group Total | 2011 £m 30 Jun* Group Total | 31 Dec* Group Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **Equity and liabilities** | | | | | | | | | | |
| *Equity* | | | | | | | | | | |
| Shareholders' equity | 2,722 | 3,919 | 2,403 | 9,044 | 1,888 | (1,640) | – | 9,292 | 7,990 | 8,564 |
| Non-controlling interests | 29 | – | 5 | 34 | – | – | – | 34 | 46 | 43 |
| Total equity | 2,751 | 3,919 | 2,408 | 9,078 | 1,888 | (1,640) | – | 9,326 | 8,036 | 8,607 |
| *Liabilities* | | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) note Y | 128,387 | 75,264 | 32,768 | 236,419 | – | – | – | 236,419 | 221,432 | 227,075 |
| Unallocated surplus of with-profits funds note Y | 9,750 | – | 52 | 9,802 | – | – | – | 9,802 | 10,872 | 9,215 |
| Total policyholder liabilities and unallocated surplus of with-profits funds | 138,137 | 75,264 | 32,820 | 246,221 | – | – | – | 246,221 | 232,304 | 236,290 |
| Core structural borrowings of shareholder-financed operations: | | | | | | | | | | |
| Subordinated debt | – | – | – | – | – | 2,638 | – | 2,638 | 3,044 | 2,652 |
| Other | – | 159 | – | 159 | 250 | 549 | – | 958 | 954 | 959 |
| Total note V | – | 159 | – | 159 | 250 | 3,187 | – | 3,596 | 3,998 | 3,611 |
| Operational borrowings attributable to shareholder-financed operations note W | 42 | 91 | 93 | 226 | 10 | 2,568 | – | 2,804 | 2,912 | 3,340 |
| Borrowings attributable to with-profits operations note W | 955 | – | – | 955 | – | – | – | 955 | 1,440 | 972 |
| Deferred tax liabilities note K | 1,258 | 2,069 | 550 | 3,877 | 20 | 16 | – | 3,913 | 3,936 | 3,929 |
| Other non-insurance liabilities note (ii) | 9,399 | 3,153 | 3,418 | 15,970 | 5,201 | 499 | (5,860) | 15,810 | 16,071 | 15,996 |
| Total liabilities | 149,791 | 80,736 | 36,881 | 267,408 | 5,481 | 6,270 | (5,860) | 273,299 | 260,661 | 264,138 |
| **Total equity and liabilities** | 152,542 | 84,655 | 39,289 | 276,486 | 7,369 | 4,630 | (5,860) | 282,625 | 268,697 | 272,745 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

Notes

(i) Within other non-investment and non-cash assets are premiums receivable of £274 million (30 June 2011: £290 million; 31 December 2011: £265 million) of which approximately two-thirds are due within one year. The remaining one-third, due after one year, relates to products where charges are levied against premiums in future years.

(ii) Within other non-insurance liabilities are other creditors of £2,989 million (30 June 2011: £2,599 million; 31 December 2011: £2,544 million) of which £2,683 million (30 June 2011: £2,599 million; 31 December 2011: £2,268 million) are due within one year.

# Notes on the IFRS basis results
continued

## N: Statement of financial position – analysis of Group position by segment and business type continued

### ii Group statement of financial position – additional analysis by business type

| | 2012 £m | | | | | | | 2011 £m | |
|---|---|---|---|---|---|---|---|---|---|
| | | Shareholder-backed business | | | | | | | |
| | Participating funds | Unit-linked and variable annuity | Non-linked business | Asset management operations | Unallocated to a segment (central operations) | Intra-group eliminations | 30 Jun Group Total | 30 Jun* Group Total | 31 Dec* Group Total |
| **Assets** | | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | | |
| Goodwill note P | – | – | 237 | 1,230 | – | – | 1,467 | 1,469 | 1,465 |
| Deferred acquisition costs and other intangible assets note Q | – | – | 4,299 | 15 | 19 | – | 4,333 | 4,060 | 4,234 |
| Total | – | – | 4,536 | 1,245 | 19 | – | 5,800 | 5,529 | 5,699 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | 178 | – | – | – | – | – | 178 | 169 | 178 |
| Deferred acquisition costs and other intangible assets | 84 | – | – | – | – | – | 84 | 93 | 89 |
| Total | 262 | – | – | – | – | – | 262 | 262 | 267 |
| Total | 262 | – | 4,536 | 1,245 | 19 | – | 6,062 | 5,791 | 5,966 |
| Deferred tax assets note K | 104 | 1 | 1,866 | 110 | 98 | – | 2,179 | 2,120 | 2,276 |
| Other non-investment and non-cash assets | 3,245 | 575 | 4,206 | 1,104 | 4,079 | (5,860) | 7,349 | 6,521 | 6,638 |
| Investments of long-term business and other operations: | | | | | | | | | |
| Investment properties | 8,564 | 685 | 1,573 | – | – | – | 10,822 | 10,965 | 10,757 |
| Investments accounted for using the equity method | – | – | 70 | 42 | – | – | 112 | 71 | 70 |
| Financial investments: | | | | | | | | | |
| Loans note S | 2,866 | 1 | 5,907 | 1,207 | – | – | 9,981 | 9,017 | 9,714 |
| Equity securities and portfolio holdings in unit trusts | 23,406 | 66,050 | 1,007 | 79 | – | – | 90,542 | 91,037 | 87,349 |
| Debt securities note T | 58,930 | 9,062 | 58,402 | 1,875 | – | – | 128,269 | 117,213 | 124,498 |
| Other investments | 4,664 | 125 | 3,231 | 72 | 51 | – | 8,143 | 6,121 | 7,509 |
| Deposits | 8,830 | 1,433 | 2,111 | 55 | – | – | 12,429 | 10,858 | 10,708 |
| Total investments | 107,260 | 77,356 | 72,301 | 3,330 | 51 | – | 260,298 | 245,282 | 250,605 |
| Properties held for sale | – | – | – | – | – | – | – | 394 | 3 |
| Cash and cash equivalents | 2,176 | 1,308 | 1,290 | 1,580 | 383 | – | 6,737 | 8,589 | 7,257 |
| **Total assets** | 113,047 | 79,240 | 84,199 | 7,369 | 4,630 | (5,860) | 282,625 | 268,697 | 272,745 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

| | 2012 £m | | | | | | | 2011 £m | |
|---|---|---|---|---|---|---|---|---|---|
| | | Shareholder-backed business | | | | | | | |
| | Participating funds | Unit-linked and variable annuity | Non-linked business | Asset management operations | Unallocated to a segment (central operations) | Intra-group eliminations | 30 Jun Group Total | 30 Jun* Group Total | 31 Dec* Group Total |
| **Equity and liabilities** | | | | | | | | | |
| *Equity* | | | | | | | | | |
| Shareholders' equity | – | – | 9,044 | 1,888 | (1,640) | – | 9,292 | 7,990 | 8,564 |
| Non-controlling interests | 29 | – | 5 | – | – | – | 34 | 46 | 43 |
| Total equity | 29 | – | 9,049 | 1,888 | (1,640) | – | 9,326 | 8,036 | 8,607 |
| *Liabilities* | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4)[note Y] | 94,635 | 77,476 | 64,308 | – | – | – | 236,419 | 221,432 | 227,075 |
| Unallocated surplus of with-profits funds[note Y] | 9,802 | – | – | – | – | – | 9,802 | 10,872 | 9,215 |
| Total policyholder liabilities and unallocated surplus of with-profits funds | 104,437 | 77,476 | 64,308 | – | – | – | 246,221 | 232,304 | 236,290 |
| Core structural borrowings of shareholder-financed operations: | | | | | | | | | |
| Subordinated debt | – | – | – | – | 2,638 | – | 2,638 | 3,044 | 2,652 |
| Other | – | – | 159 | 250 | 549 | – | 958 | 954 | 959 |
| Total[note V] | – | – | 159 | 250 | 3,187 | – | 3,596 | 3,998 | 3,611 |
| Operational borrowings attributable to shareholder-financed operations[note W] | – | – | 226 | 10 | 2,568 | – | 2,804 | 2,912 | 3,340 |
| Borrowings attributable to with-profits operations[note W] | 955 | – | – | – | – | – | 955 | 1,440 | 972 |
| Deferred tax liabilities[note K] | 1,149 | 31 | 2,697 | 20 | 16 | – | 3,913 | 3,936 | 3,929 |
| Other non-insurance liabilities | 6,477 | 1,733 | 7,760 | 5,201 | 499 | (5,860) | 15,810 | 16,071 | 15,996 |
| Total liabilities | 113,018 | 79,240 | 75,150 | 5,481 | 6,270 | (5,860) | 273,299 | 260,661 | 264,138 |
| **Total equity and liabilities** | 113,047 | 79,240 | 84,199 | 7,369 | 4,630 | (5,860) | 282,625 | 268,697 | 272,745 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

# Notes on the IFRS basis results
continued

## O: Statement of financial position – analysis of segment by business type

### i UK insurance operations

**Overview**

- In order to reflect the different types of UK business and fund structure, the statement of financial position of the UK insurance operations analyses assets and liabilities between those of the Scottish Amicable Insurance Fund (SAIF), the PAC with-profits sub-fund (WPSF), unit-linked assets and liabilities and annuity (principally PRIL) and other long-term business.
- £93 billion of the £144 billion of investments are held by SAIF and the PAC WPSF. Shareholders are exposed only indirectly to value movements on these assets.

| | 2012 £m | | | | | | | | 2011 £m | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | PAC with-profits fund note (i) | | | Other funds and subsidiaries | | | | | |
| **By operating segment** | 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 other long-term business | Total | 30 Jun Total | 30 Jun Total | 31 Dec Total |
| **Assets** | | | | | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | | | | | |
| Deferred acquisition costs and other intangible assets | – | – | – | – | – | 109 | 109 | 109 | 118 | 113 |
| Total | – | – | – | – | – | 109 | 109 | 109 | 118 | 113 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | – | 178 | – | 178 | – | – | – | 178 | 169 | 178 |
| Deferred acquisition costs | – | 6 | – | 6 | – | – | – | 6 | 11 | 6 |
| Total | – | 184 | – | 184 | – | – | – | 184 | 180 | 184 |
| Total | – | 184 | – | 184 | – | 109 | 109 | 293 | 298 | 297 |
| Deferred tax assets | – | 103 | 1 | 104 | – | 139 | 139 | 243 | 198 | 231 |
| Other non-investment and non-cash assets | 400 | 2,397 | 142 | 2,539 | 471 | 2,027 | 2,498 | 5,437 | 3,949 | 4,771 |
| Investments of long-term business and other operations: | | | | | | | | | | |
| Investment properties | 552 | 7,283 | 729 | 8,012 | 685 | 1,537 | 2,222 | 10,786 | 10,930 | 10,712 |
| Investments accounted for using the equity method | – | – | – | – | – | 70 | 70 | 70 | 69 | 70 |
| Financial investments: | | | | | | | | | | |
| Loans notes S | 129 | 1,936 | 75 | 2,011 | – | 1,295 | 1,295 | 3,435 | 2,401 | 3,115 |
| Equity securities and portfolio holdings in unit trusts | 2,086 | 18,572 | 119 | 18,691 | 13,242 | 17 | 13,259 | 34,036 | 40,470 | 36,722 |
| Debt securities note T | 3,988 | 38,684 | 5,783 | 44,467 | 6,135 | 25,310 | 31,445 | 79,900 | 74,818 | 77,953 |
| Other investments note (v) | 290 | 3,688 | 292 | 3,980 | 84 | 329 | 413 | 4,683 | 4,046 | 4,568 |
| Deposits | 956 | 7,530 | 290 | 7,820 | 936 | 1,393 | 2,329 | 11,105 | 9,759 | 9,287 |
| Total investments | 8,001 | 77,693 | 7,288 | 84,981 | 21,082 | 29,951 | 51,033 | 144,015 | 142,493 | 142,427 |
| Properties held for sale | – | – | – | – | – | – | – | – | 391 | – |
| Cash and cash equivalents | 85 | 1,267 | 122 | 1,389 | 714 | 366 | 1,080 | 2,554 | 3,815 | 2,965 |
| **Total assets** | 8,486 | 81,644 | 7,553 | 89,197 | 22,267 | 32,592 | 54,859 | 152,542 | 151,144 | 150,691 |

| | 2012 £m | | | | | | | | 2011 £m | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | PAC with-profits fund note (i) | | | Other funds and subsidiaries | | | | | |
| | 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 other long-term business | Total | 30 Jun Total | 30 Jun Total | 31 Dec Total |
| **Equity and liabilities** | | | | | | | | | | |
| *Equity* | | | | | | | | | | |
| Shareholders' equity | – | – | – | – | – | 2,722 | 2,722 | 2,722 | 2,342 | 2,581 |
| Non-controlling interests | – | 29 | – | 29 | – | – | – | 29 | 38 | 33 |
| Total equity | – | 29 | – | 29 | – | 2,722 | 2,722 | 2,751 | 2,380 | 2,614 |
| *Liabilities* | | | | | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) note Y | 8,143 | 67,764 | 5,384 | 73,148 | 21,258 | 25,838 | 47,096 | 128,387 | 126,544 | 127,024 |
| Unallocated surplus of with-profits funds (reflecting application of 'realistic' basis provisions for UK regulated with-profits funds) note Y and (vi) | – | 8,305 | 1,445 | 9,750 | – | – | – | 9,750 | 10,811 | 9,165 |
| Total | 8,143 | 76,069 | 6,829 | 82,898 | 21,258 | 25,838 | 47,096 | 138,137 | 137,355 | 136,189 |
| Operational borrowings attributable to shareholder-financed operations | – | – | – | – | – | 42 | 42 | 42 | 102 | 103 |
| Borrowings attributable to with-profits funds | 18 | 937 | – | 937 | – | – | – | 955 | 1,440 | 972 |
| Deferred tax liabilities | 31 | 616 | 129 | 745 | – | 482 | 482 | 1,258 | 1,626 | 1,349 |
| Other non-insurance liabilities | 294 | 3,993 | 595 | 4,588 | 1,009 | 3,508 | 4,517 | 9,399 | 8,241 | 9,464 |
| Total liabilities | 8,486 | 81,615 | 7,553 | 89,168 | 22,267 | 29,870 | 52,137 | 149,791 | 148,764 | 148,077 |
| **Total equity and liabilities** | 8,486 | 81,644 | 7,553 | 89,197 | 22,267 | 32,592 | 54,859 | 152,542 | 151,144 | 150,691 |

Notes

(i) 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 per cent to its policyholders and 10 per cent to shareholders as surplus for distribution is determined via the annual actuarial valuation. For the purposes of this table and subsequent explanation, references to the WPSF also include, for convenience, the amounts attaching to the Defined Charges Participating Sub-fund which comprises 3.3 per cent of the total assets of the WPSF and 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). Profits to shareholders on this with-profits annuity business emerge on a 'charges less expenses' basis and policyholders are entitled to 100 per cent of the investment earnings.

(ii) 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. 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.

# Notes on the IFRS basis results continued

## O: Statement of financial position – analysis of segment by business type continued

(v) Other investments comprise:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Derivative assets* | 1,310 | 841 | 1,461 |
| Partnerships in investment pools and other† | 3,373 | 3,205 | 3,107 |
| | 4,683 | 4,046 | 4,568 |

* 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 £1,337 million (30 June 2011: £909 million; 31 December 2011: £1,298 million), which are also included in the statement of financial position, the overall derivative position was a net liability of £27 million (30 June 2011: net liability of £68 million; 31 December 2011: net asset of £163 million).

† Partnerships in investment pools and other comprise mainly investments held by the PAC with-profits fund. These investments are primarily investments in limited partnerships and additionally investments in property funds.

(vi) Unallocated surplus of with-profits funds

Prudential's long-term business written in the UK comprises predominantly life insurance policies 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 Group's Asia operations, subject to local market and regulatory conditions. Such policies are called with-profits policies. Prudential maintains with-profits funds within the 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.

The unallocated surplus represents the excess of assets over policyholder liabilities for the Group's with-profits funds. As allowed under IFRS 4, the 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, including the shareholders' share of future bonuses that has been provided for in determining policyholders' liabilities. The balance of the unallocated surplus is determined after full provision for deferred tax on unrealised appreciation of investments.

### ii US insurance operations

| | 2012 £m | | | 2011 £m | |
|---|---|---|---|---|---|
| | Variable annuity separate account assets and liabilities note (i) | Fixed annuity, GIC and other business note (i) | 30 Jun Total | 30 Jun* Total | 31 Dec* Total |
| **Assets** | | | | | |
| Intangible assets attributable to shareholders: | | | | | |
| Deferred acquisition costs and other intangibles | – | 3,203 | 3,203 | 2,939 | 3,115 |
| Total | – | 3,203 | 3,203 | 2,939 | 3,115 |
| Deferred tax assets | – | 1,633 | 1,633 | 1,346 | 1,392 |
| Other non-investment and non-cash assets | – | 1,536 | 1,536 | 1,151 | 1,542 |
| Investments of long-term business and other operations: | | | | | |
| Investment properties | – | 25 | 25 | 25 | 35 |
| Financial investments: | | | | | |
| Loans note S | – | 4,168 | 4,168 | 4,062 | 4,110 |
| Equity securities and portfolio holdings in unit trusts note (iv) | 43,625 | 249 | 43,874 | 36,263 | 38,036 |
| Debt securities note T and U | – | 27,061 | 27,061 | 25,286 | 27,022 |
| Other investments note (ii) | – | 2,634 | 2,634 | 1,352 | 2,376 |
| Deposits | – | 228 | 228 | 182 | 167 |
| Total investments | 43,625 | 34,365 | 77,990 | 67,170 | 71,746 |
| Properties held for sale | – | – | – | 3 | 3 |
| Cash and cash equivalents | – | 293 | 293 | 214 | 271 |
| **Total assets** | 43,625 | 41,030 | 84,655 | 72,823 | 78,069 |
| **Equity and liabilities** | | | | | |
| *Equity* | | | | | |
| Shareholders' equity note (iii) | – | 3,919 | 3,919 | 3,298 | 3,761 |
| Total equity | – | 3,919 | 3,919 | 3,298 | 3,761 |
| *Liabilities* | | | | | |
| Policyholder: | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) note Y | 43,625 | 31,639 | 75,264 | 64,707 | 69,189 |
| Total | 43,625 | 31,639 | 75,264 | 64,707 | 69,189 |
| Core structural borrowings of shareholder-financed operations | – | 159 | 159 | 155 | 160 |
| Operational borrowings attributable to shareholder-financed operations | – | 91 | 91 | 34 | 127 |
| Deferred tax liabilities | – | 2,069 | 2,069 | 1,554 | 1,818 |
| Other non-insurance liabilities | – | 3,153 | 3,153 | 3,075 | 3,014 |
| Total liabilities | 43,625 | 37,111 | 80,736 | 69,525 | 74,308 |
| **Total equity and liabilities** | 43,625 | 41,030 | 84,655 | 72,823 | 78,069 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

# Notes on the IFRS basis results
continued

## O: Statement of financial position – analysis of segment by business type continued

Notes
(i) Assets and liabilities attaching to variable annuity business that are not held in the separate account are shown within other business.
(ii) Other investments comprise:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Derivative assets* | 1,866 | 749 | 1,677 |
| Partnerships in investment pools and other† | 768 | 603 | 699 |
| | 2,634 | 1,352 | 2,376 |

* 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 derivative liabilities of £1,046 million (30 June 2011: £718 million; 31 December 2011: £887 million), which are also included in the statement of financial position, the overall derivative position is a net asset of £820 million (30 June 2011: £31 million; 31 December 2011: £790 million).
† Partnerships in investment pools and other comprise primarily investments in limited partnerships. These include interests in the PPM America Private Equity Fund and diversified investments in other partnerships by independent money managers that generally invest in various equities and fixed income loans and securities.

(iii) Changes in shareholders' equity

| | 2012 30 Jun £m | 2011* 30 Jun £m | 2011* 31 Dec £m |
|---|---|---|---|
| Operating profits based on longer-term investment returns note C | 442 | 340 | 651 |
| Short-term fluctuations in investment returns note F | (125) | 7 | (167) |
| Profit before shareholder tax | 317 | 347 | 484 |
| Tax note K | (71) | (102) | (127) |
| Profit for the period | 246 | 245 | 357 |

| | 2012 30 Jun £m | 2011* 30 Jun £m | 2011* 31 Dec £m |
|---|---|---|---|
| Profit for the period (as above) | 246 | 245 | 357 |
| Items recognised in other comprehensive income: | | | |
| Exchange movements | (34) | (80) | 35 |
| Unrealised valuation movements on securities classified as available-for sale: | | | |
| Unrealised holding gains arising during the period | 470 | 287 | 912 |
| Add back net losses/deduct net (gains) included in income statement | 12 | (50) | (101) |
| Total unrealised valuation movements | 482 | 237 | 811 |
| Related change in amortisation of deferred income and acquisition costs note Q | (181) | (71) | (275) |
| Related tax | (105) | (57) | (187) |
| Total other comprehensive income | 162 | 29 | 384 |
| Total comprehensive income for the period | 408 | 274 | 741 |
| Dividends, interest payments to central companies and other movements | (250) | (326) | (330) |
| Net increase (decrease) in equity | 158 | (52) | 411 |
| Shareholders' equity at beginning of period: | | | |
| As previously reported | 4,271 | 3,815 | 3,815 |
| Effect of change in accounting policy for deferred acquisition costs | (510) | (465) | (465) |
| After effect of change | 3,761 | 3,350 | 3,350 |
| Shareholders' equity at end of period | 3,919 | 3,298 | 3,761 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

(iv) Equity securities and portfolio holdings in unit trusts includes investments in mutual funds, the majority of which are equity based.

### iii Asia insurance operations

| | 2012 £m | | | | 2011 £m | |
|---|---|---|---|---|---|---|
| | With-profits business† | Unit-linked assets and liabilities | Other | 30 Jun Total | 30 Jun* Total | 31 Dec* Total |
| **Assets** | | | | | | |
| Intangible assets attributable to shareholders: | | | | | | |
| Goodwill | – | – | 237 | 237 | 239 | 235 |
| Deferred acquisition costs and other intangible assets | – | – | 987 | 987 | 981 | 977 |
| Total | – | – | 1,224 | 1,224 | 1,220 | 1,212 |
| Intangible assets attributable to with-profits funds: | | | | | | |
| Deferred acquisition costs and other intangible assets | 78 | – | – | 78 | 82 | 83 |
| Deferred tax assets | – | 1 | 94 | 95 | 94 | 115 |
| Other non-investment and non-cash assets | 306 | 104 | 643 | 1,053 | 899 | 1,024 |
| Investments of long-term business and other operations: | | | | | | |
| Investment properties | – | – | 11 | 11 | 10 | 10 |
| Investments accounted for using the equity method | – | – | – | – | 2 | – |
| Financial investments: | | | | | | |
| Loans note S | 726 | 1 | 444 | 1,171 | 1,283 | 1,233 |
| Equity securities and portfolio holdings in unit trusts | 2,629 | 9,183 | 741 | 12,553 | 14,159 | 11,997 |
| Debt securities note T | 10,475 | 2,927 | 6,031 | 19,433 | 15,357 | 17,681 |
| Other investments | 394 | 41 | 268 | 703 | 504 | 470 |
| Deposits | 54 | 497 | 490 | 1,041 | 827 | 1,165 |
| Total investments | 14,278 | 12,649 | 7,985 | 34,912 | 32,142 | 32,556 |
| Cash and cash equivalents | 702 | 594 | 631 | 1,927 | 2,075 | 1,977 |
| **Total assets** | 15,364 | 13,348 | 10,577 | 39,289 | 36,512 | 36,967 |
| **Equity and liabilities** | | | | | | |
| *Equity* | | | | | | |
| Shareholders' equity | – | – | 2,403 | 2,403 | 2,224 | 2,306 |
| Non-controlling interests | – | – | 5 | 5 | 5 | 5 |
| Total equity | – | – | 2,408 | 2,408 | 2,229 | 2,311 |
| *Liabilities* | | | | | | |
| Policyholder liabilities and unallocated surplus of with-profits funds: | | | | | | |
| Contract liabilities (including amounts in respect of contracts classified as investment contracts under IFRS 4) note Y | 13,344 | 12,593 | 6,831 | 32,768 | 30,181 | 30,862 |
| Unallocated surplus of with-profits funds note Y | 52 | – | – | 52 | 61 | 50 |
| Total | 13,396 | 12,593 | 6,831 | 32,820 | 30,242 | 30,912 |
| Operational borrowings attributable to shareholder-financed operations | – | – | 93 | 93 | 139 | 141 |
| Deferred tax liabilities | 373 | 31 | 146 | 550 | 518 | 506 |
| Other non-insurance liabilities | 1,595 | 724 | 1,099 | 3,418 | 3,384 | 3,097 |
| Total liabilities | 15,364 | 13,348 | 8,169 | 36,881 | 34,283 | 34,656 |
| **Total equity and liabilities** | 15,364 | 13,348 | 10,577 | 39,289 | 36,512 | 36,967 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.
† 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 business'.

# Notes on the IFRS basis results continued

## O: Statement of financial position – analysis of segment by business type continued

### iv Asset management operations

| | 2012 £m | | | | 2011 £m | |
|---|---|---|---|---|---|---|
| | M&G note (i) | US | Eastspring Investments | 30 Jun Total | 30 Jun Total | 31 Dec Total |
| **Assets** | | | | | | |
| Intangible assets: | | | | | | |
| Goodwill note P | 1,153 | 16 | 61 | 1,230 | 1,230 | 1,230 |
| Deferred acquisition costs | 11 | 2 | 2 | 15 | 10 | 16 |
| Total | 1,164 | 18 | 63 | 1,245 | 1,240 | 1,246 |
| Other non-investment and non-cash assets note (iii) | 945 | 176 | 93 | 1,214 | 1,172 | 1,129 |
| Investments accounted for using the equity method | 42 | – | – | 42 | – | – |
| Financial investments: | | | | | | |
| Loans note S | 1,207 | – | – | 1,207 | 1,271 | 1,256 |
| Equity securities and portfolio holdings in unit trusts | 66 | – | 13 | 79 | 145 | 594 |
| Debt securities note T | 1,867 | – | 8 | 1,875 | 1,752 | 1,842 |
| Other investments | 70 | 2 | – | 72 | 49 | 78 |
| Deposits | 5 | 15 | 35 | 55 | 90 | 89 |
| Total investments note (iii) | 3,257 | 17 | 56 | 3,330 | 3,307 | 3,859 |
| Cash and cash equivalents note (iii) | 1,408 | 47 | 125 | 1,580 | 2,179 | 1,735 |
| **Total assets** | 6,774 | 258 | 337 | 7,369 | 7,898 | 7,969 |
| **Equity and liabilities** | | | | | | |
| *Equity* | | | | | | |
| Shareholders' equity | 1,501 | 124 | 263 | 1,888 | 1,860 | 1,783 |
| Non-controlling interests | – | – | – | – | 3 | 5 |
| Total equity | 1,501 | 124 | 263 | 1,888 | 1,863 | 1,788 |
| *Liabilities* | | | | | | |
| Core structural borrowing of shareholder-financed operations | 250 | – | – | 250 | 250 | 250 |
| Intra-group debt represented by operational borrowings at Group level note (ii) | 2,568 | – | – | 2,568 | 2,633 | 2,956 |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds note (iii) | 313 | – | – | 313 | 516 | 678 |
| Other non-insurance liabilities note (iii) and (iv) | 2,142 | 134 | 74 | 2,350 | 2,636 | 2,297 |
| Total liabilities | 5,273 | 134 | 74 | 5,481 | 6,035 | 6,181 |
| **Total equity and liabilities** | 6,774 | 258 | 337 | 7,369 | 7,898 | 7,969 |

Notes
(i) M&G includes those assets and liabilities in respect of Prudential Capital.
(ii) 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:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Commercial paper | 2,318 | 2,384 | 2,706 |
| Medium-term notes | 250 | 249 | 250 |
| Total intra-group debt represented by operational borrowings at Group level | 2,568 | 2,633 | 2,956 |

(iii) 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 the following, which are non-recourse to M&G and the Group:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Cash and cash equivalents | 305 | 357 | 348 |
| Total investments | 88 | 193 | 415 |
| Other net assets and liabilities | (80) | (34) | (85) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (313) | (516) | (678) |
| Shareholders' equity | – | – | – |

(iv) Other non-insurance liabilities consist primarily of intra-group balances, derivative liabilities and other creditors.

## P: Goodwill attributable to shareholders

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| **Cost** | | | |
| At beginning of period | 1,585 | 1,586 | 1,586 |
| Exchange differences | 2 | 3 | (1) |
| At end of period | 1,587 | 1,589 | 1,585 |
| Aggregate impairment | (120) | (120) | (120) |
| **Net book amount at end of period** | 1,467 | 1,469 | 1,465 |

Goodwill attributable to shareholders comprises:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| M&G | 1,153 | 1,153 | 1,153 |
| Other | 314 | 316 | 312 |
| | 1,467 | 1,469 | 1,465 |

Other represents goodwill amounts allocated to entities in the Asia and US operations. Other goodwill amounts are individually not material.

# Notes on the IFRS basis results
continued

## Q: Deferred acquisition costs and other intangible assets attributable to shareholders

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 regimes, these costs are accounted for in a way that is consistent with the principles of the ABI SORP with deferral and amortisation against margins in future revenues on the related insurance policies. In general, this deferral is presentationally shown by an explicit carrying value for deferred acquisition costs (DAC) in the balance sheet. However, in some Asia operations the deferral is implicit through the reserving methodology. The recoverability of the explicitly and implicitly deferred acquisition costs is measured and is deemed impaired if the projected margins are less than the carrying value. To the extent that the future margins differ from those anticipated, an adjustment to the carrying value will be necessary. For UK regulated with-profits funds where the realistic FSA regime is applied, the basis of setting liabilities is such that it would be inappropriate for acquisition costs to be deferred, therefore these costs are expensed as incurred.

The deferral and amortisation of acquisition costs is of most relevance to the Group's results for shareholder-financed long-term business of Jackson and Asia operations. The majority of the UK shareholder-backed business is individual and group annuity business where the incidence of acquisition costs is negligible.

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

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun* | 31 Dec* |
| Deferred acquisition costs related to insurance contracts as classified under IFRS 4 | 3,919 | 3,628 | 3,805 |
| Deferred acquisition costs related to investment management contracts, including life assurance contracts classified as financial instruments and investment management contracts under IFRS 4 | 103 | 107 | 107 |
| | 4,022 | 3,735 | 3,912 |
| Present value of acquired in-force policies for insurance contracts as classified under IFRS 4 (PVIF) | 62 | 68 | 64 |
| Other intangibles† | 249 | 257 | 258 |
| | 311 | 325 | 322 |
| Total of deferred acquisition costs and other intangible assets | 4,333 | 4,060 | 4,234 |

| | Deferred acquisition costs | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | UK £m | US note (i) £m | Asia £m | Asset management £m | PVIF and Other intangibles £m | Total 30 Jun 2012 £m | Total 30 Jun 2011* £m | Total 31 Dec 2011* £m |
| **Balance at beginning of period:** | | | | | | | | |
| As previously reported | 111 | 3,880 | 744 | 12 | 322 | 5,069 | 4,667 | 4,667 |
| Effect of change in accounting policy[note B] | – | (785) | (50) | – | – | (835) | (766) | (766) |
| **After effect of change** | 111 | 3,095 | 694 | 12 | 322 | 4,234 | 3,901 | 3,901 |
| Additions | 6 | 398 | 130 | 1 | 14 | 549 | 618 | 1,117 |
| Amortisation to the income statement: | | | | | | | | |
| Operating profit | (10) | (179) | (97) | (2) | (23) | (311) | (385) | (792) |
| Amortisation related to short-term fluctuations in investment returns | – | 80 | – | – | – | 80 | 68 | 287 |
| | (10) | (99) | (97) | (2) | (23) | (231) | (317) | (505) |
| Exchange differences | – | (28) | (8) | – | (2) | (38) | (71) | (2) |
| Change in shadow DAC related to movement in unrealised appreciation of Jackson's securities classified as available-for-sale | – | (181) | – | – | – | (181) | (71) | (275) |
| Disposals | – | – | – | – | – | – | – | (2) |
| **Balance at end of period** | 107 | 3,185 | 719 | 11 | 311 | 4,333 | 4,060 | 4,234 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

† In the second half of 2011, the Group made a reclassification of computer software from tangible assets to other intangible assets. Accordingly, for the 30 June 2011 position, computer software with a net book value of £56 million has been transferred from tangible assets (as previously published) to other intangible assets. This is only a presentational adjustment with no impact on the Group's results or shareholders' equity.

Note
(i) The DAC amount in respect of US insurance operations comprises amounts in respect of:

| | 2012 30 Jun £m | 2011* 30 Jun £m | 2011* 31 Dec £m |
|---|---|---|---|
| Variable annuity business | **3,287** | 2,451 | 2,960 |
| Other business | **794** | 962 | 855 |
| Cumulative shadow DAC (for unrealised gains/losses booked in other comprehensive income) | **(896)** | (491) | (720) |
| Total DAC for US operations | **3,185** | 2,922 | 3,095 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

## Overview of the deferral and amortisation of acquisition costs for Jackson

Under IFRS 4, the Group applies 'grandfathered' US GAAP for measuring the insurance assets and liabilities of Jackson. In the case of Jackson term business, acquisition costs are deferred and amortised in line with expected premiums. For annuity and interest-sensitive life business, acquisition costs are deferred and amortised in line with a combination of historical and future expected gross profits on the relevant contracts. For fixed and indexed annuity and interest-sensitive life business, the key assumption is the long-term spread between the earned rate on investments and the rate credited to policyholders, which is based on an annual spread analysis. Expected gross profits also 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 mortality, lapse and expense experience is performed using internally developed experience studies.

As with fixed and indexed annuity and interest-sensitive life business, acquisition costs for Jackson's variable annuity products are amortised in line with the emergence of profits. The measurement of the amortisation in part reflects current period fees (including those for guaranteed minimum death, income, or withdrawal benefits) earned on assets covering liabilities to policyholders, and the historical and expected level of future gross profits which depends on the assumed level of future fees, as well as components related to mortality, lapse, and expense.

### Change of accounting policy

As explained in note B, the Company has adopted the US Financial Accounting Standards Board requirements in EITF Update No 2010-26 on 'Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts' from 1 January 2012 into Prudential's Group IFRS reporting for the results of Jackson and those Asia operations whose IFRS insurance assets and liabilities are measured principally by reference to US GAAP principles. Under the Update insurers are required to capitalise only those incremental costs directly relating to acquiring a contract from 1 January 2012. For Group IFRS reporting the Company has chosen to apply this new basis retrospectively for the results of these operations.

On application of the new policy for Jackson the deferred costs balance for business in force at 31 December 2011 was retrospectively reduced from £3,880 million to £3,095 million.

### Mean reversion technique

Under US GAAP (as 'grandfathered' under IFRS 4) the projected gross profits, against which acquisition costs are amortised, reflect an assumed long-term level of equity return which, for Jackson, is 8.4 per cent after deduction of net external fund management fees. This is applied to the period end level of separate account assets after application of a mean reversion technique that removes a portion of the effect of levels of short-term variability in current market returns.

Under the mean reversion technique applied by Jackson, the projected level of return for each of the next five years is adjusted from period to period so that in combination with the actual rates of return for the preceding two years and the current year, the 8.4 per cent annual return is realised on average over the entire eight-year period. Projected returns after the mean reversion period revert back to the 8.4 per cent assumption.

However, to ensure that the methodology does not over anticipate a reversion to trend following adverse markets, the mean reversion technique has a cap and floor feature whereby the projected returns in each of the next five years can be no more than 15 per cent per annum and no less than 0 per cent per annum (both after deduction of net external fund management fees) in each year. The capping feature was relevant in late 2008, 2009 and 2010 due to the very sharp market falls in 2008. Notwithstanding this capping feature the mean reversion technique gave rise to a benefit in 2008 of £110 million. This benefit was effectively 'paid back' under the mean reversion technique through charges for accelerated amortisation in 2011, as discussed below.

At 31 December 2011, the projected rate of return for the next five years was less than 8.4 per cent. If Jackson had not applied the mean reversion methodology and had instead applied a constant 8.4 per cent from asset values at 31 December 2011, the Jackson DAC balance would have increased by approximately £30 million from £3,095 million to £3,125 million.

# Notes on the IFRS basis results
continued

## Q: Deferred acquisition costs and other intangible assets attributable to shareholders continued

**Sensitivity of amortisation charge**

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

(i) a core amount that reflects a relatively stable proportion of underlying profits; and

(ii) an element of acceleration or deceleration arising from market movements differing from expectations.

In periods where the cap and floor feature of the mean reversion technique are not relevant, the technique operates to dampen the second element above. Nevertheless, extreme market movements can cause material acceleration or deceleration of amortisation in spite of this dampening effect.

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

**Half year and full year 2011**

In half and full year 2011, the DAC amortisation charge to operating profit included £66 million and £190 million of accelerated amortisation respectively. These amounts reflected the combined effect of:

(i) the separate account performance in the periods (half year 2011: 4 per cent; full year 2011: negative 4 per cent, net of all fees) as it compared with the assumed level for the period; and

(ii) the reduction in the previously assumed future rates of return for the upcoming 5 years from 15 per cent, to a level nearer the middle of the corridor (of 0 per cent and 15 per cent), so that in combination with the historical returns, the 8-year average in the mean reversion calculation was the 8.4 per cent assumption.

The reduction in assumed future rates reflected in large part the elimination from the calculation in 2011, of the 2008 negative returns. Setting aside other complications and the growth in the book, the 2011 accelerated amortisation can be broadly equated as 'paying back' the benefit experienced in 2008.

**Half year 2012**

In half year 2012, the DAC amortisation charge to operating profit was determined after including a credit for decelerated amortisation of £25 million. This amount primarily reflects the separate account performance of 5 per cent, net of all fees, over the assumed level for the period.

**Full year 2012**

The sensitivity for the full year 2012 remains broadly the same as previously published with the 2011 full year results, namely that on the assumption that market returns for 2012 are within the range of negative 15 per cent to positive 15 per cent, the estimated effect on the amortisation charge, is a range from acceleration of £100 million to deceleration of £100 million.

## R: Valuation bases for Group assets

The accounting carrying values of the Group's assets reflect the requirements of IFRS. For financial investments the basis of valuation reflects the Group's application of IAS 39 'Financial Instruments: Recognition and Measurement' as described further below. The basis applied for the assets section of the statement of financial position at 30 June 2012 is summarised below:

| | 2012 £m | | | 2011 £m | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | At fair value | Cost/ Amortised cost note (i) | 30 Jun Total | At fair value | Cost/ Amortised cost note (i) | 30 Jun* Total | At fair value | Cost/ Amortised cost note (i) | 31 Dec* Total |
| Intangible assets attributable to shareholders: | | | | | | | | | |
| Goodwill note P | – | 1,467 | 1,467 | – | 1,469 | 1,469 | – | 1,465 | 1,465 |
| Deferred acquisition costs and other intangible assets note Q | – | 4,333 | 4,333 | – | 4,060 | 4,060 | – | 4,234 | 4,234 |
| Total | – | 5,800 | 5,800 | – | 5,529 | 5,529 | – | 5,699 | 5,699 |
| Intangible assets attributable to with-profits funds: | | | | | | | | | |
| In respect of acquired subsidiaries for venture fund and other investment purposes | – | 178 | 178 | – | 169 | 169 | – | 178 | 178 |
| Deferred acquisition costs and other intangible assets | – | 84 | 84 | – | 93 | 93 | – | 89 | 89 |
| Total | – | 262 | 262 | – | 262 | 262 | – | 267 | 267 |
| Total | – | 6,062 | 6,062 | – | 5,791 | 5,791 | – | 5,966 | 5,966 |
| Other non-investment and non-cash assets: | | | | | | | | | |
| Property, plant and equipment | – | 798 | 798 | – | 705 | 705 | – | 748 | 748 |
| Reinsurers' share of insurance contract liabilities | – | 1,703 | 1,703 | – | 1,334 | 1,334 | – | 1,647 | 1,647 |
| Deferred tax assets note K | – | 2,179 | 2,179 | – | 2,120 | 2,120 | – | 2,276 | 2,276 |
| Current tax recoverable | – | 308 | 308 | – | 384 | 384 | – | 546 | 546 |
| Accrued investment income | – | 2,713 | 2,713 | – | 2,460 | 2,460 | – | 2,710 | 2,710 |
| Other debtors | – | 1,827 | 1,827 | – | 1,638 | 1,638 | – | 987 | 987 |
| Total | – | 9,528 | 9,528 | – | 8,641 | 8,641 | – | 8,914 | 8,914 |
| Investments of long-term business and other operations: note (ii) | | | | | | | | | |
| Investment properties | 10,822 | – | 10,822 | 10,965 | – | 10,965 | 10,757 | – | 10,757 |
| Investments accounted for using the equity method | – | 112 | 112 | – | 71 | 71 | – | 70 | 70 |
| Loans note S | 285 | 9,696 | 9,981 | 245 | 8,772 | 9,017 | 279 | 9,435 | 9,714 |
| Equity securities and portfolio holdings in unit trusts | 90,542 | – | 90,542 | 91,037 | – | 91,037 | 87,349 | – | 87,349 |
| Debt securities note T | 128,269 | – | 128,269 | 117,213 | – | 117,213 | 124,498 | – | 124,498 |
| Other investments | 8,143 | – | 8,143 | 6,121 | – | 6,121 | 7,509 | – | 7,509 |
| Deposits | – | 12,429 | 12,429 | – | 10,858 | 10,858 | – | 10,708 | 10,708 |
| Total | 238,061 | 22,237 | 260,298 | 225,581 | 19,701 | 245,282 | 230,392 | 20,213 | 250,605 |
| Properties held for sale | – | – | – | 394 | – | 394 | 3 | – | 3 |
| Cash and cash equivalents | – | 6,737 | 6,737 | – | 8,589 | 8,589 | – | 7,257 | 7,257 |
| **Total assets** | 238,061 | 44,564 | 282,625 | 225,975 | 42,722 | 268,697 | 230,395 | 42,350 | 272,745 |
| Percentage of Group total assets | 84% | 16% | 100% | 84% | 16% | 100% | 84% | 16% | 100% |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

# Notes on the IFRS basis results
continued

## R: Valuation bases for Group assets continued

Notes
(i) Assets carried at cost or amortised cost are subject to impairment testing where appropriate under IFRS requirements. This category also includes assets which are valued by reference to specific IFRS standards such as reinsurers' share of insurance contract liabilities, deferred tax assets and investments accounted for under the equity method.
(ii) Realised gains and losses on the Group's investments for half year 2012 amounted to a net gain of £3.6 billion (half year 2011: £2.5 billion; full year 2011: £4.3 billion).

### Determination of fair value

The fair values of the financial assets and liabilities of the Group 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 exchange-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 eg market illiquidity. The valuation techniques used include comparison to recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option adjusted spread models and, if applicable, enterprise valuation. 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 judgments 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 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 disclosed value cannot be realised in immediate settlement of the financial instrument.

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 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 Group's risk management framework, all internally generated valuations are subject to assessment against external counterparties' valuations.

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 Group financial instruments

The table overleaf includes financial instruments carried at fair value analysed by level of the IFRS 7 'Financial Instruments: Disclosures' 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.

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 includes financial instruments where there is clear evidence that the valuation is based on a quoted publicly traded price in an active market (eg exchange listed equities, mutual funds with quoted prices and exchange traded derivatives).

#### Level 2 – inputs other than quoted prices included within level 1 that are observable either directly (ie as prices) or indirectly (ie derived from prices)

Level 2 includes investments where a direct link to an actively traded price is not readily apparent, but which are valued using inputs which are largely observable either directly (ie as prices) or indirectly (ie derived from prices). A significant proportion of the Group's level 2 assets are corporate bonds, structured securities and other non-national government debt securities. These assets, in line with market practice, are generally valued using independent pricing services or third-party broker quotes. These valuations are determined using independent external quotations from multiple sources and are subject to a number of monitoring controls, such as monthly price variances, stale price reviews and variance analysis on prices achieved on subsequent trades.

Pricing services, where available, are used to obtain the third-party broker quotes. Where pricing services providers are used, a single valuation is obtained and applied.

When prices are not available from pricing services, quotes are sourced directly from brokers. Prudential seeks to obtain a number of quotes from different brokers so as to obtain the most comprehensive information available on their executability. Where quotes are sourced directly from brokers, the price used in the valuation is normally selected from one of the quotes based on a number of factors, including the timeliness, regularity and accuracy of the quotes considering the spreads provided. The selected quote is the one which best represents an executable quote for the security at the measurement date.

Generally, no adjustment is made to the prices obtained from independent third parties. Adjustment is made in only limited circumstances, where it is determined that the third party valuations obtained do not reflect fair value (eg either because the value is stale and/or the values are extremely diverse in range). These are usually securities which are distressed or that could be subject to a debt restructure or where reliable market prices are no longer available due to an inactive market or market dislocation. In these instances, prices are derived using internal valuation techniques including those as described above in this note 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 techniques used require a number of assumptions relating to variables such as credit risk and interest rates. Examples of such variables include an average credit spread based on the corporate bond universe and the relevant duration of the asset being valued. Prudential measures the input assumptions based on the best available information at the measurement dates. Securities valued in such manner are classified as level 3 where these significant inputs are not based on observable market data.

Of the total level 2 debt securities of £97,052 million at 30 June 2012 (30 June 2011: £89,051 million; 31 December 2011: £94,378 million), £7,287 million are valued internally (30 June 2011: £6,644 million; 31 December 2011: £6,847 million). The majority of such securities are valued using matrix pricing, which is based on assessing the credit quality of the underlying borrower to derive a suitable discount rate relative to government securities of a comparable duration. Under matrix pricing, the debt securities are priced taking the credit spreads on comparable quoted public debt securities and applying these to the equivalent debt instruments factoring in a specified liquidity premium. The majority of the parameters used in this valuation technique are readily observable in the market and, therefore, are not subject to interpretation.

**Level 3 – significant inputs for the asset or liability that are not based on observable market data (unobservable inputs)**
Level 3 includes investments which are internally valued or subject to a significant number of unobservable assumptions (eg private equity funds and certain derivatives which are bespoke or long-dated).

At 30 June 2012 the Group held £4,863 million (30 June 2011: £4,423 million; 31 December 2011: £4,565 million), 2 per cent of the fair valued financial investments, net of derivative liabilities (30 June 2011: 2 per cent; 31 December 2011: 2 per cent), within level 3. Of these amounts £3,971 million (30 June 2011: £3,723 million; 31 December 2011: £3,732 million) was held by the Group's participating funds and therefore shareholders' profit and equity are not impacted by movements in the valuation of these financial instruments. At 30 June 2012, the £3,971 million (30 June 2011: £3,723 million; 31 December 2011: £3,732 million) represented 4.6 per cent (30 June 2011: 4.3 per cent; 31 December 2011: 4.3 per cent) of the total fair valued financial instruments, net of derivative liabilities of the participating funds.

Of the £861 million level 3 fair valued financial investments, net of derivative liabilities at 30 June 2012 (30 June 2011: £699 million; 31 December 2011: £800 million), which support non-linked shareholder-backed business (representing 1.4 per cent of the total fair valued financial investments net of derivative liabilities backing this business (30 June 2011: 1.2 per cent; 31 December 2011: 1.3 per cent)), £819 million of net assets are externally valued and £42 million are internally valued (30 June 2011: net assets of £745 million and net liabilities of £(46) million respectively; 31 December 2011: net assets of £757 million and £43 million respectively). These level 3 internal valuations, which represent 0.1 per cent of the total fair valued financial investments net of derivative liabilities supporting non-linked shareholder-backed business at 30 June 2012 (30 June 2011: (0.1) per cent; 31 December 2011: 0.1 per cent), are inherently more subjective than the external valuations.

**Transfers between levels**
During half year 2012, the transfers between levels within the Group's portfolio were primarily transfers from level 1 to 2 of £263 million and from level 3 to 2 of £145 million. These transfers which relate to equity securities and debt securities arose to reflect the change in the observability of the inputs used in valuing these securities.

# Notes on the IFRS basis results
continued

## R: Valuation bases for Group assets continued

| | 30 Jun 2012 £m | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **Analysis of financial investments, net of derivative liabilities by business type** | | | | |
| **With-profits** | | | | |
| Equity securities and portfolio holdings in unit trusts | 21,543 | 1,388 | 475 | 23,406 |
| Debt securities | 14,549 | 43,849 | 532 | 58,930 |
| Other investments (including derivative assets) | 295 | 1,405 | 2,964 | 4,664 |
| Derivative liabilities | (41) | (1,410) | – | (1,451) |
| Total financial investments, net of derivative liabilities | 36,346 | 45,232 | 3,971 | 85,549 |
| Percentage of total | 42% | 53% | 5% | 100% |
| **Unit-linked and variable annuity separate account** | | | | |
| Equity securities and portfolio holdings in unit trusts | 65,845 | 183 | 22 | 66,050 |
| Debt securities | 3,843 | 5,210 | 9 | 9,062 |
| Other investments (including derivative assets) | 45 | 80 | – | 125 |
| Derivative liabilities | (8) | (9) | – | (17) |
| Total financial investments, net of derivative liabilities | 69,725 | 5,464 | 31 | 75,220 |
| Percentage of total | 93% | 7% | 0% | 100% |
| **Non-linked shareholder-backed** | | | | |
| Loans | – | 285 | – | 285 |
| Equity securities and portfolio holdings in unit trusts | 1,002 | 11 | 73 | 1,086 |
| Debt securities | 12,069 | 47,993 | 215 | 60,277 |
| Other investments (including derivative assets) | 32 | 2,548 | 774 | 3,354 |
| Derivative liabilities | (132) | (1,651) | (201) | (1,984) |
| Total financial investments, net of derivative liabilities | 12,971 | 49,186 | 861 | 63,018 |
| Percentage of total | 21% | 78% | 1% | 100% |
| **Group total analysis, including other financial liabilities held at fair value** | | | | |
| **Group total** | | | | |
| Loans | – | 285 | – | 285 |
| Equity securities and portfolio holdings in unit trusts | 88,390 | 1,582 | 570 | 90,542 |
| Debt securities | 30,461 | 97,052 | 756 | 128,269 |
| Other investments (including derivative assets) | 372 | 4,033 | 3,738 | 8,143 |
| Derivative liabilities | (181) | (3,070) | (201) | (3,452) |
| Total financial investments, net of derivative liabilities | 119,042 | 99,882 | 4,863 | 223,787 |
| Borrowings attributable to the with-profits fund held at fair value | – | (41) | – | (41) |
| Investment contract liabilities without discretionary participation features held at fair value | – | (15,221) | – | (15,221) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (2,779) | (466) | (533) | (3,778) |
| Other financial liabilities held at fair value | – | (311) | – | (311) |
| Total | 116,263 | 83,843 | 4,330 | 204,436 |
| Percentage of total | 57% | 41% | 2% | 100% |

| | 30 Jun 2011 £m | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **Analysis of financial investments, net of derivative liabilities by business type** | | | | |
| **With-profits** | | | | |
| Equity securities and portfolio holdings in unit trusts | 28,379 | 1,269 | 361 | 30,009 |
| Debt securities | 12,673 | 40,755 | 721 | 54,149 |
| Other investments (including derivative assets) | 133 | 1,228 | 2,688 | 4,049 |
| Derivative liabilities | (40) | (895) | (47) | (982) |
| Total financial investments, net of derivative liabilities | 41,145 | 42,357 | 3,723 | 87,225 |
| Percentage of total | 47% | 49% | 4% | 100% |
| **Unit-linked and variable annuity separate account** | | | | |
| Equity securities and portfolio holdings in unit trusts | 60,132 | 13 | – | 60,145 |
| Debt securities | 4,148 | 4,577 | 1 | 8,726 |
| Other investments (including derivative assets) | 16 | 96 | – | 112 |
| Total financial investments, net of derivative liabilities | 64,296 | 4,686 | 1 | 68,983 |
| Percentage of total | 93% | 7% | 0% | 100% |
| **Non-linked shareholder-backed** | | | | |
| Loans | – | 245 | – | 245 |
| Equity securities and portfolio holdings in unit trusts | 755 | 23 | 105 | 883 |
| Debt securities | 10,385 | 43,719 | 234 | 54,338 |
| Other investments (including derivative assets) | 52 | 1,298 | 610 | 1,960 |
| Derivative liabilities | (36) | (1,117) | (250) | (1,403) |
| Total financial investments, net of derivative liabilities | 11,156 | 44,168 | 699 | 56,023 |
| Percentage of total | 20% | 79% | 1% | 100% |
| **Group total analysis, including other financial liabilities held at fair value** | | | | |
| **Group total** | | | | |
| Loans | – | 245 | – | 245 |
| Equity securities and portfolio holdings in unit trusts | 89,266 | 1,305 | 466 | 91,037 |
| Debt securities | 27,206 | 89,051 | 956 | 117,213 |
| Other investments (including derivative assets) | 201 | 2,622 | 3,298 | 6,121 |
| Derivative liabilities | (76) | (2,012) | (297) | (2,385) |
| Total financial investments, net of derivative liabilities | 116,597 | 91,211 | 4,423 | 212,231 |
| Borrowings attributable to the with-profits fund held at fair value | – | (71) | – | (71) |
| Investment contract liabilities without discretionary participation features held at fair value | – | (14,708) | – | (14,708) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (1,773) | (980) | (450) | (3,203) |
| Total | 114,824 | 75,452 | 3,973 | 194,249 |
| Percentage of total | 59% | 39% | 2% | 100% |

# Notes on the IFRS basis results
continued

## R: Valuation bases for Group assets continued

| | 31 Dec 2011 £m | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **Analysis of financial investments, net of derivative liabilities by business type** | | | | |
| **With-profits** | | | | |
| Equity securities and portfolio holdings in unit trusts | 24,001 | 1,762 | 284 | 26,047 |
| Debt securities | 13,298 | 43,279 | 655 | 57,232 |
| Other investments (including derivative assets) | 252 | 1,378 | 2,793 | 4,423 |
| Derivative liabilities | (214) | (1,127) | – | (1,341) |
| Total financial investments, net of derivative liabilities | 37,337 | 45,292 | 3,732 | 86,361 |
| Percentage of total | 43% | 53% | 4% | 100% |
| **Unit-linked and variable annuity separate account** | | | | |
| Equity securities and portfolio holdings in unit trusts | 59,662 | 198 | 30 | 59,890 |
| Debt securities | 4,160 | 4,698 | 3 | 8,861 |
| Other investments (including derivative assets) | 18 | 95 | – | 113 |
| Derivative liabilities | (2) | (7) | – | (9) |
| Total financial investments, net of derivative liabilities | 63,838 | 4,984 | 33 | 68,855 |
| Percentage of total | 93% | 7% | 0% | 100% |
| **Non-linked shareholder-backed** | | | | |
| Loans | – | 279 | – | 279 |
| Equity securities and portfolio holdings in unit trusts | 1,175 | 176 | 61 | 1,412 |
| Debt securities | 11,753 | 46,401 | 251 | 58,405 |
| Other investments (including derivative assets) | 30 | 2,237 | 706 | 2,973 |
| Derivative liabilities | (78) | (1,408) | (218) | (1,704) |
| Total financial investments, net of derivative liabilities | 12,880 | 47,685 | 800 | 61,365 |
| Percentage of total | 21% | 78% | 1% | 100% |
| **Group total analysis, including other financial liabilities held at fair value** | | | | |
| **Group total** | | | | |
| Loans | – | 279 | – | 279 |
| Equity securities and portfolio holdings in unit trusts | 84,838 | 2,136 | 375 | 87,349 |
| Debt securities | 29,211 | 94,378 | 909 | 124,498 |
| Other investments (including derivative assets) | 300 | 3,710 | 3,499 | 7,509 |
| Derivative liabilities | (294) | (2,542) | (218) | (3,054) |
| Total financial investments, net of derivative liabilities | 114,055 | 97,961 | 4,565 | 216,581 |
| Borrowings attributable to the with-profits fund held at fair value | – | (39) | – | (39) |
| Investment contract liabilities without discretionary participation features held at fair value | – | (15,056) | – | (15,056) |
| Net asset value attributable to unit holders of consolidated unit trusts and similar funds | (2,586) | (805) | (449) | (3,840) |
| Other financial liabilities held at fair value | – | (281) | – | (281) |
| Total | 111,469 | 81,780 | 4,116 | 197,365 |
| Percentage of total | 57% | 41% | 2% | 100% |

## S: Loans portfolio

Loans are accounted for at amortised cost net of impairment except for certain mortgage loans of the UK insurance operations which have been designated at fair value through profit and loss as this loan portfolio is managed and evaluated on a fair value basis. The amounts included in the statement of financial position are analysed as follows:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| Insurance operations | | | |
| UK note(i) | 3,435 | 2,401 | 3,115 |
| US note(ii) | 4,168 | 4,062 | 4,110 |
| Asia note(iii) | 1,171 | 1,283 | 1,233 |
| Asset management operations | | | |
| M&G note(iv) | 1,207 | 1,271 | 1,256 |
| **Total** | 9,981 | 9,017 | 9,714 |

Notes

(i) UK insurance operations

The loans of the Group's UK insurance operations comprise:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| SAIF and PAC WPSF | | | |
| Mortgage loans* | 1,282 | 269 | 1,036 |
| Policy loans | 18 | 22 | 20 |
| Other loans† | 840 | 1,031 | 917 |
| Total PAC WPSF loans | 2,140 | 1,322 | 1,973 |
| Shareholder-backed | | | |
| Mortgage loans* | 1,290 | 1,075 | 1,137 |
| Other loans | 5 | 4 | 5 |
| Total shareholder-backed loans | 1,295 | 1,079 | 1,142 |
| Total UK insurance operations loans | 3,435 | 2,401 | 3,115 |

* The mortgage loans are collateralised by properties. £1,161 million of the £1,290 million held for shareholder-backed business relate to lifetime (equity release) mortgage business which have an average loan to property value of 29 per cent.

† Other loans held by the PAC WPSF are all commercial loans and comprise mainly syndicated loans.

(ii) US insurance operations

The loans of the Group's US insurance operations comprise:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Mortgage loans† | 3,623 | 3,525 | 3,559 |
| Policy loans‡ | 545 | 536 | 551 |
| Other loans | – | 1 | – |
| Total US insurance operations loans | 4,168 | 4,062 | 4,110 |

† 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 is as follows:

# Notes on the IFRS basis results
continued

## S: Loans portfolio continued

| | 2012 30 Jun % | 2011 30 Jun % | 2011 31 Dec % |
|---|---|---|---|
| Industrial | 27 | 27 | 28 |
| Multi-family residential | 24 | 23 | 23 |
| Office | 19 | 19 | 19 |
| Retail | 19 | 20 | 19 |
| Hotels | 11 | 10 | 11 |
| Other | – | 1 | – |
| | 100 | 100 | 100 |

The US insurance operations' commercial mortgage loan portfolio has an average loan size of £6.7 million (30 June 2011: £6.3 million; 31 December 2011: £6.6 million). The portfolio has a current estimated average loan to value of 66 per cent (30 June 2011: 72 per cent; 31 December 2011: 68 per cent) which provides significant cushion to withstand substantial declines in value.

At 30 June 2012, Jackson had mortgage loans with a carrying value of £84 million where the contractual terms of the agreements had been restructured. In addition to the regular impairment review afforded all loans in the portfolio, restructured loans are also reviewed for impairment. An impairment will be recorded if the expected cash flows under the newly restructured terms discounted at the original yield (the pre-structured interest rate) are below the carrying value of the loan.

‡ 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) Asia insurance operations

The loans of the Group's Asia insurance operations comprise:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Mortgage loans‡ | 34 | 31 | 31 |
| Policy loans‡ | 593 | 544 | 572 |
| Other loans§ | 544 | 708 | 630 |
| Total Asia insurance operations loans | 1,171 | 1,283 | 1,233 |

‡ 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 operation in Malaysia and which are all investment graded by two local rating agencies.

(iv) M&G

The M&G loans 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 Group's asset management operations, as part of the risk management process, are:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Loans and receivables internal ratings: | | | |
| A+ to A- | 108 | 29 | 129 |
| BBB+ to BBB- | 980 | 943 | 1,000 |
| BB+ to BB- | 89 | 255 | 89 |
| B+ to B- | 30 | 44 | 38 |
| Total M&G loans | 1,207 | 1,271 | 1,256 |

All loans in the portfolio are currently paying interest on scheduled coupon dates and no interest due has been capitalised or deferred. All loans are in compliance with their covenants at 30 June 2012. The loans in the portfolio generally have ratchet mechanisms included within the loan agreements at inception so that margins increase over time to encourage early repayment or have had margins increased to reflect revised commercial terms.

## T: Debt securities portfolio

Debt securities are carried at fair value. The amounts included in the statement of financial position are analysed as follows, with further information relating to the credit quality of the Group's debt securities at 30 June 2012 provided in the notes below.

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| Insurance operations | | | |
| UK note (i) | 79,900 | 74,818 | 77,953 |
| US note (ii) | 27,061 | 25,286 | 27,022 |
| Asia note (iii) | 19,433 | 15,357 | 17,681 |
| Asset management operations note (iv) | 1,875 | 1,752 | 1,842 |
| Total | 128,269 | 117,213 | 124,498 |

Notes

(i) UK insurance operations

| | 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 £m | PRIL £m | Other annuity and long-term business £m | 2012 30 Jun Total £m | 2011 30 Jun Total £m | 2011 31 Dec Total £m |
| S&P – AAA | 464 | 4,235 | 496 | 4,731 | 611 | 2,886 | 455 | 9,147 | 11,642 | 9,928 |
| S&P – AA+ to AA- | 544 | 3,827 | 714 | 4,541 | 737 | 3,009 | 343 | 9,174 | 7,040 | 8,647 |
| S&P – A+ to A- | 1,109 | 10,893 | 1,303 | 12,196 | 1,743 | 6,382 | 846 | 22,276 | 21,437 | 21,474 |
| S&P – BBB+ to BBB- | 899 | 9,255 | 656 | 9,911 | 1,224 | 3,783 | 607 | 16,424 | 12,775 | 15,746 |
| S&P – Other | 241 | 2,176 | 59 | 2,235 | 152 | 254 | 38 | 2,920 | 3,080 | 3,175 |
| | 3,257 | 30,386 | 3,228 | 33,614 | 4,467 | 16,314 | 2,289 | 59,941 | 55,974 | 58,970 |
| Moody's – Aaa | 262 | 2,510 | 1,227 | 3,737 | 1,186 | 2,412 | 691 | 8,288 | 7,898 | 7,945 |
| Moody's – Aa1 to Aa3 | 37 | 340 | 85 | 425 | 109 | 429 | 87 | 1,087 | 687 | 651 |
| Moody's – A1 to A3 | 39 | 473 | 62 | 535 | 52 | 428 | 53 | 1,107 | 772 | 1,008 |
| Moody's – Baa1 to Baa3 | 52 | 539 | 164 | 703 | 99 | 321 | 41 | 1,216 | 1,001 | 1,030 |
| Moody's – Other | 13 | 170 | 8 | 178 | 41 | 29 | 7 | 268 | 404 | 242 |
| | 403 | 4,032 | 1,546 | 5,578 | 1,487 | 3,619 | 879 | 11,966 | 10,762 | 10,876 |
| Fitch | 21 | 208 | 77 | 285 | 31 | 164 | 19 | 520 | 475 | 492 |
| Other | 307 | 4,058 | 932 | 4,990 | 150 | 1,922 | 104 | 7,473 | 7,607 | 7,615 |
| Total debt securities | 3,988 | 38,684 | 5,783 | 44,467 | 6,135 | 22,019 | 3,291 | 79,900 | 74,818 | 77,953 |

# Notes on the IFRS basis results
continued

## T: Debt securities portfolio continued

Where no external ratings are available, internal ratings produced by the Group's asset management operation, which are prepared on the Company's assessment of a comparable basis to external ratings, are used where possible. The £7,473 million total debt securities held at 30 June 2012 (30 June 2011: £7,607 million; 31 December 2011: £7,615 million) which are not externally rated are either internally rated or unrated. These are analysed as follows:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Internal ratings or unrated: | | | |
| AAA to A- | 2,847 | 2,276 | 2,726 |
| BBB to B- | 3,599 | 3,791 | 3,773 |
| Below B- or unrated | 1,027 | 1,540 | 1,116 |
| Total | 7,473 | 7,607 | 7,615 |

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 £2,026 million PRIL and other annuity and long-term business investments which are not externally rated, £6 million were internally rated AAA, £313 million AA, £641 million A, £838 million BBB, £112 million BB and £116 million were internally rated B+ and below or unrated.

(ii) US insurance operations

US insurance operations held total debt securities with a carrying value of £27,061 million at 30 June 2012 (30 June 2011: £25,286 million; 31 December 2011: £27,022 million). The table below provides information relating to the credit risk of the aforementioned debt securities.

| **Summary** | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Corporate and government security and commercial loans: | | | |
| Government | 2,107 | 1,758 | 2,163 |
| Publicly traded and SEC Rule 144A securities | 16,724 | 14,872 | 16,281 |
| Non-SEC Rule 144A securities | 3,263 | 3,058 | 3,198 |
| Total | 22,094 | 19,688 | 21,642 |
| Residential mortgage-backed securities | 2,282 | 2,536 | 2,591 |
| Commercial mortgage-backed securities | 2,129 | 2,274 | 2,169 |
| Other debt securities | 556 | 788 | 620 |
| Total debt securities | 27,061 | 25,286 | 27,022 |

The following table summarises the securities detailed above by rating as at 30 June 2012 using Standard and Poor's (S&P), Moody's, Fitch and implicit ratings of mortgage-backed securities (MBS) based on NAIC valuations:

| | **2012 30 Jun £m** | **2011 30 Jun £m** | **2011 31 Dec* £m** |
|---|---|---|---|
| S&P – AAA | 71 | 3,252 | 133 |
| S&P – AA+ to AA- | 4,187 | 835 | 4,476 |
| S&P – A+ to A- | 6,767 | 5,490 | 6,382 |
| S&P – BBB+ to BBB- | 8,516 | 7,872 | 8,446 |
| S&P – Other | 954 | 939 | 999 |
| | 20,495 | 18,388 | 20,436 |
| Moody's – Aaa | 69 | 110 | 62 |
| Moody's – Aa1 to Aa3 | 17 | 14 | 15 |
| Moody's – A1 to A3 | 24 | 34 | 29 |
| Moody's – Baa1 to Baa3 | 63 | 73 | 67 |
| Moody's – Other | 21 | 60 | 17 |
| | 194 | 291 | 190 |
| Implicit ratings of MBS based on NAIC valuations (see below) | | | |
| NAIC 1 | 2,577 | 2,914 | 2,577 |
| NAIC 2 | 114 | 209 | 147 |
| NAIC 3-6 | 289 | 222 | 368 |
| | 2,980 | 3,345 | 3,092 |
| Fitch | 220 | 97 | 184 |
| Other† | 3,172 | 3,165 | 3,120 |
| Total debt securities | 27,061 | 25,286 | 27,022 |

In the table above, with the exception of some mortgage-backed securities, 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 alternatives.

For some mortgage-backed securities within Jackson, the table above includes these securities using the regulatory ratings detail issued by the NAIC. These regulatory ratings levels were established by external third parties (PIMCO for residential mortgage-backed securities and BlackRock Solutions for commercial mortgage-backed securities).

* The movement in the S&P AAA rated debt securities in the second half of 2011 reflects the downgrade of US Sovereign debt to AA+ in the period.
† The amounts within 'Other' which are not rated by S&P, Moody's nor Fitch, nor are MBS securities using the revised regulatory ratings, have the following NAIC classifications:

| | **2012 30 Jun £m** | **2011 30 Jun £m** | **2011 31 Dec £m** |
|---|---|---|---|
| NAIC 1 | 1,279 | 1,217 | 1,258 |
| NAIC 2 | 1,823 | 1,861 | 1,792 |
| NAIC 3-6 | 70 | 87 | 70 |
| Total | 3,172 | 3,165 | 3,120 |

# Notes on the IFRS basis results
continued

## T: Debt securities portfolio continued

(iii) Asia insurance operations

| | With-profits business £m | Unit-linked assets £m | Other business £m | 2012 30 Jun Total £m | 2011 30 Jun Total £m | 2011 31 Dec Total £m |
|---|---|---|---|---|---|---|
| S&P – AAA | 605 | 20 | 40 | 665 | 2,370 | 1,423 |
| S&P – AA+ to AA- | 2,877 | 84 | 1,868 | 4,829 | 1,981 | 3,843 |
| S&P – A+ to A- | 1,843 | 582 | 1,088 | 3,513 | 3,070 | 3,055 |
| S&P – BBB+ to BBB- | 1,204 | 79 | 366 | 1,649 | 1,066 | 1,451 |
| S&P – Other | 1,081 | 578 | 765 | 2,424 | 1,787 | 2,137 |
| | 7,610 | 1,343 | 4,127 | 13,080 | 10,274 | 11,909 |
| Moody's – Aaa | 691 | 233 | 475 | 1,399 | 1,344 | 1,489 |
| Moody's – Aa1 to Aa3 | 62 | 70 | 10 | 142 | 129 | 128 |
| Moody's – A1 to A3 | 210 | 32 | 62 | 304 | 146 | 304 |
| Moody's – Baa1 to Baa3 | 139 | 183 | 68 | 390 | 52 | 131 |
| Moody's – Other | 72 | 14 | 14 | 100 | 64 | 59 |
| | 1,174 | 532 | 629 | 2,335 | 1,735 | 2,111 |
| Fitch | 27 | 18 | 29 | 74 | 146 | 351 |
| Other | 1,664 | 1,034 | 1,246 | 3,944 | 3,202 | 3,310 |
| Total debt securities | 10,475 | 2,927 | 6,031 | 19,433 | 15,357 | 17,681 |

The following table analyses debt securities of 'Other business' which are not externally rated:

| | 2012 30 Jun Total £m | 2011 30 Jun Total £m | 2011 31 Dec Total £m |
|---|---|---|---|
| Government bonds | 352 | 387 | 244 |
| Corporate bonds rated as investment grade by local external ratings agencies | 854 | 626 | 776 |
| Structured deposits issued by banks which are themselves rated, but where the specific deposits are not rated | – | 113 | – |
| Other | 40 | 25 | 45 |
| Total | 1,246 | 1,151 | 1,065 |

(iv) Asset Management Operations
Of the total debt securities at 30 June 2012 of £1,875 million, £1,867 million was held by M&G.

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| M&G | | | |
| AAA to A- by Standard and Poor's or Aaa rated by Moody's | 1,620 | 1,573 | 1,547 |
| Other | 247 | 166 | 287 |
| Total M&G | 1,867 | 1,739 | 1,834 |

(v) Group exposure to holdings in asset-backed securities

The Group's exposure to holdings in asset-backed securities, which comprise residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDO) funds and other asset-backed securities (ABS), at 30 June 2012 is as follows:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| **Shareholder-backed operations (excluding assets held in unit-linked funds):** | | | |
| UK insurance operations[note (a)] | 1,538 | 993 | 1,358 |
| US insurance operations[note (b)] | 4,967 | 5,598 | 5,380 |
| Asia insurance operations | 172 | 110 | 176 |
| Other operations[note (d)] | 622 | 659 | 594 |
| | 7,299 | 7,360 | 7,508 |
| **With-profits operations:** | | | |
| UK insurance operations[note (a)] | 5,743 | 5,602 | 5,351 |
| Asia insurance operations[note (c)] | 407 | 263 | 454 |
| | 6,150 | 5,865 | 5,805 |
| Total | 13,449 | 13,225 | 13,313 |

Notes

(a) UK insurance operations

The UK insurance operations' exposure to asset-backed securities at 30 June 2012 comprises:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Shareholder-backed business (2012: 37% AAA, 12% AA)* | 1,538 | 993 | 1,358 |
| With-profits operations (2012: 61% AAA, 8% AA)† | 5,743 | 5,602 | 5,351 |
| Total | 7,281 | 6,595 | 6,709 |

* All of the exposure of the shareholder-backed business relates to the UK market and primarily relates to investments held by PRIL.

† Of the £5,743 million exposure of the with-profits operations at 30 June 2012 (30 June 2011: £5,602 million; 31 December 2011: £5,351 million), £1,683 million (30 June 2011: £1,242 million; 31 December 2011: £1,314 million) relates to exposure to the US markets and with the remaining exposure being primarily to the UK market.

(b) US insurance operations

US insurance operations' exposure to asset-backed securities at 30 June 2012 comprises:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| RMBS | | | |
| Sub-prime (2012: 21% AAA, 3% AA)† | 213 | 218 | 207 |
| Alt-A (2012: 12% AAA, 4% AA) | 281 | 390 | 310 |
| Prime including agency (2012: 3% AAA, 77% AA) | 1,788 | 1,928 | 2,074 |
| CMBS (2012: 36% AAA, 10% AA)† | 2,129 | 2,274 | 2,169 |
| CDO funds (2012: 0% AAA, 1% AA)*, including £nil exposure to sub-prime | 37 | 107 | 44 |
| Other ABS (2012: 16% AAA, 18% AA), including £6.4 million exposure to sub-prime | 519 | 681 | 576 |
| Total | 4,967 | 5,598 | 5,380 |

* Including the Group's economic interest in Piedmont and other consolidated CDO funds.

† MBS ratings refer to the ratings implicit within NAIC risk-based capital valuation see note C (a).

# Notes on the IFRS basis results
continued

## T: Debt securities portfolio continued

(c) Asia insurance operations

The Asia insurance operations' exposure to asset-backed securities is primarily held by the with-profits operations.

The £407 million (30 June 2011: £263 million; 31 December 2011: £454 million) asset-backed securities exposure of the Asia with-profits operations comprises:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| CMBS | 124 | 88 | 149 |
| CDO funds and ABS | 283 | 175 | 305 |
| Total | 407 | 263 | 454 |

The £407 million includes £332 million (30 June 2011: £176 million; 31 December 2011: £398 million) held by investment funds consolidated under IFRS in recognition of the control arrangements for those funds and include an amount not owned by the Group with a corresponding liability of £22 million (30 June 2011: £7 million; 31 December 2011: £20 million) 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 Group. Of the £407 million, 61 per cent (30 June 2011: 52 per cent; 31 December 2011: 75 per cent) are investment graded by Standard and Poor's.

(d) Other operations

Other operations' exposure to asset-backed securities at 30 June 2012 is held by Prudential Capital and comprises:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| RMBS: Prime (2012: 92% AAA, 4% AA) | 363 | 340 | 340 |
| CMBS (2012: 30% AAA, 14% AA) | 132 | 185 | 146 |
| CDO funds and other ABS – all without sub-prime exposure (2012: 99% AAA) | 127 | 134 | 108 |
| Total | 622 | 659 | 594 |

(vi) Group sovereign debt exposure

The exposure of the Group's shareholder and with-profits funds to sovereign debt (including credit default swaps that are referenced to sovereign debt) at 30 June 2012 is as follows:

| | 30 Jun 2012 £m | | 31 Dec 2011 £m | |
|---|---|---|---|---|
| | Shareholder sovereign debt | With-profits sovereign debt | Shareholder sovereign debt | With-profits sovereign debt |
| Continental Europe: | | | | |
| Italy | 44 | 54 | 43 | 52 |
| Spain | 1 | 36 | 1 | 33 |
| | 45 | 90 | 44 | 85 |
| Germany | 463 | 530 | 598 | 602 |
| Other Europe (principally Isle of Man and Belgium) | 58 | 47 | 48 | 62 |
| | 566 | 667 | 690 | 749 |
| United Kingdom | 3,323 | 2,303 | 3,254 | 2,801 |
| United States | 2,365 | 3,305 | 2,448 | 2,615 |
| Other, predominantly Asia | 2,888 | 341 | 2,850 | 332 |
| Total | 9,142 | 6,616 | 9,242 | 6,497 |

Sovereign debt represented 15 per cent or £9.1 billion of the debt portfolio backing shareholder business at 30 June 2012 (31 December 2011: 16 per cent or £9.2 billion). 43 per cent of this was rated AAA and 91 per cent investment grade (31 December 2011: 43 per cent AAA, 94 per cent investment grade). At 30 June 2012, the Group's total holding in continental Europe shareholder sovereign debt fell from £690 million at 31 December 2011 to £566 million, principally due to a reduction in the level of German debt held from £598 million to £463 million. Of the total £566 million debt, 82 per cent was AAA rated (31 December 2011: 87 per cent AAA rated). Shareholder exposure to the Eurozone sovereigns of Portugal, Italy, Ireland, Greece and Spain (PIIGS) is £45 million (31 December 2011: £44 million). The Group does not have any sovereign debt exposure to Greece, Portugal or Ireland.

**Exposure to bank debt securities**

The Group held the following direct exposures to bank debt securities of shareholder-backed business at 30 June 2012 and 31 December 2011.

| | Bank debt securities – shareholder-backed business £m | | | | | | |
|---|---|---|---|---|---|---|---|
| | Senior debt | | | Subordinated debt | | | |
| | Covered | Senior | Total senior debt | Tier 2 | Tier 1 | Total subordinated debt | 30 Jun 2012 Total |
| Portugal | – | 26 | 26 | – | – | – | 26 |
| Ireland | – | 14 | 14 | – | – | – | 14 |
| Italy | – | 11 | 11 | 56 | – | 56 | 67 |
| Greece | – | – | – | – | – | – | – |
| Spain | 137 | 10 | 147 | 42 | 3 | 45 | 192 |
| | 137 | 61 | 198 | 98 | 3 | 101 | 299 |
| Austria | – | – | – | 10 | – | 10 | 10 |
| Belgium | – | – | – | – | – | – | – |
| France | 17 | 34 | 51 | 58 | 30 | 88 | 139 |
| Germany | – | 31 | 31 | 1 | – | 1 | 32 |
| Luxembourg | – | – | – | – | – | – | – |
| Netherlands | – | 11 | 11 | 89 | 66 | 155 | 166 |
| United Kingdom | 457 | 182 | 639 | 618 | 101 | 719 | 1,358 |
| **Total Europe** | 611 | 319 | 930 | 874 | 200 | 1,074 | 2,004 |
| United States | – | 1,434 | 1,434 | 382 | 1 | 383 | 1,817 |
| Other, predominantly Asia | 20 | 303 | 323 | 339 | 229 | 568 | 891 |
| **Total** | 631 | 2,056 | 2,687 | 1,595 | 430 | 2,025 | 4,712 |

| | Bank debt securities – shareholder-backed business £m | | | | | | |
|---|---|---|---|---|---|---|---|
| | Senior debt | | | Subordinated debt | | | |
| | Covered | Senior | Total senior debt | Tier 2 | Tier 1 | Total subordinated debt | 31 Dec 2011 Total |
| Portugal | – | 24 | 24 | – | – | – | 24 |
| Ireland | – | 13 | 13 | – | – | – | 13 |
| Italy | – | 11 | 11 | 56 | 14 | 70 | 81 |
| Greece | – | – | – | – | – | – | – |
| Spain | 107 | 11 | 118 | 90 | 2 | 92 | 210 |
| | 107 | 59 | 166 | 146 | 16 | 162 | 328 |
| Austria | – | – | – | 9 | – | 9 | 9 |
| Belgium | – | – | – | – | – | – | – |
| France | 2 | 34 | 36 | 78 | 35 | 113 | 149 |
| Germany | – | 28 | 28 | 1 | – | 1 | 29 |
| Luxembourg | – | – | – | – | – | – | – |
| Netherlands | – | 7 | 7 | 81 | 64 | 145 | 152 |
| United Kingdom | 228 | 145 | 373 | 615 | 95 | 710 | 1,083 |
| **Total Europe** | 337 | 273 | 610 | 930 | 210 | 1,140 | 1,750 |
| United States | – | 1,362 | 1,362 | 352 | 2 | 354 | 1,716 |
| Other, predominantly Asia | – | 246 | 246 | 562 | 33 | 595 | 841 |
| **Total** | 337 | 1,881 | 2,218 | 1,844 | 245 | 2,089 | 4,307 |

# Notes on the IFRS basis results
continued

## T: Debt securities portfolio continued

In addition to the exposures held by the shareholder-backed business, the Group held the following bank debt securities at 30 June 2012 and 31 December 2011 within its with-profits funds.

| | Bank debt securities - participating funds £m | | | | | | |
|---|---|---|---|---|---|---|---|
| | Senior debt | | | Subordinated debt | | | |
| | Covered | Senior | Total senior debt | Tier 2 | Tier 1 | Total subordinated debt | 30 Jun 2012 Total |
| Portugal | – | 7 | 7 | – | – | – | 7 |
| Ireland | 5 | – | 5 | – | – | – | 5 |
| Italy | – | 47 | 47 | 49 | – | 49 | 96 |
| Greece | – | – | – | – | – | – | – |
| Spain | 157 | 12 | 169 | 5 | 1 | 6 | 175 |
| | 162 | 66 | 228 | 54 | 1 | 55 | 283 |
| Austria | – | – | – | – | – | – | – |
| Belgium | – | – | – | – | – | – | – |
| France | 11 | 69 | 80 | 48 | 5 | 53 | 133 |
| Germany | – | 6 | 6 | – | – | – | 6 |
| Luxembourg | – | – | – | – | – | – | – |
| Netherlands | – | 133 | 133 | – | 4 | 4 | 137 |
| United Kingdom | 704 | 435 | 1,139 | 753 | 42 | 795 | 1,934 |
| **Total Europe** | 877 | 709 | 1,586 | 855 | 52 | 907 | 2,493 |
| United States | – | 1,720 | 1,720 | 202 | 36 | 238 | 1,958 |
| Other, predominantly Asia | 9 | 437 | 446 | 202 | 130 | 332 | 778 |
| **Total** | 886 | 2,866 | 3,752 | 1,259 | 218 | 1,477 | 5,229 |

| | Bank debt securities - participating funds £m | | | | | | |
|---|---|---|---|---|---|---|---|
| | Senior debt | | | Subordinated debt | | | |
| | Covered | Senior | Total senior debt | Tier 2 | Tier 1 | Total subordinated debt | 31 Dec 2011 Total |
| Portugal | – | 7 | 7 | – | – | – | 7 |
| Ireland | 5 | – | 5 | – | – | – | 5 |
| Italy | – | 45 | 45 | 49 | 2 | 51 | 96 |
| Greece | – | – | – | – | – | – | – |
| Spain | 137 | – | 137 | 1 | – | 1 | 138 |
| | 142 | 52 | 194 | 50 | 2 | 52 | 246 |
| Austria | – | – | – | – | – | – | – |
| Belgium | – | – | – | – | – | – | – |
| France | – | 80 | 80 | 47 | 17 | 64 | 144 |
| Germany | – | 7 | 7 | – | – | – | 7 |
| Luxembourg | – | 7 | 7 | – | – | – | 7 |
| Netherlands | – | 80 | 80 | 14 | 28 | 42 | 122 |
| United Kingdom | 319 | 385 | 704 | 772 | 74 | 846 | 1,550 |
| **Total Europe** | 461 | 611 | 1,072 | 883 | 121 | 1,004 | 2,076 |
| United States | – | 1,378 | 1,378 | 396 | 278 | 674 | 2,052 |
| Other, predominantly Asia | 1 | 384 | 385 | 341 | 20 | 361 | 746 |
| **Total** | 462 | 2,373 | 2,835 | 1,620 | 419 | 2,039 | 4,874 |

## U: Debt securities of US insurance operations: valuation basis, accounting presentation of gains and losses and securities in an unrealised loss position

### i Valuation basis

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 do not have an externally quoted price based on regular trades or where markets for the securities are no longer active as a result of market conditions, IAS 39 requires that valuation techniques be applied. IFRS 7 requires classification of the fair values applied by the Group into a three level hierarchy. At 30 June 2012, 0.1 per cent of Jackson's debt securities were classified as level 3 (30 June 2011: 0.1 per cent; 31 December 2011: 0.1 per cent) comprising of fair values where there are significant inputs which are not based on observable market data.

### ii Accounting presentation of gains and losses

With the exception of debt securities of US insurance operations classified as 'available-for-sale' under IAS 39, unrealised value movements on the Group's investments are booked within the income statement. For with-profits operations, such value movements are reflected in changes to asset share liabilities to policyholders or the liability for unallocated surplus. For shareholder-backed operations, the unrealised value movements form part of the total return for the year booked in the profit before tax attributable to shareholders. Separately, as noted elsewhere and in note C in this report, and as applied previously, the Group provides an analysis of this profit distinguishing operating profit based on longer-term investment returns and short-term fluctuations in investment returns.

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, recorded in the income statement are as shown in note F of this report. This classification is applied for most of the debt securities of the Group's US insurance operations.

### iii Half year 2012 movements in unrealised gains and losses

In half year 2012 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 £2,057 million to a net unrealised gain of £2,522 million. This increase reflects the effects of lower interest rates. The gross unrealised gain in the statement of financial position increased from £2,303 million at 31 December 2011 to £2,679 million at 30 June 2012, while the gross unrealised loss decreased from £246 million at 31 December 2011 to £157 million at 30 June 2012.

# Notes on the IFRS basis results
continued

## U: Debt securities of US insurance operations: valuation basis, accounting presentation of gains and losses and securities in an unrealised loss position continued

These features are included in the table shown below of the movements in the values of available-for-sale securities.

| | 30 Jun 2012 | Changes in Unrealised appreciation† | Foreign exchange translation | 31 Dec 2011 |
|---|---|---|---|---|
| | | Reflected as part of movement in comprehensive income | | |
| | £m | £m | £m | £m |
| Assets fair valued at below book value: | | | | |
| Book value* | 1,670 | | | 2,455 |
| Unrealised loss(iv)(a),(b) | (157) | 87 | 2 | (246) |
| Fair value (as included in statement of financial position) | 1,513 | | | 2,209 |
| Assets fair valued at or above book value: | | | | |
| Book value* | 22,863 | | | 22,504 |
| Unrealised gain | 2,679 | 395 | (19) | 2,303 |
| Fair value (as included in statement of financial position) | 25,542 | | | 24,807 |
| Total: | | | | |
| Book value* | 24,533 | | | 24,959 |
| Net unrealised gain (loss) | 2,522 | 482 | (17) | 2,057 |
| Fair value (as included in statement of financial position)‡ | 27,055 | | | 27,016 |

* Book value represents cost/amortised cost of the debt securities.
† Translated at the average rate of US$1.5768: £1.
‡ Debt securities for US operations included in the statement of financial position at 30 June 2012 and as referred to in note T, comprise:

| | 2012 30 Jun £m | 2011 31 Dec £m |
|---|---|---|
| Available-for-sale | 27,055 | 27,016 |
| Consolidated investment funds classified as fair value through profit and loss | 6 | 6 |
| | 27,061 | 27,022 |

Included within the movement in gross unrealised losses for the debt securities of Jackson of £87 million as shown above was a net decrease in value of £12 million relating to sub-prime and Alt-A securities for which the carrying values are shown in the 'Fair value of securities as a percentage of book value' table opposite.

### iv Debt securities classified as available-for-sale in an unrealised loss position

The following tables show some key attributes of those securities that are in an unrealised loss position at 30 June 2012.

#### (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:

| | 30 Jun 2012 £m | | 31 Dec 2011 £m | |
|---|---|---|---|---|
| | Fair value | Unrealised loss | Fair value | Unrealised loss |
| Between 90% and 100% | 1,160 | (27) | 1,829 | (60) |
| Between 80% and 90% | 190 | (31) | 172 | (28) |
| Below 80% note(d) | 163 | (99) | 208 | (158) |
| Total | 1,513 | (157) | 2,209 | (246) |

Included within the table above are amounts relating to sub-prime and Alt-A securities of:

| | 30 Jun 2012 £m | | 31 Dec 2011 £m | |
|---|---|---|---|---|
| | Fair value | Unrealised loss | Fair value | Unrealised loss |
| Between 90% and 100% | 127 | (5) | 142 | (7) |
| Between 80% and 90% | 50 | (9) | 58 | (11) |
| Below 80% note(d) | 62 | (25) | 69 | (35) |
| Total | 239 | (39) | 269 | (53) |

#### (b) Unrealised losses by maturity of security

| | 2012 30 Jun £m | 2011 31 Dec £m |
|---|---|---|
| Less than 1 year | – | – |
| 1 year to 5 years | (2) | (7) |
| 5 years to 10 years | (18) | (28) |
| More than 10 years | (11) | (28) |
| Mortgage-backed and other debt securities | (126) | (183) |
| Total | (157) | (246) |

#### (c) Age analysis of unrealised losses for the years indicated

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

| | 30 Jun 2012 £m | | | 31 Dec 2011 £m | | |
|---|---|---|---|---|---|---|
| | Non-investment grade | Investment grade | Total | Non-investment grade | Investment grade | Total |
| Less than 6 months | (7) | (15) | (22) | (11) | (31) | (42) |
| 6 months to 1 year | (4) | (6) | (10) | (7) | (8) | (15) |
| 1 year to 2 years | (5) | (3) | (8) | (5) | (1) | (6) |
| 2 years to 3 years | (3) | – | (3) | (7) | (10) | (17) |
| More than 3 years | (52) | (62) | (114) | (61) | (105) | (166) |
| Total | (71) | (86) | (157) | (91) | (155) | (246) |

At 30 June 2012, the gross unrealised losses in the statement of financial position for the sub-prime and Alt-A securities in an unrealised loss position were £39 million (31 December 2011: £53 million), as shown above in note (a). Of these losses £2 million (31 December 2011: £10 million) relate to securities that have been in an unrealised loss position for less than one year and £37 million (31 December 2011: £43 million) to securities that have been in an unrealised loss position for more than one year.

# Notes on the IFRS basis results
continued

## U: Debt securities of US insurance operations: valuation basis, accounting presentation of gains and losses and securities in an unrealised loss position continued

### (d) Securities whose fair value were below 80 per cent of the book value

As shown in the table (a) on the previous page, £99 million of the £157 million of gross unrealised losses at 30 June 2012 (31 December 2011: £158 million of the £246 million of gross unrealised losses) related to securities whose fair value was below 80 per cent of the book value. The analysis of the £99 million (31 December 2011: £158 million), by category of debt securities and by age analysis indicating the length of time for which their fair value was below 80 per cent of the book value, is as follows:

| | 30 Jun 2012 £m | | 31 Dec 2011 £m | |
|---|---|---|---|---|
| **Category analysis** | **Fair value** | **Unrealised loss** | **Fair value** | **Unrealised loss** |
| Residential mortgage-backed securities: | | | | |
| Prime (including agency) | 27 | (10) | 38 | (16) |
| Alt-A | 11 | (3) | 12 | (3) |
| Sub-prime | 51 | (22) | 58 | (32) |
| | 89 | (35) | 108 | (51) |
| Commercial mortgage-backed securities | 8 | (29) | 6 | (29) |
| Other asset-backed securities | 53 | (31) | 65 | (58) |
| Total structured securities | 150 | (95) | 179 | (138) |
| Corporates | 13 | (4) | 29 | (20) |
| Total | 163 | (99) | 208 | (158) |

The following table shows the age analysis as at 30 June 2012, of the securities whose fair value were below 80 per cent of the book value:

| | 30 Jun 2012 £m | | 31 Dec 2011 £m | |
|---|---|---|---|---|
| **Age analysis** | **Fair value** | **Unrealised loss** | **Fair value** | **Unrealised loss** |
| Less than 3 months | 32 | (10) | 15 | (5) |
| 3 months to 6 months | – | – | 45 | (15) |
| More than 6 months | 131 | (89) | 148 | (138) |
| Total | 163 | (99) | 208 | (158) |

## V: Net core structural borrowings of shareholder-financed operations

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| Core structural borrowings of shareholder-financed operations:note (i) | | | |
| Perpetual subordinated capital securities (Innovative Tier 1)note (ii) | 1,808 | 1,764 | 1,823 |
| Subordinated notes (Lower Tier 2)note (ii) | 830 | 1,280 | 829 |
| Subordinated debt total | 2,638 | 3,044 | 2,652 |
| Senior debt:note (iii) | | | |
| 2023 | 300 | 300 | 300 |
| 2029 | 249 | 249 | 249 |
| Holding company total | 3,187 | 3,593 | 3,201 |
| PruCap bank loannote (iv) | 250 | 250 | 250 |
| Jackson surplus notes (Lower Tier 2)note (ii) | 159 | 155 | 160 |
| Total (per condensed consolidated statement of financial position) | 3,596 | 3,998 | 3,611 |
| Less: Holding company cash and short-term investments (recorded within the condensed consolidated statement of financial position)note (v) | (1,222) | (1,476) | (1,200) |
| Net core structural borrowings of shareholder-financed operations | 2,374 | 2,522 | 2,411 |

Notes

(i) The maturity profile, currencies and interest rates applicable to the core structural borrowings of shareholder-financed operations of the Group are as detailed in note H13 of the Group's consolidated financial statements for the year ended 31 December 2011. There were no changes in half year 2012 affecting these core structural borrowings.

(ii) These debt classifications are consistent with the treatment of capital for regulatory purposes, as defined in the FSA handbook. In January 2011, the Company issued US$550 million 7.75 per cent Tier 1 subordinated debt, primarily to retail investors. The proceeds, net of costs, were US$539 million (£340 million) and were used to finance the repayments of the €500 million Tier 2 subordinated debt in December 2011.

The Group has designated US$2.85 billion (30 June and 31 December 2011: US$2.85 billion) of its Tier 1 subordinated debt as a net investment hedge under IAS 39 to hedge the currency risks related to the net investment in Jackson.

(iii) The senior debt ranks above subordinated debt in the event of liquidation.

(iv) The £250 million PruCap bank loan was made in December 2010 in two tranches: £135 million maturing in June 2014, currently drawn at a cost of twelve month £LIBOR plus 1.2 per cent and £115 million maturing in December 2012, currently drawn at a cost of twelve month £LIBOR plus 0.99 per cent.

(v) Including central finance subsidiaries.

## W: Other borrowings

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| **Operational borrowings attributable to shareholder-financed operations**note (i) | | | |
| Borrowings in respect of short-term fixed income securities programmes | 2,568 | 2,633 | 2,956 |
| Non-recourse borrowings of US operations | 20 | 34 | 21 |
| Other borrowingsnote (ii) | 216 | 245 | 363 |
| Total | 2,804 | 2,912 | 3,340 |
| **Borrowings attributable to with-profits operations** | | | |
| Non-recourse borrowings of consolidated investment funds | 742 | 1,212 | 747 |
| £100m 8.5% undated subordinated guaranteed bonds of Scottish Amicable Finance plc | 100 | 100 | 100 |
| Other borrowings (predominantly obligations under finance leases) | 113 | 128 | 125 |
| Total | 955 | 1,440 | 972 |

Notes

(i) In addition to the debt listed above, £200 million Floating Rate Notes were issued by Prudential plc in April 2012 which mature in October 2012. These Notes have been wholly subscribed to by a Group subsidiary and accordingly have been eliminated on consolidation in the Group financial statements. These Notes were originally issued in October 2008 and have been reissued upon their maturity.

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

The Group has chosen to designate as a fair value hedge under IAS 39 certain fixed to floating rate swaps which hedge the fair value interest rate exposure movements of these borrowings.

# Notes on the IFRS basis results
continued

## X: Defined benefit pension schemes

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

### Summary Group position

| | 2012 £m | | | 2011 £m | |
|---|---|---|---|---|---|
| | PSPS | Other schemes | 30 Jun | 30 Jun | 31 Dec |
| Underlying economic surplus note (ii) | 1,416 | 9 | 1,425 | 754 | 1,543 |
| Less: unrecognised surplus and adjustment for obligation for deficit funding note (ii) | (1,249) | – | (1,249) | (893) | (1,607) |
| Economic surplus (deficit) (including investment in Prudential insurance policies) note (ii) | 167 | 9 | 176 | (139) | (64) |
| Attributable to: | | | | | |
| PAC with-profits fund | 116 | (18) | 98 | (74) | (41) |
| Shareholder-backed operations | 51 | 27 | 78 | (65) | (23) |
| Consolidation adjustment against policyholder liabilities for investment in Prudential insurance policies | – | (169) | (169) | (222) | (165) |
| IAS 19 pension asset (liability) on the Group statement of financial position* | 167 | (160) | 7 | (361) | (229) |

* At 30 June 2012, the PSPS' pension asset of £167 million and the other schemes' pension liability of £160 million were included within 'Other debtors' and 'Provisions', respectively on the condensed consolidated statement of financial position. The 2011 comparative liabilities of £361 million and £229 million as at 30 June 2011 and 31 December 2011 respectively, were included within 'Provisions'.

The Group business operations operate a number of pension schemes. The largest defined benefit scheme is the principal UK scheme, namely the Prudential Staff Pension Scheme (PSPS). In the UK, the Group also operates two smaller defined benefit schemes for employees in respect of Scottish Amicable 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 pension scheme in Taiwan.

Defined benefit schemes in the UK are generally 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. The valuation of PSPS as at 5 April 2011 was finalised in the second quarter of 2012. This valuation demonstrated the scheme to be 111 per cent funded by reference to the Scheme Solvency Target that forms the basis of the scheme's funding objective. As a result of this valuation, future contributions into the scheme have been reduced to the minimum level of contributions required under the scheme rules effective from July 2012. Excluding expenses, the contributions will fall to approximately £6 million per annum from the £50 million per annum paid previously. The new contributions are only for ongoing service of current employees. No deficit type funding is required. Deficit funding for PSPS, where applicable, is apportioned in the ratio of 70/30 between the PAC with-profits 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.

The valuation of the Scottish Amicable Pension Scheme (SAPS) as at 31 March 2008 demonstrated the scheme to be 91 per cent funded. Based on this valuation and subsequent agreement with the Trustees, deficit funding of £13.1 million per annum is currently being paid into the scheme. The valuation of SAPS as at 31 March 2011 is currently being finalised, but it is anticipated the current level of funding will continue, extending the Group's commitment to pay deficit funding.

The valuation of the M&G pension scheme as at 31 December 2008 demonstrated the scheme to be 76 per cent funded. Based on this valuation, deficit funding amounts designed to eliminate the actuarial deficit over a five year period have been 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. During 2011, the Group agreed with the Trustees to pay an additional funding of £1.2 million per annum from January 2012, until the conclusion of the next formal valuation as at 31 December 2011 which is currently in progress.

Under the IAS 19 'Employee Benefits' valuation basis, the Group applies IFRIC 14, 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. Under IFRIC 14, a surplus is only recognised to the extent that the Company is able to access the surplus either through an unconditional right of refund to the surplus or through reduced future contributions relating to ongoing service which have been substantively enacted or contractually agreed. Further, the IFRS financial position recorded reflects the higher of any underlying IAS 19 deficit and any obligation for committed deficit funding obligation.

For PSPS, the Group does not have unconditional right of refund to any surplus of the scheme. Accordingly, prior to the finalisation of the 5 April 2011 triennial valuation, the Group had not recognised the underlying surplus of PSPS (30 June 2011: £858 million gross of deferred tax; 31 December 2011: £1,588 million gross of deferred tax) and had recognised a liability for deficit funding (30 June 2011: £35 million gross of deferred tax; 31 December 2011: £19 million gross of deferred tax).

The underlying IAS 19 surplus for PSPS at 30 June 2012 was £1,416 million. The finalisation of the 5 April 2011 triennial valuation was accompanied by an agreement with the Trustees that additional deficit type funding would no longer be necessary and furthermore, the level of contributions for ongoing service of current employees was reduced to the minimum level required by the scheme rules. As a consequence, a portion of the surplus, being £169 million, is now recognised as recoverable. The £169 million represents the present value of the economic benefits available from the reductions to future ongoing contributions to the scheme. Accordingly, including a £2 million residual obligation for deficit funding from the 2008 valuation agreement, a net surplus of £167 million gross of deferred tax was recognised at 30 June 2012. Of this amount, £116 million was allocated to the PAC with-profits fund and £51 million was allocated to the shareholders' fund.

The IAS 19 deficit of the Scottish Amicable Pension Scheme at 30 June 2012 was £35 million (30 June 2011: deficit of £99 million; 31 December 2011: deficit of £55 million) and has been allocated approximately 50 per cent to the PAC with-profits fund and 50 per cent to the shareholders' fund.

The IAS 19 surplus of the M&G pension scheme on an economic basis at 30 June 2012 was £44 million (30 June 2011: deficit of £5 million; 31 December 2011: surplus of £10 million) and is wholly attributable to shareholders. The underlying position on an economic basis reflects the assets (including investments in Prudential insurance policies that are offset against liabilities to policyholders on the Group consolidation) and the liabilities of the schemes. As at 30 June 2012, the M&G pension scheme has invested £169 million in Prudential insurance policies (30 June 2011: £222 million; 31 December 2011: £165 million). After excluding these investments that are offset against liabilities to policyholders, the IAS 19 basis position of the M&G pension scheme is a deficit of £125 million (30 June 2011: deficit of £227 million; 31 December 2011: deficit of £155 million).

### i Assumptions

The actuarial assumptions used in determining benefit obligations and the net periodic benefit costs for the period ended 30 June 2012 were as follows:

| | 2012 30 Jun % | 2011 30 Jun % | 2011 31 Dec % |
|---|---|---|---|
| Discount rate* | 4.6 | 5.6 | 4.7 |
| Rate of increase in salaries | 2.6 | 5.7 | 2.9 |
| Rate of inflation:† | | | |
| Retail Price Index (RPI) | 2.6 | 3.7 | 2.9 |
| Consumer Price Index (CPI) | 1.6 | 2.7 | 1.9 |
| Rate of increase of pensions in payment for inflation: | | | |
| Guaranteed (maximum 5%) | 2.5 | 2.7 | 2.5 |
| Guaranteed (maximum 2.5%)‡ | 2.5 | 2.5 | 2.5 |
| Discretionary‡ | 2.5 | 2.5 | 2.5 |
| Expected returns on plan assets | 3.1 | 5.1 | 5.1 |

* 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 rate of inflation reflects the long-term assumption for the UK RPI or CPI depending on the tranche of the schemes.

‡ The rates of 2.5 per cent are those for PSPS. Assumed rates of increase of pensions in payments for inflation for all other schemes are 2.6 per cent for 30 June 2012 (30 June 2011: 2.7 per cent; 31 December 2011: 2.9 per cent).

The calculations are based on current actuarially calculated mortality estimates with a specific allowance made for future improvements in mortality. The specific allowance for half year 2012 and full year 2011 is in line with a custom calibration of the 2009 mortality model from the Continuous Mortality Investigation Bureau of the Institute and Faculty of Actuaries (CMI).

The tables used for PSPS immediate annuities in payment at 30 June 2012, 30 June 2011 and 31 December 2011 were:

Male: 108.6 per cent PNMA 00 with improvements in line with a custom calibration of the CMIs 2009 mortality model, with a long-term mortality improvement rate of 1.75 per cent per annum; and
Female: 103.4 per cent PNFA 00 with improvements in line with a custom calibration of the CMIs 2009 mortality model, with a long-term mortality improvement rate of 1.00 per cent per annum.

# Notes on the IFRS basis results
continued

## X: Defined benefit pension schemes continued

### ii 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:

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | | (Charge) credit to income statement | | | |
| | Surplus (deficit) in scheme at 1 Jan 2012 | Operating results (based on longer-term investment returns) note (a) | Actuarial and other gains and losses note (b) | Contributions paid | Surplus (deficit) in scheme at 30 Jun 2012 note (c) |
| **All schemes** | | | | | |
| **Underlying position (without the effect of IFRIC 14)** | | | | | |
| Surplus (deficit) | 1,543 | (137) | (26) | 45 | 1,425 |
| Less: amount attributable to PAC with-profits fund | (1,083) | 89 | 40 | (21) | (975) |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | 460 | (48) | 14 | 24 | 450 |
| Related tax | (117) | 18 | (3) | (6) | (108) |
| Net of shareholders' tax | 343 | (30) | 11 | 18 | 342 |
| **Effect of IFRIC 14** | | | | | |
| Derecognition of surplus and set-up of additional funding obligation | (1,607) | 119 | 239 | – | (1,249) |
| Less: amount attributable to PAC with-profits fund | 1,124 | (81) | (166) | – | 877 |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | (483) | 38 | 73 | – | (372) |
| Related tax | 123 | (16) | (18) | – | 89 |
| Net of shareholders' tax | (360) | 22 | 55 | – | (283) |
| **With the effect of IFRIC 14** | | | | | |
| Surplus (deficit) | (64) | (18) | 213 | 45 | 176 |
| Less: amount attributable to PAC with-profits fund | 41 | 8 | (126) | (21) | (98) |
| Shareholders' share: | | | | | |
| Gross of tax surplus (deficit) | (23) | (10) | 87 | 24 | 78 |
| Related tax | 6 | 2 | (21) | (6) | (19) |
| Net of shareholders' tax | (17) | (8) | 66 | 18 | 59 |

Notes

(a) The components of the credit (charge) to operating results (comprising amounts attributable to the PAC with-profits fund and shareholder-backed operations) are as follows:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| Current service cost | (17) | (19) | (35) |
| Past service cost: | | | |
| RPI to CPI inflation measure change in 2011[note (i)] | – | 282 | 282 |
| Exceptional discretionary pension increase for PSPS in 2012[note (i)] | (106) | – | – |
| Finance (expense) income: | | | |
| Interest on pension scheme liabilities | (132) | (153) | (299) |
| Expected return on assets | 118 | 156 | 308 |
| Total (charge) credit without the effect IFRIC 14 | (137) | 266 | 256 |
| Effect of IFRIC 14 for pension schemes | 119 | (220) | (229) |
| Total (charge) credit after the effect of IFRIC 14 as shown above relating to the Group's operating profit based on longer-term investment returns[note (ii)] | (18) | 46 | 27 |

Notes

(i) Past service cost

RPI/CPI inflation measure change in 2011

During 2011 the Group altered its inflation measure basis for future statutory increases to pension payments for certain tranches of its UK defined benefit pension schemes. This reflected the UK Government's decision to replace the basis of indexation from RPI with CPI.

The £282 million credit in 2011 shown above comprised £216 million for PSPS and £66 million for other schemes. As noted earlier, the PSPS scheme surplus was not recognised for accounting purposes due to the application of IFRIC 14. The £66 million for other schemes (as shown in the table below) was allocated as £24 million to PAC with-profits fund and £42 million to shareholders referred to in note C.

Exceptional discretionary pension increase for PSPS in 2012

During the first half of 2012, the Group awarded an exceptional discretionary increase to pensions in payment of PSPS, which resulted in a past service cost of £106 million. As the PSPS scheme surplus is substantially not recognised for accounting purposes, this past service cost has no impact on the Group's results.

(ii) The net (charge) credit to operating profit (comprising amounts attributable to the PAC with-profits fund and shareholder-backed operations) of £(18) million (half year 2011: £46 million; full year 2011: £27 million) is made up the following:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| Underlying IAS 19 charge for other pension schemes | (8) | (9) | (17) |
| Cash costs for PSPS | (10) | (10) | (20) |
| Unwind of discount on opening provision for deficit funding for PSPS | – | (1) | (2) |
| Negative past service cost – RPI to CPI inflation measure change in 2011 (note (i) to table above) | – | 66 | 66 |
| | (18) | 46 | 27 |

Consistent with the derecognition of a substantial portion of the Company's interest in the underlying IAS 19 surplus of PSPS, the charge to operating profit based 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.

(b) The components of the credit (charge) for actuarial and other gains and losses (comprising amounts attributable to the PAC with-profits fund and shareholder-backed operations) are as follows:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| Actual less expected return on assets | (32) | 65 | 982 |
| Gains (losses) on changes of assumptions for plan liabilities | 10 | 69 | (414) |
| Experience (losses) gains on liabilities | (4) | (5) | 314 |
| Total (charge) credit without the effect of IFRIC 14 | (26) | 129 | 882 |
| Effect of IFRIC 14 for pension schemes | 239 | (141) | (846) |
| Actuarial and other gains and losses after the effect of IFRIC 14 | 213 | (12) | 36 |

# Notes on the IFRS basis results continued

## X: Defined benefit pension schemes continued

The net credit (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 (ie net of allocation of the share to the PAC with-profits funds) is excluded from operating profit based on longer-term investment returns.

The half year 2012 actuarial and other gains of £213 million (comprising amounts attributable to PAC with-profits fund and shareholder-backed operations and before the application of IFRIC 14) primarily reflects the positive impact of inflation rate movements in the period, offset by lower discount rates as interest rate falls, and partial recognition of actuarial surplus in PSPS described below.

Consistent with the derecognition of a substantial portion of the Company's interest in the underlying IAS 19 surplus of PSPS under IFRIC 14, the actuarial gains and losses of PSPS is not included in the £213 million above. Rather, for half year 2012, a £51 million credit was included in the actuarial and other gains for the effect of the partial recognition of PSPS' surplus. This credit arises from altered funding arrangement following the finalisation of the 5 April 2011 triennial valuation.

(c) 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 were:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Equities | **512** | 513 | 483 |
| Bonds | **5,852** | 4,491 | 5,954 |
| Properties | **327** | 345 | 317 |
| Cash-like investments | **485** | 805 | 409 |
| Total value of assets | **7,176** | 6,154 | 7,163 |
| Present value of benefit obligations | **(5,751)** | (5,400) | (5,620) |
| | **1,425** | 754 | 1,543 |
| Effect of the application of IFRIC 14 for pension schemes: | | | |
| Derecognition of PSPS surplus | **(1,247)** | (858) | (1,588) |
| Adjust for additional funding for PSPS | **(2)** | (35) | (19) |
| Pre-tax surplus (deficit) | **176** | (139) | (64) |

### iii Sensitivity of the pension scheme liabilities to key variables

The total underlying Group pension scheme liabilities of £5,751 million (30 June 2011: £5,400 million; 31 December 2011: £5,620 million) comprise £5,007 million (30 June 2011: £4,612 million; 31 December 2011: £4,844 million) for PSPS and £744 million (30 June 2011: £788 million; 31 December 2011: £776 million) for the other schemes. The table below shows the sensitivity of the underlying PSPS and the other scheme liabilities at 30 June 2012, 30 June 2011 and 31 December 2011 to changes in discount rates, inflation rates and mortality rates.

| | | 30 Jun 2012 | |
|---|---|---|---|
| **Assumption** | **Change in assumption** | **Impact on scheme liabilities on IAS 19 basis** | |
| Discount rate | Decrease by 0.2% from 4.6% to 4.4% | Increase in scheme liabilities by: | |
| | | PSPS | 3.0% |
| | | Other schemes | 4.8% |
| Discount rate | Increase by 0.2% from 4.6% to 4.8% | Decrease in scheme liabilities by: | |
| | | PSPS | 2.9% |
| | | Other schemes | 4.5% |
| Rate of inflation | RPI: Decrease by 0.2% from 2.6% to 2.4% | Decrease in scheme liabilities by: | |
| | CPI: Decrease by 0.2% from 1.6% to 1.4% | PSPS | 1.5% |
| | with consequent reduction in salary increases | Other schemes | 4.3% |
| Mortality rate | Increase life expectancy by 1 year | Increase in scheme liabilities by: | |
| | | PSPS | 2.7% |
| | | Other schemes | 2.3% |

| 30 Jun 2011 | | | |
|---|---|---|---|
| **Assumption** | **Change in assumption** | **Impact on scheme liabilities on IAS 19 basis** | |
| Discount rate | Decrease by 0.2% from 5.6% to 5.4% | Increase in scheme liabilities by: | |
| | | PSPS | 3.5% |
| | | Other schemes | 5.0% |
| Discount rate | Increase by 0.2% from 5.6% to 5.8% | Decrease in scheme liabilities by: | |
| | | PSPS | 3.3% |
| | | Other schemes | 4.6% |
| Rate of inflation | RPI: Decrease by 0.2% from 3.7% to 3.5% | Decrease in scheme liabilities by: | |
| | CPI: Decrease by 0.2% from 2.7% to 2.5% | PSPS | 1.1% |
| | with consequent reduction in salary increases | Other schemes | 4.7% |
| Mortality rate | Increase life expectancy by 1 year | Increase in scheme liabilities by: | |
| | | PSPS | 2.1% |
| | | Other schemes | 2.6% |

| 31 Dec 2011 | | | |
|---|---|---|---|
| **Assumption** | **Change in assumption** | **Impact on scheme liabilities on IAS 19 basis** | |
| Discount rate | Decrease by 0.2% from 4.7% to 4.5% | Increase in scheme liabilities by: | |
| | | PSPS | 3.3% |
| | | Other schemes | 4.8% |
| Discount rate | Increase by 0.2% from 4.7% to 4.9% | Decrease in scheme liabilities by: | |
| | | PSPS | 3.1% |
| | | Other schemes | 4.5% |
| Rate of inflation | RPI: Decrease by 0.2% from 2.9% to 2.7% | Decrease in scheme liabilities by: | |
| | CPI: Decrease by 0.2% from 1.9% to 1.7% | PSPS | 0.6% |
| | with consequent reduction in salary increases | Other schemes | 4.1% |
| Mortality rate | Increase life expectancy by 1 year | Increase in scheme liabilities by: | |
| | | PSPS | 2.7% |
| | | Other schemes | 2.4% |

The sensitivity of the underlying pension scheme liabilities to changes in discount, inflation and mortality 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 above.

The sensitivity to the changes in the key variables as shown in the table above has no significant impact on the pension costs included in the Group's operating results. This is due to the pension costs charged in each of the periods presented being derived largely from market conditions at the beginning of the period. After applying IFRIC 14 and to the extent attributable to shareholders, any residual impact from the changes to these variables is reflected as actuarial gains and losses on defined benefit pension schemes within the supplementary analysis of profits. The relevance of this is described further below.

For PSPS, a substantial portion of the underlying surplus of the scheme to the amount of £1,355 million (30 June 2011: the whole surplus of £858 million; 31 December 2011: the whole surplus of £1,588 million) has not been recognised under IFRIC 14. Changes to the underlying scheme liabilities as a result of assumption changes are used to reduce this unrecognised surplus before there is an impact on the Group's results and financial position. As such, based on the underlying financial position of PSPS as at 30 June 2012, none of the changes to the underlying scheme liabilities for the changes in the variables shown in the table above have had an impact on the Group's half year 2012 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 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.

The deficit of the Scottish Amicable pension scheme has been allocated approximately 50 per cent to the PAC with-profits fund and 50 per cent to the shareholders. Accordingly, half of the changes to its scheme liabilities, which at 30 June 2012 were £516 million (30 June 2011: £540 million; 31 December 2011: £527 million), for the changes in the variables shown in the table above would have had an impact on the Group's shareholder results and financial position.

# Notes on the IFRS basis results
continued

## Y: Policyholder liabilities

**Analysis of movement in policyholder liabilities and unallocated surplus of with-profits funds**
**Group insurance operations**

| | Insurance operations £m | | | |
|---|---|---|---|---|
| **Half year 2012 movements** | **UK** | **US** | **Asia** | **Total** |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 127,024 | 69,189 | 30,862 | 227,075 |
| *– Unallocated surplus of with-profits funds* | 9,165 | – | 50 | 9,215 |
| At 1 January 2012 | 136,189 | 69,189 | 30,912 | 236,290 |
| Premiums | 4,062 | 7,303 | 2,641 | 14,006 |
| Surrenders | (2,378) | (2,083) | (1,252) | (5,713) |
| Maturities/Deaths | (3,819) | (451) | (294) | (4,564) |
| Net flows | (2,135) | 4,769 | 1,095 | 3,729 |
| Shareholders' transfers post-tax | (110) | – | (15) | (125) |
| Investment-related items and other movements | 4,276 | 1,906 | 1,055 | 7,237 |
| Foreign exchange translation differences | (83) | (600) | (227) | (910) |
| At 30 June 2012 | 138,137 | 75,264 | 32,820 | 246,221 |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 128,387 | 75,264 | 32,768 | 236,419 |
| *– Unallocated surplus of with-profits funds* | 9,750 | – | 52 | 9,802 |
| **Half year 2011 movements** | | | | |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 125,530 | 60,523 | 28,674 | 214,727 |
| *– Unallocated surplus of with-profits funds* | 10,187 | – | 66 | 10,253 |
| At 1 January 2011 | 135,717 | 60,523 | 28,740 | 224,980 |
| Premiums | 3,871 | 6,805 | 2,395 | 13,071 |
| Surrenders | (2,301) | (2,153) | (1,119) | (5,573) |
| Maturities/Deaths | (3,571) | (436) | (341) | (4,348) |
| Net flows | (2,001) | 4,216 | 935 | 3,150 |
| Shareholders' transfers post-tax | (113) | – | (14) | (127) |
| Investment-related items and other movements | 3,632 | 1,429 | 634 | 5,695 |
| Foreign exchange translation differences | 120 | (1,461) | (53) | (1,394) |
| At 30 June 2011 | 137,355 | 64,707 | 30,242 | 232,304 |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 126,544 | 64,707 | 30,181 | 221,432 |
| *– Unallocated surplus of with-profits funds* | 10,811 | – | 61 | 10,872 |
| Average policyholder liability balances* | | | | |
| Half year 2012 | 127,705 | 72,227 | 31,815 | 231,747 |
| Half year 2011 | 126,037 | 62,615 | 29,428 | 218,080 |

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

The items above represent the amount attributable to changes in policyholder liabilities and unallocated surplus of with-profits funds as a result of each of the components listed.

Premiums, surrenders and maturities/deaths represent the amounts impacting policyholder liabilities and are not intended to represent the total cash paid/received (for example, premiums are net of any deductions to cover acquisition costs and claims represents the policyholder liabilities released).

**UK insurance operations**

A reconciliation of the total policyholder liabilities and unallocated surplus of with-profits funds of UK insurance operations is as follows:

| | | Other shareholder-backed funds and subsidiaries | | |
|---|---|---|---|---|
| **Half year 2012 movements** | SAIF and PAC with-profits sub-fund £m | Unit-linked liabilities £m | Annuity and other long-term business £m | Total £m |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 80,976 | 21,281 | 24,767 | 127,024 |
| *– Unallocated surplus of with-profits funds* | 9,165 | – | – | 9,165 |
| At 1 January 2012 | 90,141 | 21,281 | 24,767 | 136,189 |
| Premiums | 2,044 | 1,064 | 954 | 4,062 |
| Surrenders | (1,071) | (1,247) | (60) | (2,378) |
| Maturities/Deaths | (2,649) | (314) | (856) | (3,819) |
| Net flows[note (a)] | (1,676) | (497) | 38 | (2,135) |
| Shareholders' transfers post-tax | (110) | – | – | (110) |
| Switches | (131) | 131 | – | – |
| Investment-related items and other movements[note (b)] | 2,900 | 343 | 1,033 | 4,276 |
| Foreign exchange translation differences | (83) | – | – | (83) |
| At 30 June 2012 | 91,041 | 21,258 | 25,838 | 138,137 |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 81,291 | 21,258 | 25,838 | 128,387 |
| *– Unallocated surplus of with-profits funds* | 9,750 | – | – | 9,750 |
| **Half year 2011 movements** | | | | |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 81,586 | 21,671 | 22,273 | 125,530 |
| *– Unallocated surplus of with-profits funds* | 10,187 | – | – | 10,187 |
| At 1 January 2011 | 91,773 | 21,671 | 22,273 | 135,717 |
| Premiums | 1,693 | 1,261 | 917 | 3,871 |
| Surrenders | (1,216) | (1,085) | – | (2,301) |
| Maturities/Deaths | (2,473) | (322) | (776) | (3,571) |
| Net flows[note (a)] | (1,996) | (146) | 141 | (2,001) |
| Shareholders' transfers post-tax | (113) | – | – | (113) |
| Switches | (113) | 113 | – | – |
| Investment-related items and other movements[note (b)] | 2,527 | 666 | 439 | 3,632 |
| Foreign exchange translation differences | 120 | – | – | 120 |
| At 30 June 2011 | 92,198 | 22,304 | 22,853 | 137,355 |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 81,387 | 22,304 | 22,853 | 126,544 |
| *– Unallocated surplus of with-profits funds* | 10,811 | – | – | 10,811 |
| Average policyholder liability balances* | | | | |
| **Half year 2012** | 81,134 | 21,269 | 25,302 | 127,705 |
| Half year 2011 | 81,487 | 21,987 | 22,563 | 126,037 |

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

# Notes on the IFRS basis results continued

## Y: Policyholder liabilities continued

Notes
(a) Net outflows increased from £2.0 billion in the first half of 2011 to £2.1 billion for the same period in 2012. An improvement in the net outflows of the with-profits business, following increased sales of with-profits bonds in the period, has been more than offset by an increase in outflows in the unit-linked business. The levels of inflows/outflows for unit-linked business is driven by the activity of corporate pension schemes with transfers in or out from only one or two schemes influencing the level of flows in the period. The net flows of negative £497 million in unit-linked business was a result of lower single premiums in and higher transfers out of the All Stocks Corporate Bonds fund.
(b) Investment-related items and other movements of £4.3 billion across fund types reflected the continued strong performance of UK equity markets in 2012, as well as investment gains from debt securities.

### US insurance operations

| Half year 2012 movements | Variable annuity separate account liabilities £m | Fixed annuity, GIC and other business £m | Total £m |
|---|---|---|---|
| At 1 January 2012 | 37,833 | 31,356 | 69,189 |
| Premiums | 5,060 | 2,243 | 7,303 |
| Surrenders | (1,024) | (1,059) | (2,083) |
| Maturities/Deaths | (194) | (257) | (451) |
| Net flows[note (b)] | 3,842 | 927 | 4,769 |
| Transfers from general to separate account | 708 | (708) | – |
| Investment-related items and other movements[note (c)] | 1,557 | 349 | 1,906 |
| Foreign exchange translation differences[note (a)] | (315) | (285) | (600) |
| At 30 June 2012 | 43,625 | 31,639 | 75,264 |
| **Half year 2011 movements** | | | |
| At 1 January 2011 | 31,203 | 29,320 | 60,523 |
| Premiums | 5,015 | 1,790 | 6,805 |
| Surrenders | (974) | (1,179) | (2,153) |
| Maturities/Deaths | (148) | (288) | (436) |
| Net flows[note (b)] | 3,893 | 323 | 4,216 |
| Transfers from general to separate account | 541 | (541) | – |
| Investment-related items and other movements[note (c)] | 1,103 | 326 | 1,429 |
| Foreign exchange translation differences | (735) | (726) | (1,461) |
| At 30 June 2011 | 36,005 | 28,702 | 64,707 |
| Average policyholder liability balances* | | | |
| **Half year 2012** | 40,729 | 31,498 | 72,227 |
| Half year 2011 | 33,604 | 29,011 | 62,615 |

* Averages have been based on opening and closing balances.

Notes
(a) Movements in the period have been translated at an average rate of $1.58/£1.00 (30 June 2011: $1.62/£1.00). The closing balances have been translated at closing rate of $1.57/£1.00 (30 June 2011: $1.61/£1.00). Differences upon retranslation are included in foreign exchange translation differences.
(b) Net flows have increased by £553 million from £4,216 million in the first half of 2011 to £4,769 million in the first half of 2012. The increase was largely driven by increased new business volumes for fixed annuity and GIC business. The flows in the fixed annuity, GIC and other business column include flows from non-VA business as well as the flows in relation to investments into the general account from the variable annuities where policyholders have selected this basis.
(c) Positive investment-related items and other movements in variable annuity separate account liabilities of £1.6 billion for the first six months of 2012 reflects the increase in the US equity market during the period. Fixed annuity, GIC and other business investment and other movements primarily reflects the interest credited to policyholder account in the period.

**Asia insurance operations**

| **Half year 2012 movements** | **With-profits business £m** | **Unit-linked liabilities £m** | **Other £m** | **Total £m** |
|---|---|---|---|---|
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 12,593 | 12,015 | 6,254 | 30,862 |
| *– Unallocated surplus of with-profits funds* | 50 | – | – | 50 |
| At 1 January 2012 | 12,643 | 12,015 | 6,254 | 30,912 |
| Premiums | | | | |
| New business | 110 | 638 | 297 | 1,045 |
| In-force | 593 | 617 | 386 | 1,596 |
| | 703 | 1,255 | 683 | 2,641 |
| Surrenders note (c) | (303) | (819) | (130) | (1,252) |
| Maturities/Deaths | (196) | (16) | (82) | (294) |
| Net flows note (b) | 204 | 420 | 471 | 1,095 |
| Shareholders' transfers post-tax | (15) | – | – | (15) |
| Investment-related items and other movements note (d) | 558 | 325 | 172 | 1,055 |
| Foreign exchange translation differences note (a) | 6 | (167) | (66) | (227) |
| At 30 June 2012 | 13,396 | 12,593 | 6,831 | 32,820 |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 13,344 | 12,593 | 6,831 | 32,768 |
| *– Unallocated surplus of with-profits funds* | 52 | – | – | 52 |
| **Half year 2011 movements** | | | | |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 10,958 | 12,724 | 4,992 | 28,674 |
| *– Unallocated surplus of with-profits funds* | 66 | – | – | 66 |
| At 1 January 2011 | 11,024 | 12,724 | 4,992 | 28,740 |
| Premiums | | | | |
| New business | 90 | 553 | 305 | 948 |
| In-force | 506 | 578 | 363 | 1,447 |
| | 596 | 1,131 | 668 | 2,395 |
| Surrenders note (c) | (215) | (799) | (105) | (1,119) |
| Maturities/Deaths | (249) | (16) | (76) | (341) |
| Net flows note (b) | 132 | 316 | 487 | 935 |
| Shareholders' transfers post-tax | (14) | – | – | (14) |
| Investment-related items and other movements note (d) | 449 | 110 | 75 | 634 |
| Foreign exchange translation differences note (a) | (61) | 72 | (64) | (53) |
| At 30 June 2011 | 11,530 | 13,222 | 5,490 | 30,242 |
| *Comprising:* | | | | |
| *– Policyholder liabilities* | 11,469 | 13,222 | 5,490 | 30,181 |
| *– Unallocated surplus of with-profits funds* | 61 | – | – | 61 |
| Average policyholder liability balances* | | | | |
| **Half year 2012** | 12,969 | 12,304 | 6,542 | 31,815 |
| Half year 2011 | 11,214 | 12,973 | 5,241 | 29,428 |

* Averages have been based on opening and closing balances and exclude unallocated surplus of the with-profits funds. There were no corporate transactions in both periods that had an impact on the averages.

Financial results

Notes on the IFRS basis results

# Notes on the IFRS basis results continued

## Y: Policyholder liabilities continued

Notes
(a) Movements in the period have been translated at the average exchange rate for the six months ended 30 June 2012. The closing balance has been translated at the closing spot rates as at 30 June 2012. Differences upon retranslation are included in foreign exchange translation differences.
(b) Net flows have increased by £160 million from £935 million in 2011 to £1,095 million in 2012 primarily reflecting increased flows from new business and growth in the in-force books.
(c) The rate of surrenders for shareholder-backed business (expressed as a percentage of opening liabilities) was 5.2 per cent in the first half of 2012 which is broadly in line with 5.1 per cent in the first half of 2011. For with-profits business, surrenders have increased from £215 million in 2011 to £303 million in 2012, primarily as a result of certain products in Hong Kong reaching their five year anniversary, the point at which some product features trigger.
(d) Positive investment-related items and other movements of £1,055 million in half year 2012 primarily reflects improvements in the Asia equity market, together with positive movements within the with-profits funds including positive returns in Hong Kong and Singapore.

## Z: Share capital, share premium and own shares

| | Number of ordinary shares | Share capital £m | Share premium £m |
|---|---|---|---|
| Issued shares of 5p each fully paid: | | | |
| At 1 January 2011 | 2,545,594,506 | 127 | 1,856 |
| Shares issued under share option schemes | 2,122,869 | – | 15 |
| At 30 June 2011 | 2,547,717,375 | 127 | 1,871 |
| At 1 January 2011 | 2,545,594,506 | 127 | 1,856 |
| Shares issued under share option schemes | 2,444,824 | – | 17 |
| At 31 December 2011 | 2,548,039,330 | 127 | 1,873 |
| At 1 January 2012 | 2,548,039,330 | 127 | 1,873 |
| Shares issued under share option schemes | 8,209,568 | – | 14 |
| **At 30 June 2012** | **2,556,248,898** | **127** | **1,887** |

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

At 30 June 2012, there were options outstanding under Save As You Earn schemes to subscribe for shares as follows:

| | Number of shares to subscribe for | Share price range from | Share price range to | Exercisable by year |
|---|---|---|---|---|
| 30 June 2012 | 8,181,704 | 288p | 572p | 2017 |
| 30 June 2011 | 12,027,702 | 288p | 572p | 2016 |
| 31 December 2011 | 13,329,709 | 288p | 572p | 2017 |

### Transactions by Prudential plc and its subsidiaries in Prudential plc shares

The Group buys and sells Prudential plc (own shares) either in relation to its share schemes or via transactions undertaken by authorised investment funds that the Group is deemed to control. Further information about these transactions is set out below.

The cost of own shares of £101 million as at 30 June 2012 (30 June 2011: £82 million; 31 December 2011: £109 million) is deducted from retained earnings. The Company has established trusts to facilitate the delivery of shares under employee incentive plans and savings-related share option schemes. At 30 June 2012, 6.5 million (30 June 2011: 5.2 million; 31 December 2011: 8.1 million) Prudential plc shares with a market value of £49 million (30 June 2011: £38 million; 31 December 2011: £52 million) were held in such trusts. Of this total, 6.5 million (30 June 2011: 5.1 million; 31 December 2011: 8.0 million) shares were held in trusts under employee incentive plans.

In half year 2012, the Company purchased the following number of shares in respect of employee incentive plans.

| | Number of shares purchased* (in millions) | Cost £m |
|---|---|---|
| Half year 2012 | 5.8 | 44.2 |
| Half year 2011 | 3.2 | 15.5 |
| Full year 2011 | 8.2 | 54.7 |

* The maximum number of shares held during half year 2012 was 8.1 million which was at the beginning of the period.

Of the total shares held in trust 0.1 million (30 June 2011: 0.1 million; 31 December 2011: 0.1 million) 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 Group has consolidated a number of authorised investment funds where it is deemed to control these funds under IFRS. Some of these funds hold shares in Prudential plc. The total number of shares held by these funds at 30 June 2012 was 8.3 million (30 June 2011: 9.2 million; 31 December 2011: 8.6 million) and the cost of acquiring these shares of £50 million (30 June 2011: £45 million; 31 December 2011: £52 million) is included in the cost of own shares. The market value of these shares as at 30 June 2012 was £56 million (30 June 2011: £66 million; 31 December 2011: £54 million).

During half year 2012 these funds made net disposals of 357,340 Prudential shares (30 June 2011: 554,285; 31 December 2011: 1,171,635) for a net decrease of £2.6 million to book cost (30 June 2011: net decrease of £2 million; 31 December 2011: net increase of £4.8 million).

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

Other than set out above the Group did not purchase, sell or redeem any Prudential plc listed securities during half year 2012 or 2011.

## AA: Acquisition of subsidiaries

### Acquisition of Reassure America Life Insurance Company (REALIC)

On 30 May 2012, Jackson National Life Insurance Company (JNLI), an indirect wholly-owned subsidiary of Prudential plc, entered into an agreement to buy SRLC America Holding Corp. (SRLC), a life insurance business, from Swiss Re. The primary operating subsidiary of SRLC is REALIC. Swiss Re will retain a portion of the SRLC business through reinsurance arrangements to be undertaken prior to closing. JNLI will pay US$621 million (£398 million) in cash for the business financed from its own resources. The price is subject to adjustment to reflect the actual value of SRLC according to its balance sheet at closing. This adjustment is not expected to exceed £60 million. The transaction is subject to regulatory approval and is expected to close in the third quarter of 2012. The acquisition-related costs incurred in the period have been expensed in half year 2012.

## AB: Associates and joint ventures

The Group had two associates at 30 June 2012 (30 June 2011: two; 31 December 2011: one) that were accounted for under the equity method. The Group's associates at 30 June 2012 are a 25 per cent interest in PruHealth Holdings Limited and a 47 per cent interest in PPM South Africa, following the dilution of the Group's holding in the period (see note G). At 30 June 2011, in addition to PruHealth, the Group had a 30 per cent interest in The Nam Khang, a Vietnamese property developer which was disposed of in the second half of 2011. The Group's share of the profit and loss of these associates during the period was a profit of £6 million (half year 2011: a loss of £1 million; full year 2011: a loss of £3 million). This is reflected in the Group's profit after tax attributable to equity holders during the period.

# Notes on the IFRS basis results continued

## AB: Associates and joint ventures continued

The Group owns a number of joint ventures. Joint ventures represent activities over which the Group exercises joint control through contractual agreement with one or more parties. The Group's significant joint ventures, which are accounted for using proportionate consolidation, comprise various joint ventures relating to property investments where the Group has a 50 per cent interest as well as the following interests:

| Investment | % held | Principal activity | Country |
|---|---|---|---|
| CITIC Prudential Life Insurance Company Limited | 50 | Life assurance | China |
| CITIC-Prudential Fund Management Company Limited | 49 | Asset management | China |
| ICICI Prudential Asset Management Company Limited | 49 | Asset management | India |
| Prudential BSN Takaful Berhad | 49 | General and life insurance | Malaysia |
| BOCI-Prudential Asset Management Limited | 36 | Asset management | China |
| ICICI Prudential Life Insurance Company Limited | 26 | Life assurance | India |

Joint ventures contributed £51 million (30 June 2011: £20 million; 31 December 2011: £54 million) to profit after tax attributable to equity holders during the period. The period-on-period movements in these joint ventures' contributions reflect primarily the growth in their operating profit based on longer-term investment returns and the increase in short-term fluctuations in investment returns by these joint ventures.

Further, in June 2012, the PAC with-profits fund, via its venture fund holdings and as part of its investment portfolio, entered into a joint venture to acquire control of Veolia Water RegCo, the UK regulated water business of Veolia Environnement S.A. This joint venture investment is carried at fair value through profit and loss in the Group's financial statements, as permitted under IAS 28, 'Investments in associates and joint ventures'.

In addition to the above, the Group has associates that are carried at fair value through profit and loss, as allowed under IAS 28, that comprise investment in Open-Ended Investment Companies (OEICs), unit trusts, funds holding collateralised debt obligations, property unit trusts and venture capital investments of the PAC with-profits funds where the Group has significant influence.

## AC: Related party transactions

The nature of the related party transactions of the Group has not changed from those described in the Group's consolidated financial statements for the year ended 31 December 2011.

There were no transactions with related parties during the six months ended 30 June 2012 which have had a material effect on the results or financial position of the Group.

## AD: Contingencies and related obligations

The Group is involved in various 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 Group's financial condition, results of operations or cash flows.

There have been no material changes to the Group's contingencies and related obligations in the six month period ended 30 June 2012.

## AE: Post balance sheet events

The 2012 interim dividend approved by the Board of Directors after 30 June 2012 is as described in note M.

Details of the reduction in the UK corporation tax rate to 23 per cent which became substantively enacted after the balance sheet date on 3 July 2012 and the subsequent proposed phased rate change to 22 per cent are as described in note K. The changes to the rules relating to the taxation of life insurance companies, which will be effective 1 January 2013 are also outlined in note K.

# Statement of directors' responsibilities

The directors are responsible for preparing the Half Year Financial Report in accordance with applicable law and regulations.

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

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

  (a) DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the six months ended 30 June 2012, and their impact on the condensed consolidated financial statements, and a description of the principal risks and uncertainties for the remaining six months of the year; and

  (b) DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place during the six months ended 30 June 2012 and that have materially affected the financial position or the performance of the Group during the period and changes in the related party transactions described in the Group's consolidated financial statements for the year ended 31 December 2011.

The current directors of Prudential plc are as listed in the Group's 2011 Annual Report. Subsequent to the Annual Report, on 28 May 2012, the Group announced the appointment of Paul Manduca as Chairman. Mr Manduca assumed the position on 2 July 2012, succeeding Harvey McGrath who retired from the Board on 2 July 2012.

# Combined IFRS basis results and EEV basis results report
## Independent review report to Prudential plc

### Introduction
We have been engaged by the Company to review the International Financial Reporting Standards (IFRS) basis financial information in the Half Year Financial Report for the six months ended 30 June 2012 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Statement of Changes in Equity, the Condensed Consolidated Statement of Financial Position, the Condensed Consolidated Statement of Cash Flows and the related explanatory notes.

We have also been engaged by the Company to review the European Embedded Value (EEV) basis supplementary financial information for the six months ended 30 June 2012 which comprises the Operating Profit Based on Longer-Term Investment Returns, the Summary Consolidated Income Statement, the Movement in Shareholders' Equity, the Summary Statement of Financial Position and the related explanatory notes and Total Insurance and Investment Products New Business information.

We have read the other information contained in the Half Year Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the IFRS basis financial information or the EEV basis supplementary financial information.

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

### Directors' responsibilities
The Half Year Financial Report, including the IFRS basis financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Half Year Financial Report in accordance with the DTR of the UK FSA. The directors have accepted responsibility for preparing the EEV basis supplementary financial information in accordance with the European Embedded Value Principles issued in May 2004 by the European CFO Forum ('the EEV Principles') and for determining the methodology and assumptions used in the application of those principles.

The annual IFRS basis financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union ('EU'). The IFRS basis financial information included in this Half Year Financial Report has been prepared in accordance with IAS 34 Interim Financial Reporting as adopted by the EU.

The EEV basis supplementary financial information has been prepared in accordance with the EEV principles using the methodology and assumptions set out in notes 1 and 16 to the EEV basis supplementary financial information. The EEV basis supplementary financial information should be read in conjunction with the IFRS basis financial information.

### Our responsibility
Our responsibility is to express to the Company a conclusion on the IFRS basis financial information in the Half Year Financial Report and the EEV basis supplementary financial information based on our reviews, as set out in our engagement letter with you dated 29 July 2011.

### Scope of review
We conducted our reviews in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Conclusion
Based on our review, nothing has come to our attention that causes us to believe that the IFRS basis financial information in the Half Year Financial Report for the six months ended 30 June 2012 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.

Based on our review, nothing has come to our attention that causes us to believe that the EEV basis supplementary financial information for the six months ended 30 June 2012 is not prepared, in all material respects, in accordance with the EEV Principles, using the methodology and assumptions set out in notes 1 and 16 to the EEV basis supplementary financial information.

Rees Aronson

**Rees Aronson**

For and on behalf of KPMG Audit Plc
Chartered Accountants
London

9 August 2012

# Index to the additional financial information*





* The additional financial information is not covered by the KPMG independent review opinion.

# Additional financial information

## I (a): Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver

This schedule classifies the Group's pre-tax operating earnings from long-term insurance operations into the underlying drivers of those profits, using the following categories:

i **Spread income** represents the difference between net investment income (or premium income in the case of the UK annuities new business) and amounts credited to policyholder accounts. It excludes the longer-term investment return on assets in excess of those covering shareholder-backed policyholder liabilities, which has been separately disclosed as expected return on shareholder assets.

ii **Fee income** represents profits driven by net investment performance, being asset management fees that vary with the size of the underlying policyholder funds net of investment management expenses.

iii **With-profits** business represents the shareholders' transfer from the with-profits fund in the period.

iv **Insurance margin** primarily represents profits derived from the insurance risks of mortality, morbidity and persistency.

v **Margin on revenues** primarily represents amounts deducted from premiums to cover acquisition costs and administration expenses.

vi **Acquisition costs and administration expenses** represent expenses incurred in the period attributable to shareholders. It excludes items such as restructuring costs and Solvency II costs which are not included in the segment profit for insurance as well as items that are more appropriately included in other source of earnings lines (eg investment expenses are netted off investment income as part of spread income or fee income as appropriate).

vii **DAC adjustments** comprises DAC amortisation for the period, excluding amounts related to short-term fluctuations, net of costs deferred in respect of new business.

### Analysis of pre-tax IFRS operating profit by source

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Unallocated | Total |
| Spread income | 55 | 349 | 132 | – | 536 |
| Fee income | 66 | 408 | 35 | – | 509 |
| With-profits | 18 | – | 146 | – | 164 |
| Insurance margin | 256 | 153 | 11 | – | 420 |
| Margin on revenues | 636 | – | 68 | – | 704 |
| Expenses: | | | | | |
| Acquisition costs | (428) | (480) | (64) | – | (972) |
| Administration expenses | (250) | (242) | (63) | – | (555) |
| DAC adjustments note (i) | 33 | 219 | (4) | – | 248 |
| Expected return on shareholders' assets | 20 | 35 | 75 | – | 130 |
| Long-term business operating profit | 406 | 442 | 336 | – | 1,184 |
| Asset management operating profit | 34 | 17 | 199 | – | 250 |
| GI commission | – | – | 17 | – | 17 |
| Other income and expenditure note (iii) | – | – | – | (289) | (289) |
| Total operating profit based on longer-term investment returns | 440 | 459 | 552 | (289) | 1,162 |

| | Half year 2011 note (ii) £m | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Unallocated | Total |
| Spread income | 46 | 365 | 122 | – | 533 |
| Fee income | 67 | 327 | 29 | – | 423 |
| With-profits | 17 | – | 154 | – | 171 |
| Insurance margin | 225 | 113 | 7 | – | 345 |
| Margin on revenues | 560 | – | 78 | – | 638 |
| Expenses: | | | | | |
| Acquisition costs | (349) | (485) | (66) | – | (900) |
| Administration expenses | (242) | (195) | (60) | – | (497) |
| DAC adjustments note (i) | (13) | 164 | (1) | – | 150 |
| Expected return on shareholders' assets | 11 | 51 | 69 | – | 131 |
| Long-term business operating profit | 322 | 340 | 332 | – | 994 |
| Asset management operating profit | 43 | 17 | 199 | – | 259 |
| GI commission | – | – | 21 | – | 21 |
| RPI to CPI inflation measure change on defined benefit schemes | – | – | – | 42 | 42 |
| Other income and expenditure note (iii) | – | – | – | (288) | (288) |
| Total operating profit based on longer-term investment returns | 365 | 357 | 552 | (246) | 1,028 |

| | Full year 2011 £m | | | | |
|---|---|---|---|---|---|
| | Asia | US | UK | Unallocated | Total |
| Spread income | 88 | 730 | 247 | – | 1,065 |
| Fee income | 131 | 680 | 59 | – | 870 |
| With-profits | 38 | – | 293 | – | 331 |
| Insurance margin | 477 | 232 | 27 | – | 736 |
| Margin on revenues | 1,199 | – | 226 | – | 1,425 |
| Expenses: | | | | | |
| Acquisition costs | (766) | (890) | (127) | – | (1,783) |
| Administration expenses | (503) | (412) | (128) | – | (1,043) |
| DAC adjustments note (i) | 14 | 228 | (5) | – | 237 |
| Expected return on shareholders' assets | 26 | 83 | 91 | – | 200 |
| Long-term business operating profit | 704 | 651 | 683 | – | 2,038 |
| Asset management operating profit | 80 | 24 | 357 | – | 461 |
| GI commission | – | – | 40 | – | 40 |
| RPI to CPI inflation measure change on defined benefit schemes | – | – | – | 42 | 42 |
| Other income and expenditure note (iii) | – | – | – | (554) | (554) |
| Total operating profit based on longer-term investment returns | 784 | 675 | 1,080 | (512) | 2,027 |

Notes

(i) DAC adjustments have been adjusted for the retrospective application of the accounting policy improvement described in note B of the IFRS financial statements.

(ii) Starting from full year 2011 and following the reduction in 2010 of the Group's interest in the PruHealth and PruProtect businesses from 50 per cent to 25 per cent, the profits of these businesses have been shown as a single line in the insurance margin line consistent with associate accounting principles. Half year 2011 has been amended in light of this change.

(iii) Including restructuring and Solvency II implementation costs.

# Additional financial information
continued

## I (a): Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver continued

### Margin analysis of long-term insurance business

The following analysis expresses certain of the Group's sources of operating profit as a margin of policyholder liabilities or other suitable driver. The margin is on an annualised basis in which half year profits are annualised by multiplying by two. Details of the Group's average policyholder liability balances are given in note Y.

| | Total | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Half year 2012 | | | Half year 2011 note (v) | | | Full year 2011 | | |
| Long-term business | Profit £m | Average Liability note (iv) £m | Margin note (iii) bps | Profit £m | Average Liability note (iv) £m | Margin note (iii) bps | Profit £m | Average Liability note (iv) £m | Margin note (iii) bps |
| Spread income | 536 | 61,109 | 175 | 533 | 55,687 | 191 | 1,065 | 57,417 | 185 |
| Fee income | 509 | 74,795 | 136 | 423 | 68,435 | 124 | 870 | 68,298 | 127 |
| With-profits | 164 | 94,103 | 35 | 171 | 92,701 | 37 | 331 | 93,056 | 36 |
| Insurance margin | 420 | | | 345 | | | 736 | | |
| Margin on revenues | 704 | | | 638 | | | 1,425 | | |
| Expenses: | | | | | | | | | |
| Acquisition costs note (i) | (972) | 2,030 | (48)% | (900) | 1,824 | (49)% | (1,783) | 3,681 | (48)% |
| Administration expenses | (555) | 135,904 | (82) | (497) | 124,122 | (80) | (1,043) | 125,715 | (83) |
| DAC adjustments note (ii) | 248 | | | 150 | | | 237 | | |
| Expected return on shareholders' assets | 130 | | | 131 | | | 200 | | |
| Operating profit | 1,184 | | | 994 | | | 2,038 | | |

Notes
(i) The ratio for acquisition costs is calculated as a percentage of APE including with-profits sales. Acquisition costs include only those relating to shareholders.
(ii) DAC adjustments have adjusted for the retrospective application of the accounting policy improvement described in note B of the IFRS financial statements.
(iii) Margin represents the operating return earned in the period as a proportion of the relevant class of policyholder liabilities excluding unallocated surplus. The margin is on an annualised basis in which half year profits are annualised by multiplying by two.
(iv) For UK and Asia, opening and closing policyholder liabilities have been used to derive an average balance for the period, as this is seen as a good proxy for average balances throughout the period. The calculation of average liabilities for Jackson is derived from month-end balances throughout the period as opposed to opening and closing balances only, and liabilities held in the general account for variable annuity living and death guaranteed benefits are excluded from the calculation of the average as no spread income is earned on these balances. These changes were introduced in full year 2011 and half year 2011 has been amended for consistency albeit impacts are minimal.
(v) Starting from full year 2011 and following the reduction in 2010 of the Group's interest in the PruHealth and PruProtect businesses from 50 per cent to 25 per cent, the profits of these businesses have been shown as a single line in the insurance margin line consistent with associate accounting principles. 2011 has been amended in light of this change.

| Long-term business | Asia Half year 2012 Profit £m | Average Liability £m | Margin bps | Half year 2011 Profit £m | Average Liability £m | Margin bps | Full year 2011 Profit £m | Average Liability £m | Margin bps |
|---|---|---|---|---|---|---|---|---|---|
| Spread income | 55 | 6,542 | 168 | 46 | 5,241 | 176 | 88 | 5,623 | 157 |
| Fee income | 66 | 12,304 | 107 | 67 | 12,973 | 103 | 131 | 12,370 | 106 |
| With-profits | 18 | 12,969 | 28 | 17 | 11,214 | 30 | 38 | 11,775 | 32 |
| Insurance margin | 256 | | | 225 | | | 477 | | |
| Margin on revenues | 636 | | | 560 | | | 1,199 | | |
| Expenses: | | | | | | | | | |
| Acquisition costs note (i) | (428) | 899 | (48)% | (349) | 743 | (47)% | (766) | 1,660 | (46)% |
| Administration expenses | (250) | 18,846 | (265) | (242) | 18,214 | (266) | (503) | 17,993 | (280) |
| DAC adjustments note (ii) | 33 | | | (13) | | | 14 | | |
| Expected return on shareholders' assets | 20 | | | 11 | | | 26 | | |
| Operating profit | 406 | | | 322 | | | 704 | | |

Notes
(i) The ratio for acquisition costs is calculated as a percentage of APE including with-profits sales. Acquisition costs include only those relating to shareholders.
(ii) DAC adjustments have been adjusted for the retrospective application of the accounting policy improvement described in note B of the IFRS financial statements.

**Analysis of Asia operating profit drivers**

- **Spread income** has increased by £9 million from £46 million in half year 2011 to £55 million in half year 2012, an increase of 19 per cent that predominantly reflects the growth of the Asia non-linked policyholder liabilities.
- **Fee income** has marginally reduced from £67 million in half year 2011 to £66 million in half year 2012, broadly in line with the decrease in movement in average unit-linked liabilities, following the significant market falls in the second half of 2011.
- **Insurance margin** has increased by £31 million from £225 million in half year 2011 to £256 million in half year 2012 predominantly reflecting the continued growth of the in-force book, which contains a relatively high proportion of risk-based products. Insurance margin includes non-recurring items of £30 million (half year 2011: £25 million), reflecting assumption changes and other items that are not expected to reoccur in the future.
- **Margin on revenues** has increased by £76 million from £560 million in half year 2011 to £636 million in half year 2012 reflecting the ongoing growth in the size of the portfolio with increased premium recognised in the period. During the period the new business mix has moved towards those countries that levy higher premium charges. One-off items of negative £13 million are included in margin on revenues in half year 2012.
- **Acquisition costs** have increased by 23 per cent from £349 million in half year 2011 to £428 million in half year 2012, compared to the 21 per cent increase in sales, resulting in a marginal increase in the acquisition cost ratio. The analysis above uses shareholder acquisition costs as a proportion of total APE. If with-profits sales were excluded from the denominator the acquisition cost ratio would become 63 per cent (half year 2011: 60 per cent; full year 2011: 59 per cent). The small increase being the result of product mix changes, predominately in Hong Kong.
- **Administration expenses** have increased marginally from £242 million to £250 million in half year 2012 as the business continues to expand. The administration expense ratio has reduced from 266 basis points in half year 2011 to 265 basis points in half year 2012.
- **Expected return on shareholder assets** has increased to £20 million primarily due to higher shareholders assets and lower investment expenses in the period.

# Additional financial information
continued

## I (a): Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver continued

| | US | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Half year 2012 | | | Half year 2011 | | | Full year 2011 | | |
| Long-term business | Profit £m | Average Liability note (iii) £m | Margin bps | Profit £m | Average Liability note (iii) £m | Margin bps | Profit £m | Average Liability note (iii) £m | Margin bps |
| Spread income | 349 | 29,265 | 238 | 365 | 27,883 | 262 | 730 | 28,274 | 258 |
| Fee income | 408 | 41,222 | 198 | 327 | 33,475 | 195 | 680 | 34,452 | 197 |
| With-profits | – | | | – | | | – | | |
| Insurance margin | 153 | | | 113 | | | 232 | | |
| Margin on revenues | – | | | – | | | – | | |
| Expenses: | | | | | | | | | |
| Acquisition costs note (i) | (480) | 719 | (67)% | (485) | 672 | (72)% | (890) | 1,275 | (70)% |
| Administration expenses | (242) | 70,487 | (69) | (195) | 61,358 | (64) | (412) | 62,726 | (66) |
| DAC adjustments note (ii) | 219 | | | 164 | | | 228 | | |
| Expected return on shareholders' assets | 35 | | | 51 | | | 83 | | |
| Operating profit | 442 | | | 340 | | | 651 | | |

Notes
(i) The ratio for acquisition costs is calculated as a percentage of APE.
(ii) DAC adjustments have been adjusted for the retrospective application of the accounting policy improvement described in note B of the IFRS financial statements.
(iii) The calculation of average liabilities for Jackson is derived from month-end balances throughout the period as opposed to opening and closing balances only, and liabilities held in the general account for variable annuity living and death guaranteed benefits are excluded from the calculation of the average as no spread income is earned on these balances. These changes were introduced in full year 2011 and half year 2011 has been amended for consistency albeit impacts are minimal.

### Analysis of US operating profit drivers

- **Spread income** benefited from £75 million in half year 2012 from the effect of transactions entered into during 2011 and 2010 to more closely match the overall asset and liability duration (half year 2011: £53 million and full year 2011: £113 million). Excluding this effect, the spread margin would have been 187 basis points (half year 2011: 224 basis points and full year 2011: 218 basis points). The reported spread margin decreased as a result of downward pressure on yields caused by the low interest rate environment, the effect of which was only partly mitigated by reductions in crediting rates.
- **Fee income** has increased by 25 per cent to £408 million in half year 2012, compared to £327 million in half year 2011 as a result of the growth in separate account balances, primarily due to positive net flows from variable annuity business. Fee income margin has increased to 198 basis points (half year 2011: 195 basis points and full year 2011: 197 basis points) reflecting the benefit of pricing action and changes to business mix.
- **Insurance margin** represents operating profits from insurance risks, including variable annuity guarantees and other sundry items. Positive net flows into variable annuity business with life contingent and other guarantee fees, coupled with the benefit in the period of repricing actions, have primarily resulted in an improvement in the margin from £113 million in half year 2011 to £153 million in half year 2012.
- **Acquisition costs**, which are commissions and general expenses incurred to acquire new business, remained flat during the first half of 2012 compared to the first half of 2011. However, acquisition costs as a percentage of APE have decreased to 67 per cent for the first half of 2012, compared to 72 per cent for the first half of 2011, due to the continued increase in producers selecting asset based commission which is treated as an administrative expense in this analysis, rather than front end commissions.
- **Administration expenses** increased to £242 million in half year 2012 compared to £195 million in half year 2011, primarily as a result of higher asset-based commission paid on the larger 2012 separate account balance. Asset based commissions are paid upon policy anniversary dates and are treated as an administration expense in this analysis as opposed to a cost of acquisition and are offset by higher fee income. The administration cost was higher at 69 basis points (half year 2011: 64 basis points; full year 2011: 66 basis points). Excluding these trail commission amounts, the resulting administration expense ratio would be 47 basis points (half year 2011: 45 basis points; full year 2011: 46 basis points).

- **DAC adjustments** increased to £219 million in the first half of 2012 compared to £164 million in the first half of 2011. 2011 was lowered by £66 million of accelerated DAC amortisation as a result of the reversal of the benefit received in 2008 from the mean reversion formula. Market movements in the period led to a deceleration of DAC amortisation of £25 million which was offset by higher amortisation as a result of higher gross profits in the first half of 2012. Following the adoption of the altered US GAAP principles for deferred acquisition costs, as described in note B of the IFRS financial statements, acquisition costs are no longer fully deferrable resulting in new business strain of £82 million (half year 2011: £80 million; full year 2011: £156 million).

**Analysis of pre-tax operating profit before and after acquisition costs and DAC adjustments**

| | **Half year 2012** £m | | | | **Half year 2011** £m | | | |
|---|---|---|---|---|---|---|---|---|
| | **Other operating profits** | **Acquisition costs Incurred** | **Acquisition costs Deferred** | **Total** | **Other operating profits** | **Acquisition costs Incurred** | **Acquisition costs Deferred** | **Total** |
| Total operating profit before acquisition costs and DAC adjustments | 703 | | | 703 | 661 | | | 661 |
| Less: new business strain | | (480) | 398 | (82) | | (485) | 405 | (80) |
| Other DAC adjustments – amortisation of previously deferred acquisition costs: | | | | | | | | |
| Normal | | | (204) | (204) | | | (175) | (175) |
| Decelerated (accelerated) | | | 25 | 25 | | | (66) | (66) |
| Total | 703 | (480) | 219 | 442 | 661 | (485) | 164 | 340 |

| | **Full year 2011** £m | | | |
|---|---|---|---|---|
| | **Other operating profits** | **Acquisition costs Incurred** | **Acquisition costs Deferred** | **Total** |
| Total operating profit before acquisition costs and DAC adjustments | 1,313 | | | 1,313 |
| Less: new business strain | | (890) | 734 | (156) |
| Other DAC adjustments – amortisation of previously deferred acquisition costs: | | | | |
| Normal | | | (316) | (316) |
| Accelerated | | | (190) | (190) |
| Total | 1,313 | (890) | 228 | 651 |

# Additional financial information continued

## I (a): Analysis of long-term insurance business pre-tax IFRS operating profit based on longer-term investment returns by driver continued

| | UK | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Half year 2012 | | | Half year 2011 note (ii) | | | Full year 2011 | | |
| Long-term business | Profit £m | Average Liability £m | Margin bps | Profit £m | Average Liability £m | Margin bps | Profit £m | Average Liability £m | Margin bps |
| Spread income | 132 | 25,302 | 104 | 122 | 22,563 | 108 | 247 | 23,520 | 105 |
| Fee income | 35 | 21,269 | 33 | 29 | 21,987 | 26 | 59 | 21,476 | 27 |
| With-profits | 146 | 81,134 | 36 | 154 | 81,487 | 38 | 293 | 81,281 | 36 |
| Insurance margin | 11 | | | 7 | | | 27 | | |
| Margin on revenues | 68 | | | 78 | | | 226 | | |
| Expenses: | | | | | | | | | |
| Acquisition costs note (i) | (64) | 412 | (16)% | (66) | 409 | (16)% | (127) | 746 | (17)% |
| Administration expenses | (63) | 46,571 | (27) | (60) | 44,550 | (27) | (128) | 44,996 | (28) |
| DAC adjustments | (4) | | | (1) | | | (5) | | |
| Expected return on shareholders' assets | 75 | | | 69 | | | 91 | | |
| Operating profit | 336 | | | 332 | | | 683 | | |

Notes

(i) The ratio for acquisition costs is calculated as a percentage of APE including with-profits sales. Acquisition costs include only those relating to shareholders.

(ii) Starting from full year 2011 and following the reduction in 2010 of the Group's interest in the PruHealth and PruProtect businesses from 50 per cent to 25 per cent, the profits of these businesses have been shown as a single line in the insurance margin line consistent with associate accounting principles. Half year 2011 has been amended in light of this change.

### Analysis of UK operating profit drivers

- **Spread income** has increased from £122 million in half year 2011 to £132 million in half year 2012 principally due to increased new business profits from higher annuity sales. The margin has fallen slightly from 108 basis points to 104 basis points. Both periods benefited from similar levels of bulk annuity sales.
- **Fee income** margin increased from 26 basis points in half year 2011 to 33 basis points in half year 2012, with half year 2011 being reduced by 4 basis points or £4 million due to an adjustment relating to 2011 and prior years, to reflect compensation paid to policyholders for historic pricing issues.
- **Margin on revenues** represents premium charges for expenses and other sundry net income received by the UK. Half year 2012 income was £68 million, lower than the £78 million recorded in half year 2011.
- **Acquisition costs** as a percentage of new business sales are in line with half year 2011 at 16 per cent.

  The ratio above expresses the percentage of shareholder acquisition costs as a percentage of total APE sales. It is therefore impacted by the level of with-profits sales in the year. Acquisition costs as a percentage of shareholder-backed new business sales were 33 per cent in half year 2012 (half year 2011: 31 per cent and full year 2011: 33 per cent).
- **Administration expenses** have increased by £3 million to £63 million primarily as a result of increased project expenditure. The administration expense ratio of 27 basis points for 2012 is consistent with that recorded in the prior half year.
- **Expected return on shareholder** has increased from £69 million in half year 2011 to £75 million in half year 2012 principally due to higher IFRS shareholders' funds.

## I (b): Asia operations – analysis of IFRS operating profit by territory

Operating profit based on longer-term investment returns for Asia operations are analysed as follows:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year* | Full year* |
| Underlying operating profit | | | |
| China | 8 | – | 11 |
| Hong Kong | 47 | 31 | 69 |
| India | 28 | 24 | 47 |
| Indonesia | 123 | 95 | 212 |
| Japan | – | – | 2 |
| Korea | 8 | 9 | 17 |
| Malaysia | 60 | 57 | 104 |
| Philippines | 2 | 1 | 5 |
| Singapore | 93 | 72 | 167 |
| Taiwan (bancassurance business) | 1 | (9) | 2 |
| Thailand | 2 | 2 | 4 |
| Vietnam | 18 | 16 | 30 |
| Other | 2 | 1 | 1 |
| Non-recurrent items note (ii) | 17 | 25 | 38 |
| **Total insurance operations** note (i) | 409 | 324 | 709 |
| Development expenses | (3) | (2) | (5) |
| **Total long-term business operating profit** | 406 | 322 | 704 |
| Eastspring Investments | 34 | 43 | 80 |
| **Total Asia operations** | 440 | 365 | 784 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

Notes

(i) Analysis of operating profit between new and in-force business
The result for insurance operations comprises amounts in respect of new business and business in force as follows:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| New business strain | (40) | (41) | (70) |
| Business in force | 449 | 365 | 779 |
| Total | 409 | 324 | 709 |

The IFRS new business strain corresponds to approximately 4 per cent of new business APE premiums for half year 2012 (half year 2011: approximately 6 per cent; full year 2011: approximately 4 per cent).

The strain reflects the aggregate of the pre-tax regulatory basis strain to net worth after IFRS adjustments for deferral of acquisition costs and deferred income where appropriate.

(ii) Non-recurrent items of £17 million in half year 2012 (half year 2011: £25 million; full year 2011: £38 million), represents a small number of items that are not anticipated to re-occur in subsequent periods.

# Additional financial information
continued

## I (c): Analysis of asset management operating profit based on longer-term investment returns

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | M&G notes (i)(ii) | Eastspring Investments note (ii) | PruCap | US | Total |
| Operating income before performance-related fees | 354 | 96 | 59 | 142 | 651 |
| Performance-related fees | 1 | 1 | – | – | 2 |
| Operating income* | 355 | 97 | 59 | 142 | 653 |
| Operating expense | (186) | (63) | (35) | (125) | (409) |
| Share of associate's results | 6 | – | – | – | 6 |
| Operating profit based on longer-term investment returns | 175 | 34 | 24 | 17 | 250 |
| Average funds under management (FUM), including 47% proportional share of PPM South Africa† | £200.6 bn | | | | |
| Average funds under management (FUM), excluding PPM South Africa† | £196.8 bn | £52.1 bn | | | |
| Margin based on operating income† | 36 bps | 37 bps | | | |
| Cost/income ratio‡ | 53% | 66% | | | |

| | Half year 2011 £m | | | | |
|---|---|---|---|---|---|
| | M&G notes (i)(ii) | Eastspring Investments note (ii) | PruCap | US | Total |
| Operating income before performance-related fees | 330 | 98 | 55 | 125 | 608 |
| Performance-related fees | 12 | 3 | – | – | 15 |
| Operating income* | 342 | 101 | 55 | 125 | 623 |
| Operating expense | (183) | (58) | (28) | (108) | (377) |
| Share of associate's results | 13 | – | – | – | 13 |
| Operating profit based on longer-term investment returns | 172 | 43 | 27 | 17 | 259 |
| Average funds under management (FUM), including 100% share of PPM South Africa† | £200.5 bn | | | | |
| Average funds under management (FUM), excluding PPM South Africa† | £191.4 bn | £52.2 bn | | | |
| Margin based on operating income† | 34 bps | 38 bps | | | |
| Cost/income ratio‡ | 55% | 59% | | | |

| | Full year 2011 £m | | | | |
|---|---|---|---|---|---|
| | M&G notes (i)(ii) | Eastspring Investments note (ii) | PruCap | US | Total |
| Operating income before performance-related fees | 666 | 196 | 122 | 249 | 1,233 |
| Performance-related fees | 13 | 6 | – | – | 19 |
| Operating income* | 679 | 202 | 122 | 249 | 1,252 |
| Operating expense | (404) | (122) | (66) | (225) | (817) |
| Share of associate's results | 26 | – | – | – | 26 |
| Operating profit based on longer-term investment returns | 301 | 80 | 56 | 24 | 461 |
| Average funds under management (FUM), including 100% share of PPM South Africa† | £199.8 bn | | | | |
| Average funds under management (FUM), excluding PPM South Africa† | £191.1 bn | £51.1 bn | | | |
| Margin based on operating income† | 35 bps | 38 bps | | | |
| Cost/income ratio‡ | 61% | 62% | | | |

Notes

(i) Following the divestment in the first half of 2012 of M&G's holding in PPM South Africa from 75 per cent to 47 per cent and its treatment from 2012 as an associate, M&G's operating income and expense no longer includes any element from PPM South Africa. In order to avoid period-on-period distortion, in the table above the 2011 operating income, margin and cost/income ratio reflect the retrospective application of this basis of presentation for half year 2011 and full year 2011 results.

(ii) M&G and Eastspring Investments can be further analysed as follows:

| | M&G | | | | | |
|---|---|---|---|---|---|---|
| | Operating income before performance-related fees | | | | | |
| | Retail £m | Margin of FUM†¶ bps | Institutional§ £m | Margin of FUM† bps | Total £m | Margin of FUM† bps |
| 30 Jun 2012 | 218 | 96 | 136 | 18 | 354 | 36 |
| 30 Jun 2011 | 198 | 97 | 132 | 18 | 330 | 34 |
| 31 Dec 2011 | 396 | 98 | 270 | 18 | 666 | 35 |

| | Eastspring Investments | | | | | |
|---|---|---|---|---|---|---|
| | Operating income before performance-related fees | | | | | |
| | Retail £m | Margin of FUM†¶ bps | Institutional§ £m | Margin of FUM† bps | Total £m | Margin of FUM† bps |
| 30 Jun 2012 | 56 | 65 | 40 | 23 | 96 | 37 |
| 30 Jun 2011 | 61 | 60 | 37 | 23 | 98 | 38 |
| 31 Dec 2011 | 120 | 64 | 76 | 23 | 196 | 38 |

* Operating income is net of commissions. M&G's operating income excludes any contribution from M&G's associate, PPM South Africa.

† Margin represents operating income before performance-related fees as a proportion of the related funds under management (FUM), excluding PPM South Africa. Half year figures have been annualised by multiplying by two. For half year 2012, the opening balance of M&G's FUM has been adjusted to remove the proportional share of PPM South Africa divested following the change in treatment to associate at the beginning of the period. Opening and closing internal and external funds managed by the respective entity have been used to derive the average. Any funds held by the Group's insurance operations which are managed by third parties outside of the Prudential Group are excluded from these amounts.

‡ Cost/income ratio represents cost as a percentage of operating income before performance-related fees. In order to avoid period-on-period distortion, M&G's operating income and expense excludes any contribution from M&G's associate, PPM South Africa.

§ Institutional includes internal funds.

¶ As noted above, the margins on operating income are based on the average of the opening and closing FUM balances. For Eastspring Investments, if a monthly average FUM had been used in calculating the retail margins for half year 2012 and half year 2011, the retail margins would have been 63 basis points for half year 2012 and 61 basis points for half year 2011.

# Additional financial information
continued

## II (a): IFRS shareholders' funds summary by business unit and net asset value per share

### i Shareholders' funds summary

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | 30 Jun | 30 Jun* | 31 Dec* |
| **Asia operations** | | | |
| Insurance operations: | | | |
| Net assets of operation | 2,166 | 1,985 | 2,071 |
| Acquired goodwill | 237 | 239 | 235 |
| Total | 2,403 | 2,224 | 2,306 |
| **Eastspring Investments** | | | |
| Net assets of operation | 202 | 212 | 211 |
| Acquired goodwill | 61 | 61 | 61 |
| Total | 263 | 273 | 272 |
| Total | 2,666 | 2,497 | 2,578 |
| **US operations** | | | |
| Jackson (net of surplus note borrowings) | 3,919 | 3,298 | 3,761 |
| Broker-dealer and asset management operations: | | | |
| Net assets of operation | 108 | 108 | 113 |
| Acquired goodwill | 16 | 16 | 16 |
| Total | 124 | 124 | 129 |
| Total | 4,043 | 3,422 | 3,890 |
| **UK operations** | | | |
| Insurance operations: | | | |
| Long-term business operation | 2,709 | 2,294 | 2,552 |
| Other | 13 | 48 | 29 |
| Total | 2,722 | 2,342 | 2,581 |
| M&G: | | | |
| Net assets of operation | 348 | 310 | 229 |
| Acquired goodwill | 1,153 | 1,153 | 1,153 |
| Total | 1,501 | 1,463 | 1,382 |
| Total | 4,223 | 3,805 | 3,963 |
| **Other operations** | | | |
| Holding company net borrowings | (1,965) | (2,117) | (2,001) |
| Shareholders' share of provision for future deficit funding of the Prudential Staff Pension Scheme (net of tax) | 38 | (8) | (5) |
| Other net assets | 287 | 391 | 139 |
| Total | (1,640) | (1,734) | (1,867) |
| **Total of all operations** | 9,292 | 7,990 | 8,564 |

### ii Net asset value per share

| | 2012 | 2011 | |
|---|---|---|---|
| | 30 Jun | 30 Jun* | 31 Dec* |
| Closing equity shareholders' funds | £9,292m | £7,990m | £8,564m |
| Net asset value per share attributable to equity shareholders† | 364p | 314p | 336p |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

† Based on the closing issued share capital as at:
- 30 June 2012 of 2,556 million shares;
- 30 June 2011 of 2,548 million shares; and
- 31 December 2011 of 2,548 million shares.

## III (a): Funds under management

### i Summary

| | 2012 £bn | 2011 £bn | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| **Business area** | | | |
| Asia operations | **35.0** | 32.2 | 32.6 |
| US operations | **78.1** | 67.2 | 71.9 |
| UK operations | **147.4** | 146.4 | 146.3 |
| Internal funds under management | **260.5** | 245.8 | 250.8 |
| External funds[note] | **102.7** | 103.7 | 99.8 |
| Total funds under management | **363.2** | 349.5 | 350.6 |

Note
External funds shown above for 30 June 2012 of £102.7 billion (30 June 2011: £103.7 billion; 31 December 2011: £99.8 billion) comprise £110.2 billion (30 June 2011: £109.9 billion; 31 December 2011: £107.0 billion) in respect of investment products, as published in the New Business schedules (see schedule 7) plus Asia Money Market Funds for 30 June 2012 of £4.1 billion (30 June 2011: £5.3 billion; 31 December 2011: £4.2 billion) less £11.6 billion (30 June 2011: £11.5 billion; 31 December 2011: £11.4 billion) that are classified within internal funds.

### ii Internal funds under management – analysis by business area

| | Asia operations | | | US operations | | | UK operations | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 30 Jun £bn | 2011 30 Jun £bn | 2011 31 Dec £bn | 2012 30 Jun £bn | 2011 30 Jun £bn | 2011 31 Dec £bn | 2012 30 Jun £bn | 2011 30 Jun £bn | 2011 31 Dec £bn | 2012 30 Jun £bn | 2011 30 Jun £bn | 2011 31 Dec £bn |
| Investment properties[note] | **–** | – | – | **0.1** | 0.1 | 0.1 | **11.0** | 11.5 | 10.9 | **11.1** | 11.6 | 11.0 |
| Equity securities | **12.6** | 14.2 | 12.0 | **43.9** | 36.2 | 38.1 | **34.0** | 40.6 | 37.3 | **90.5** | 91.0 | 87.4 |
| Debt securities | **19.4** | 15.4 | 17.7 | **27.1** | 25.3 | 27.0 | **81.8** | 76.5 | 79.8 | **128.3** | 117.2 | 124.5 |
| Loans | **1.2** | 1.2 | 1.2 | **4.1** | 4.1 | 4.1 | **4.7** | 3.7 | 4.4 | **10.0** | 9.0 | 9.7 |
| Other investments and deposits | **1.8** | 1.4 | 1.7 | **2.9** | 1.5 | 2.6 | **15.9** | 14.1 | 13.9 | **20.6** | 17.0 | 18.2 |
| Total | **35.0** | 32.2 | 32.6 | **78.1** | 67.2 | 71.9 | **147.4** | 146.4 | 146.3 | **260.5** | 245.8 | 250.8 |

Note
As included in the investments section of the consolidated statement of financial position at 30 June 2012 except for £0.3 billion (30 June 2011: £0.5 billion; 31 December 2011: £0.2 billion) properties which are held for sale or occupied by the Group and, accordingly under IFRS, are included in other statement of financial position captions.

# Additional financial information
continued

## III (b): Effect of foreign currency rate movements on results

### i Rates of exchange

The income statements of foreign subsidiaries are translated at average exchange rates for the year. Assets and liabilities of foreign subsidiaries are translated at closing exchange rates. Foreign currency borrowings that have been used to provide a hedge against the Group's equity investments in overseas subsidiaries are also translated at closing exchange rates. The impact of these translations is recorded as a component of the movement in shareholders' equity.

The following translation rates have been applied:

| | Closing | Average | Closing | Average | Closing | Average |
|---|---|---|---|---|---|---|
| Local currency: £ | 2012 30 Jun | 2012 30 Jun | 2011 30 Jun | 2011 30 Jun | 2011 31 Dec | 2011 31 Dec |
| Hong Kong | 12.17 | 12.24 | 12.49 | 12.58 | 12.07 | 12.48 |
| Indonesia | 14,731.67 | 14,460.30 | 13,767.54 | 14,133.01 | 14,091.80 | 14,049.41 |
| Malaysia | 4.98 | 4.87 | 4.85 | 4.90 | 4.93 | 4.90 |
| Singapore | 1.99 | 1.99 | 1.97 | 2.03 | 2.02 | 2.02 |
| India | 87.57 | 82.27 | 71.77 | 72.74 | 82.53 | 74.80 |
| Vietnam | 32,788.45 | 32,937.67 | 33,048.21 | 33,110.56 | 32,688.16 | 33,139.22 |
| USA | 1.57 | 1.58 | 1.61 | 1.62 | 1.55 | 1.60 |

## ii Effect of rate movements on results

**IFRS basis results**

| | As published 2012 Half year £m | CER note Memorandum* 2011 Half year £m | Memorandum* 2011 Full year £m |
|---|---|---|---|
| Asia operations: | | | |
| Long-term operations | 409 | 322 | 704 |
| Development expenses | (3) | (2) | (5) |
| Total Asia insurance operations after development costs | 406 | 320 | 699 |
| Eastspring Investments | 34 | 44 | 80 |
| Total Asia operations | 440 | 364 | 779 |
| US operations: | | | |
| Jackson | 442 | 349 | 662 |
| Broker-dealer, asset management and Curian operations | 17 | 17 | 24 |
| Total US operations | 459 | 366 | 686 |
| UK operations: | | | |
| Long-term business | 336 | 332 | 683 |
| General insurance commission | 17 | 21 | 40 |
| Total UK insurance operations | 353 | 353 | 723 |
| M&G | 199 | 199 | 357 |
| Total UK operations | 552 | 552 | 1,080 |
| Total segment profit | 1,451 | 1,282 | 2,545 |
| Other income and expenditure | (255) | (253) | (483) |
| RPI to CPI inflation measure change on defined benefit pension schemes | – | 42 | 42 |
| Solvency II implementation costs | (27) | (27) | (55) |
| Restructuring costs | (7) | (8) | (16) |
| Operating profit based on longer-term investment returns | 1,162 | 1,036 | 2,033 |
| Shareholders' funds | 9,292 | 7,976 | 8,546 |

* The 2011 comparative results have been adjusted from those previously published for the retrospective application of the improvement in accounting policy described in note B.

# Additional financial information
continued

## III (b): Effect of foreign currency rate movements on results continued

### EEV basis results

| | As published 2012 Half year £m | CER[note] Memorandum 2011 Half year £m | CER[note] Memorandum 2011 Full year £m |
|---|---|---|---|
| Asia operations: | | | |
| New business | **547** | 468 | 1,074 |
| Business in force | **325** | 310 | 688 |
| Long-term operations | **872** | 778 | 1,762 |
| Eastspring Investments | **34** | 44 | 80 |
| Development expenses | **(3)** | (2) | (5) |
| Total Asia operations | **903** | 820 | 1,837 |
| US operations: | | | |
| New business | **442** | 470 | 829 |
| Business in force | **363** | 382 | 626 |
| Jackson | **805** | 852 | 1,455 |
| Broker-dealer, asset management and Curian operations | **17** | 17 | 24 |
| Total US operations | **822** | 869 | 1,479 |
| UK operations: | | | |
| New business | **152** | 146 | 260 |
| Business in force | **338** | 391 | 593 |
| Long-term business | **490** | 537 | 853 |
| General insurance commission | **17** | 21 | 40 |
| Total insurance | **507** | 558 | 893 |
| M&G | **199** | 199 | 357 |
| Total UK operations | **706** | 757 | 1,250 |
| Other income and expenditure | **(285)** | (281) | (536) |
| RPI to CPI inflation measure change on defined benefit pension schemes | **–** | 45 | 45 |
| Solvency II implementation costs | **(29)** | (28) | (56) |
| Restructuring costs | **(8)** | (9) | (18) |
| Operating profit based on longer-term investment returns | **2,109** | 2,173 | 4,001 |
| Shareholders' funds | **20,605** | 18,898 | 19,521 |

**Note**
The 'as published' operating profit for 2012 and 'memorandum' operating profit for 2011 have been calculated by applying average 2012 exchange rates (CER).

The 'as published' shareholders' funds for 2012 and 'memorandum' shareholders' funds for 2011 have been calculated by applying closing period end 2012 exchange rates.

## III (c): Option schemes

The Group maintains four share option schemes satisfied by the issue of new shares. UK-based executive directors and eligible employees may participate in the UK savings related share option scheme, and Asia-based executives and eligible employees can participate in the International savings related share option scheme. Dublin-based employees are eligible to participate in the Prudential International Assurance sharesave plan, and Hong Kong-based agents can participate in the non-employee savings related share option scheme. Further details of the schemes and accounting policies are detailed in note I4 of the IFRS basis consolidated financial statements in the 2011 Annual Report.

All options were granted at £nil consideration. No options have been granted to substantial shareholders, suppliers of goods or services (excluding options granted to agents under the non-employee savings related share option scheme) or in excess of the individual limit for the relevant scheme.

The options schemes will terminate as follows, unless the directors resolve to terminate the plans at an earlier date:

- UK savings related share option scheme: 8 May 2013;
- International savings related share option scheme: 31 May 2021;
- Prudential International Assurance sharesave plan: 3 August 2019; and
- Prudential International savings related share option scheme for non-employees 2012: 17 May 2022.

The weighted average share price of Prudential plc for the period ended 30 June 2012 was £7.19 (2011: £6.99).

The following analyses show the movements in options for each of the option schemes for the six month period ended 30 June 2012. No options were granted in the period.

### UK savings related share option scheme

| | | Exercise period | | Number of options | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Date of grant | Exercise price £ | Beginning | End | Beginning of period | Granted | Exercised | Cancelled | Forfeited | Lapsed | End of period |
| 30 Sep 04 | 3.43 | 1 Dec 11 | 31 May 12 | 3,852 | – | 3,852 | – | – | – | – |
| 12 Apr 05 | 3.87 | 1 Jun 12 | 30 Nov 12 | 8,528 | – | 5,296 | – | – | – | 3,232 |
| 29 Sep 05 | 4.07 | 1 Dec 12 | 31 May 13 | 9,072 | – | – | – | – | – | 9,072 |
| 20 Apr 06 | 5.65 | 1 Jun 13 | 30 Nov 13 | 7,322 | – | – | – | – | – | 7,322 |
| 28 Sep 06 | 4.75 | 1 Dec 11 | 31 May 12 | 11,029 | – | 11,029 | – | – | – | – |
| 28 Sep 06 | 4.75 | 1 Dec 13 | 31 May 14 | 13,325 | – | – | – | – | – | 13,325 |
| 26 Apr 07 | 5.72 | 1 Jun 10 | 30 Nov 10 | 2,865 | – | – | - | – | – | 2,865 |
| 26 Apr 07 | 5.72 | 1 Jun 12 | 30 Nov 12 | 7,191 | – | 4,213 | – | – | – | 2,978 |
| 26 Apr 07 | 5.72 | 1 Jun 14 | 30 Nov 14 | 503 | – | – | – | – | – | 503 |
| 27 Sep 07 | 5.52 | 1 Dec 12 | 31 May 13 | 17,264 | – | – | – | – | – | 17,264 |
| 27 Sep 07 | 5.52 | 1 Dec 14 | 31 May 15 | 1,668 | – | – | – | – | – | 1,668 |
| 25 Apr 08 | 5.51 | 1 Jun 13 | 30 Nov 13 | 27,099 | – | – | – | – | – | 27,099 |
| 25 Apr 08 | 5.51 | 1 Jun 15 | 30 Nov 15 | 1,544 | – | – | – | – | – | 1,544 |
| 25 Sep 08 | 4.38 | 1 Dec 11 | 31 May 12 | 40,617 | – | 37,943 | – | – | 2,455 | 219 |
| 25 Sep 08 | 4.38 | 1 Dec 13 | 31 May 14 | 47,353 | – | 2,674 | – | – | 1,305 | 43,374 |
| 25 Sep 08 | 4.38 | 1 Dec 15 | 31 May 16 | 11,371 | – | 90 | – | – | 76 | 11,205 |
| 27 Apr 09 | 2.88 | 1 Jun 12 | 30 Nov 12 | 2,767,654 | – | 2,378,675 | 4,694 | 11,735 | 4,667 | 367,883 |
| 27 Apr 09 | 2.88 | 1 Jun 14 | 30 Nov 14 | 1,789,848 | – | 17,903 | 5,425 | 7,596 | 15,086 | 1,743,838 |
| 27 Apr 09 | 2.88 | 1 Jun 16 | 30 Nov 16 | 178,968 | – | 352 | – | – | 329 | 178,287 |
| 25 Sep 09 | 4.25 | 1 Dec 12 | 31 May 13 | 224,295 | – | 4,203 | 5,294 | 939 | 1,348 | 212,511 |
| 25 Sep 09 | 4.25 | 1 Dec 14 | 31 May 15 | 90,865 | – | 2,027 | – | 117 | 2,070 | 86,651 |
| 28 Sep 10 | 4.61 | 1 Dec 13 | 31 May 14 | 271,969 | – | – | 780 | 3,510 | 390 | 267,289 |
| 28 Sep 10 | 4.61 | 1 Dec 15 | 31 May 16 | 134,304 | – | 20 | – | – | 46 | 134,238 |
| 16 Sep 11 | 4.66 | 1 Dec 14 | 31 May 15 | 485,420 | – | 160 | 3,628 | 1,621 | 1,771 | 478,240 |
| 16 Sep 11 | 4.66 | 1 Dec 16 | 31 May 17 | 197,637 | – | 15 | 1,960 | 1,960 | 115 | 193,587 |
| | | | | 6,351,563 | – | 2,468,452 | 21,781 | 27,478 | 29,658 | 3,804,194 |

The total number of securities available for issue under the scheme is 3,804,194, which represents 0.149 per cent of the issued share capital at 30 June 2012.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £6.86.

# Additional financial information
continued

## III (c): Option schemes continued

### International savings related share option scheme

| | | Exercise period | | Number of options | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Date of grant | Exercise price £ | Beginning | End | Beginning of period | Granted | Exercised | Cancelled | Forfeited | Lapsed | End of period |
| 20 Apr 06 | 5.65 | 1 Jun 11 | 30 Nov 11 | 820 | – | – | – | – | 820 | – |
| 28 Sep 06 | 4.75 | 1 Dec 11 | 31 May 12 | 709 | – | – | – | – | 709 | – |
| 26 Apr 07 | 5.72 | 1 Jun 12 | 30 Nov 12 | 17,847 | – | – | – | – | – | 17,847 |
| 27 Sep 07 | 5.52 | 1 Dec 10 | 31 May 11 | 22,185 | – | – | – | – | 22,185 | – |
| 25 Apr 08 | 5.51 | 1 Jun 11 | 30 Nov 11 | 8,928 | – | – | – | – | 8,928 | – |
| 25 Apr 08 | 5.51 | 1 Jun 13 | 30 Nov 13 | 4,192 | – | – | – | – | – | 4,192 |
| 25 Sep 08 | 4.38 | 1 Dec 11 | 31 May 12 | 195,889 | – | 28,952 | 418 | 85 | 166,434 | – |
| 25 Sep 08 | 4.38 | 1 Dec 13 | 31 May 14 | 6,951 | – | – | – | – | – | 6,951 |
| 27 Apr 09 | 2.88 | 1 Jun 12 | 30 Nov 12 | 1,740,780 | – | 1,478,499 | 20,101 | 3,454 | 418 | 238,308 |
| 27 Apr 09 | 2.88 | 1 Jun 14 | 30 Nov 14 | 81,218 | – | – | 1,748 | – | – | 79,470 |
| 25 Sep 09 | 4.25 | 1 Dec 12 | 31 May 13 | 110,422 | – | – | 3,049 | 1,694 | – | 105,679 |
| 25 Sep 09 | 4.25 | 1 Dec 14 | 31 May 15 | 2,682 | – | – | – | – | – | 2,682 |
| 28 Sep 10 | 4.61 | 1 Dec 13 | 31 May 14 | 157,107 | – | – | 16,643 | 5,513 | – | 134,951 |
| 28 Sep 10 | 4.61 | 1 Dec 15 | 31 May 16 | 6,130 | – | – | – | – | – | 6,130 |
| 16 Sep 11 | 4.66 | 1 Dec 14 | 31 May 15 | 410,756 | – | – | 11,207 | 16,069 | – | 383,480 |
| 16 Sep 11 | 4.66 | 1 Dec 16 | 31 May 17 | 25,739 | – | – | – | – | – | 25,739 |
| | | | | 2,792,355 | – | 1,507,451 | 53,166 | 26,815 | 199,494 | 1,005,429 |

The total number of securities available for issue under the scheme is 1,005,429, which represents 0.039 per cent of the issued share capital at 30 June 2012.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £6.82.

### Prudential International Assurance sharesave plan

| | | Exercise period | | Number of options | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Date of grant | Exercise price £ | Beginning | End | Beginning of period | Granted | Exercised | Cancelled | Forfeited | Lapsed | End of period |
| 25 Sep 08 | 4.38 | 1 Dec 11 | 31 May 12 | 691 | – | 691 | – | – | – | – |
| 27 Apr 09 | 2.88 | 1 Jun 12 | 30 Nov 12 | 30,320 | – | 25,485 | – | – | – | 4,835 |
| 27 Apr 09 | 2.88 | 1 Jun 14 | 30 Nov 14 | 6,567 | – | – | – | – | – | 6,567 |
| 25 Sep 09 | 4.25 | 1 Dec 12 | 31 May 13 | 2,426 | – | – | – | – | – | 2,426 |
| | | | | 40,004 | – | 26,176 | – | – | – | 13,828 |

The total number of securities available for issue under the scheme is 13,828, which represents 0.001 per cent of the issued share capital at 30 June 2012.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £6.80.

### Non-employee savings related share option scheme

| | | Exercise period | | Number of options | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Date of grant | Exercise price £ | Beginning | End | Beginning of period | Granted | Exercised | Cancelled | Forfeited | Lapsed | End of period |
| 28 Sep 06 | 4.75 | 1 Dec 11 | 31 May 12 | 5,386 | – | 3,366 | – | – | 2,020 | – |
| 26 Apr 07 | 5.72 | 1 Jun 12 | 30 Nov 12 | 15,557 | – | 2,778 | – | – | – | 12,779 |
| 27 Sep 07 | 5.52 | 1 Dec 10 | 31 May 11 | 7,607 | – | – | – | – | – | 7,607 |
| 27 Sep 07 | 5.52 | 1 Dec 12 | 31 May 13 | 2,970 | – | – | – | – | – | 2,970 |
| 25 Apr 08 | 5.51 | 1 Jun 11 | 30 Nov 11 | 4,589 | – | – | – | – | – | 4,589 |
| 25 Apr 08 | 5.51 | 1 Jun 13 | 30 Nov 13 | 3,834 | – | – | – | – | – | 3,834 |
| 25 Sep 08 | 4.38 | 1 Dec 11 | 31 May 12 | 40,488 | – | 37,857 | – | – | – | 2,631 |
| 25 Sep 08 | 4.38 | 1 Dec 13 | 31 May 14 | 13,708 | – | – | – | – | – | 13,708 |
| 27 Apr 09 | 2.88 | 1 Jun 12 | 30 Nov 12 | 874,201 | – | 691,001 | – | – | – | 183,200 |
| 27 Apr 09 | 2.88 | 1 Jun 14 | 30 Nov 14 | 714,326 | – | – | – | 12,356 | – | 701,970 |
| 25 Sep 09 | 4.25 | 1 Dec 12 | 31 May 13 | 46,446 | – | – | – | – | – | 46,446 |
| 25 Sep 09 | 4.25 | 1 Dec 14 | 31 May 15 | 11,717 | – | – | – | – | – | 11,717 |
| 28 Sep 10 | 4.61 | 1 Dec 13 | 31 May 14 | 1,118,575 | – | – | 3,555 | 9,742 | – | 1,105,278 |
| 28 Sep 10 | 4.61 | 1 Dec 15 | 31 May 16 | 375,352 | – | – | – | – | – | 375,352 |
| 16 Sep 11 | 4.66 | 1 Dec 14 | 31 May 15 | 644,407 | – | – | 5,083 | 19,776 | – | 619,548 |
| 16 Sep 11 | 4.66 | 1 Dec 16 | 31 May 17 | 266,624 | – | – | – | – | – | 266,624 |
| | | | | 4,145,787 | – | 735,002 | 8,638 | 41,874 | 2,020 | 3,358,253 |

The total number of securities available for issue under the scheme is 3,358,253, which represents 0.131 per cent of the issued share capital at 30 June 2012.

The weighted average closing price of the shares immediately before the dates on which the options were exercised during the current period was £6.82.

# European Embedded Value (EEV) basis results

## Operating profit based on longer-term investment returns[note(i)]

### Results analysis by business area

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | Half year | Half year note (v) | Full year note (v) |
| **Asia operations** | | | | |
| New business | 2 | 547 | 465 | 1,076 |
| Business in force | 3 | 325 | 309 | 688 |
| Long-term business | | 872 | 774 | 1,764 |
| Eastspring Investments | | 34 | 43 | 80 |
| Development expenses | | (3) | (2) | (5) |
| Total | | 903 | 815 | 1,839 |
| **US operations** | | | | |
| New business | 2 | 442 | 458 | 815 |
| Business in force | 3 | 363 | 373 | 616 |
| Long-term business | | 805 | 831 | 1,431 |
| Broker-dealer and asset management | | 17 | 17 | 24 |
| Total | | 822 | 848 | 1,455 |
| **UK operations** | | | | |
| New business | 2 | 152 | 146 | 260 |
| Business in force | 3 | 338 | 391 | 593 |
| Long-term business | | 490 | 537 | 853 |
| General insurance commission | | 17 | 21 | 40 |
| Total UK insurance operations | | 507 | 558 | 893 |
| M&G | | 199 | 199 | 357 |
| Total | | 706 | 757 | 1,250 |
| **Other income and expenditure** | | | | |
| Investment return and other income | | 5 | 5 | 22 |
| Interest payable on core structural borrowings | | (140) | (140) | (286) |
| Corporate expenditure | | (120) | (118) | (219) |
| Unwind of expected asset management margin[note(ii)] | | (30) | (28) | (53) |
| Total | | (285) | (281) | (536) |
| RPI to CPI inflation measure change on defined benefit pension schemes[note(iii)] | | – | 45 | 45 |
| Solvency II implementation costs[note(iv)] | | (29) | (28) | (56) |
| Restructuring costs[note(iv)] | | (8) | (9) | (19) |
| **Operating profit based on longer-term investment returns** | | 2,109 | 2,147 | 3,978 |
| **Analysed as profits (losses) from:** | | | | |
| New business | 2 | 1,141 | 1,069 | 2,151 |
| Business in force | 3 | 1,026 | 1,073 | 1,897 |
| Long-term business | | 2,167 | 2,142 | 4,048 |
| Asset management | | 250 | 259 | 461 |
| Other results | | (308) | (254) | (531) |
| Total | | 2,109 | 2,147 | 3,978 |

Notes

(i) EEV basis operating profit based on longer-term investment returns excludes the recurrent items of 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. In addition for half year 2012, operating profit excludes the gain arising upon the dilution of the Group's holding in PPM South Africa. The amounts for these items are included in total EEV profit attributable to shareholders. The Company 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 these results.

(ii) The value of future profits or losses from asset management and service companies that support the Group's covered insurance businesses are included in the profits for new business and the in-force value of the Group's long-term business. The results of the Group's asset management operations include the profits from the management of internal and external funds. For EEV basis reporting, Group shareholders' other income is adjusted to deduct the unwind of the expected margin for the period arising from the management of the assets of the covered business (as defined in note 1(a)). The deduction is on a basis consistent with that used for projecting the results for covered insurance business. Group operating profit accordingly includes the variance between actual and expected profit in respect of this business.

(iii) During the first half of 2011 the Group altered its inflation measure basis for future statutory increases to pension payments for certain tranches of its UK defined benefit pension schemes. This reflected the UK Government's decision to replace the basis of indexation from RPI with CPI. This resulted in a credit to operating profit for half year and full year 2011 on an IFRS basis of £42 million and an additional £3 million recognised on the EEV basis.

(iv) Restructuring costs comprise the charge of £(7) million recognised on an IFRS basis and an additional £(1) million recognised on the EEV basis for the shareholders' share of restructuring costs incurred by the PAC with-profits fund. Solvency II implementation costs comprise the charge of £(27) million recognised on an IFRS basis and an additional £(2) million recognised on the EEV basis.

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

# European Embedded Value (EEV) basis results continued

## Summarised consolidated income statement

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | Half year | Half year | Full year |
| **Operating profit based on longer-term investment returns** | | | | |
| Asia operations | | 903 | 815 | 1,839 |
| US operations | | 822 | 848 | 1,455 |
| UK operations: | | | | |
| UK insurance operations | | 507 | 558 | 893 |
| M&G | | 199 | 199 | 357 |
| | | 706 | 757 | 1,250 |
| Other income and expenditure | | (285) | (281) | (536) |
| RPI to CPI inflation measure change on defined benefit pension schemes | | – | 45 | 45 |
| Solvency II implementation costs | | (29) | (28) | (56) |
| Restructuring costs | | (8) | (9) | (19) |
| **Operating profit based on longer-term investment returns** | | 2,109 | 2,147 | 3,978 |
| Short-term fluctuations in investment returns | 5 | 225 | (111) | (907) |
| Mark to market value movements on core borrowings | 10 | (113) | (74) | (14) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 6 | 103 | (8) | 23 |
| Effect of changes in economic assumptions | 7 | (371) | (111) | (158) |
| Gain on dilution of Group holdings | 4 | 42 | – | – |
| **Profit before tax attributable to shareholders (including actual investment returns)** | | 1,995 | 1,843 | 2,922 |
| Tax attributable to shareholders' profit | 12 | (554) | (572) | (776) |
| **Profit for the period** | | 1,441 | 1,271 | 2,146 |
| Attributable to: | | | | |
| Equity holders of the Company | | 1,441 | 1,269 | 2,142 |
| Non-controlling interests | | – | 2 | 4 |
| **Profit for the period** | | 1,441 | 1,271 | 2,146 |

## Earnings per share (in pence)

| | Note | 2012 Half year | 2011 Half year | 2011 Full year |
|---|---|---|---|---|
| Based on operating profit including longer-term investment returns, after related tax and non-controlling interests of £1,539 million (half year 2011: £1,559 million; full year 2011: £2,930 million) | **13** | **60.7p** | 61.5p | 115.7p |
| Based on profit after tax and non-controlling interests of £1,441 million (half year 2011: £1,269 million; full year 2011: £2,142 million) | **13** | **56.8p** | 50.1p | 84.6 |

## Dividends per share (in pence)

| | 2012 Half year | 2011 Half year | 2011 Full year |
|---|---|---|---|
| Dividends relating to reporting period: | | | |
| Interim dividend (2012 and 2011) | **8.40p** | 7.95p | 7.95p |
| Final dividend (2011) | **–** | – | 17.24p |
| Total | **8.40p** | 7.95p | 25.19p |
| Dividends declared and paid in reporting period: | | | |
| Current year interim dividend | **–** | – | 7.95p |
| Final dividend for prior year | **17.24p** | 17.24p | 17.24p |
| Total | **17.24p** | 17.24p | 25.19p |

# European Embedded Value (EEV) basis results continued

## Movement in shareholders' equity (excluding non-controlling interests)

| | | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | Note | Half year | Half year | Full year |
| Profit for the period attributable to equity shareholders | | 1,441 | 1,269 | 2,142 |
| Items taken directly to equity: | | | | |
| Exchange movements on foreign operations and net investment hedges: | | | | |
| Exchange movements arising during the period | | (124) | (96) | (90) |
| Related tax | | (1) | (5) | (68) |
| Dividends | | (440) | (439) | (642) |
| New share capital subscribed | | 14 | 15 | 17 |
| Reserve movements in respect of share-based payments | | 52 | 25 | 44 |
| Treasury shares: | | | | |
| Movement in own shares in respect of share-based payment plans | | 5 | (10) | (30) |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | | 3 | 2 | (5) |
| Mark to market value movements on Jackson assets backing surplus and required capital: | | | | |
| Mark to market value movements arising during the period | | 28 | 39 | 96 |
| Related tax | | (10) | (14) | (34) |
| Net increase in shareholders' equity | 11 | 968 | 786 | 1,430 |
| Shareholders' equity at beginning of period (excluding non-controlling interests) | 8,11 | 19,637 | 18,207 | 18,207 |
| **Shareholders' equity at end of period (excluding non-controlling interests)** | **8,11** | 20,605 | 18,993 | 19,637 |

| Comprising | Note | 30 Jun 2012 £m Long-term business operations | 30 Jun 2012 £m Asset management and other operations | 30 Jun 2012 £m Total | 30 Jun 2011 £m Long-term business operations | 30 Jun 2011 £m Asset management and other operations | 30 Jun 2011 £m Total | 31 Dec 2011 £m Long-term business operations | 31 Dec 2011 £m Asset management and other operations | 31 Dec 2011 £m Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Asia operations: | | | | | | | | | | |
| Net assets of operations | | 8,849 | 202 | 9,051 | 7,825 | 212 | 8,037 | 8,510 | 211 | 8,721 |
| Acquired goodwill | | 237 | 61 | 298 | 239 | 61 | 300 | 235 | 61 | 296 |
| | 8 | 9,086 | 263 | 9,349 | 8,064 | 273 | 8,337 | 8,745 | 272 | 9,017 |
| US operations: | | | | | | | | | | |
| Net assets of operations | | 5,257 | 108 | 5,365 | 4,821 | 108 | 4,929 | 5,082 | 113 | 5,195 |
| Acquired goodwill | | – | 16 | 16 | – | 16 | 16 | – | 16 | 16 |
| | 8 | 5,257 | 124 | 5,381 | 4,821 | 124 | 4,945 | 5,082 | 129 | 5,211 |
| UK insurance operations: | | | | | | | | | | |
| Net assets of operations | 8 | 6,296 | 13 | 6,309 | 6,200 | 48 | 6,248 | 6,058 | 29 | 6,087 |
| M&G: | | | | | | | | | | |
| Net assets of operations | | – | 348 | 348 | – | 310 | 310 | – | 229 | 229 |
| Acquired goodwill | | – | 1,153 | 1,153 | – | 1,153 | 1,153 | – | 1,153 | 1,153 |
| | 8 | – | 1,501 | 1,501 | – | 1,463 | 1,463 | – | 1,382 | 1,382 |
| | | 6,296 | 1,514 | 7,810 | 6,200 | 1,511 | 7,711 | 6,058 | 1,411 | 7,469 |
| Other operations: | | | | | | | | | | |
| Holding company net borrowings at market value | | – | (2,258) | (2,258) | – | (2,364) | (2,364) | – | (2,188) | (2,188) |
| Other net assets | | – | 323 | 323 | – | 364 | 364 | – | 128 | 128 |
| | 8 | – | (1,935) | (1,935) | – | (2,000) | (2,000) | – | (2,060) | (2,060) |
| Shareholders' equity at end of period (excluding non-controlling interests) | 8 | 20,639 | (34) | 20,605 | 19,085 | (92) | 18,993 | 19,885 | (248) | 19,637 |
| Representing: | | | | | | | | | | |
| Net assets | | 20,402 | (1,264) | 19,138 | 18,846 | (1,322) | 17,524 | 19,650 | (1,478) | 18,172 |
| Acquired goodwill | | 237 | 1,230 | 1,467 | 239 | 1,230 | 1,469 | 235 | 1,230 | 1,465 |
| | | 20,639 | (34) | 20,605 | 19,085 | (92) | 18,993 | 19,885 | (248) | 19,637 |

## Net asset value per share (in pence)

| | 30 Jun 2012 | 30 Jun 2011 | 31 Dec 2011 |
|---|---|---|---|
| Based on EEV basis shareholders' equity of £20,605 million (half year 2011: £18,993 million; full year 2011: £19,637 million) | 806p | 745p | 771p |
| Number of issued shares at period end (millions) | 2,556 | 2,548 | 2,548 |
| **Annualised return on embedded value*** | 16% | 17% | 16% |

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

# European Embedded Value (EEV) basis results
continued

## Summary statement of financial position

| | Note | 2012 £m | 2011 £m† | |
|---|---|---|---|---|
| | | 30 Jun | 30 Jun | 31 Dec |
| **Total assets less liabilities, before deduction for insurance funds** | | 253,810 | 238,960 | 243,207 |
| Less insurance funds:* | | | | |
| Policyholder liabilities (net of reinsurers' share) and unallocated surplus of with-profits funds | | (244,518) | (230,970) | (234,643) |
| Less shareholders' accrued interest in the long-term business | | 11,313 | 11,003 | 11,073 |
| | | (233,205) | (219,967) | (223,570) |
| **Total net assets** | 8,11 | 20,605 | 18,993 | 19,637 |
| Share capital | | 127 | 127 | 127 |
| Share premium | | 1,887 | 1,871 | 1,873 |
| IFRS basis shareholders' reserves | | 7,278 | 5,992 | 6,564 |
| Total IFRS basis shareholders' equity | 8 | 9,292 | 7,990 | 8,564 |
| Additional EEV basis retained profit | 8 | 11,313 | 11,003 | 11,073 |
| **Total EEV basis shareholders' equity (excluding non-controlling interests)** | 8,11 | 20,605 | 18,993 | 19,637 |

* Including liabilities in respect of insurance products classified as investment contracts under IFRS 4.
† For IFRS reporting purposes, the Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the IFRS elements and additional EEV basis shareholders' interest for the comparative results for half year and full year 2011 have been adjusted for the retrospective application of this change of IFRS accounting policy. This has resulted in a reallocation of £511 million and £553 million for half year and full year 2011 respectively, from IFRS basis shareholders' reserves to shareholders' accrued interest in the long-term business, with no overall effect on the EEV basis results.

# Notes on the EEV basis results

## 1 Basis of preparation, methodology and accounting presentation

The EEV basis results have been prepared in accordance with the EEV Principles issued by the European Insurance CFO Forum in May 2004. 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. The EEV basis results for 2012 and 2011 half years are unaudited. Except for the consequential effects of the change in accounting policy for deferred acquisition costs for IFRS reporting, as described in the footnotes to the summary statement of financial position and in note 8, the 2011 full year results have been derived from the EEV basis results supplement to the Company's statutory accounts for 2011. The supplement included an unqualified audit report from the auditors.

### (a) Covered business

The EEV results for the Group are prepared for 'covered business', as defined by the EEV Principles. Covered business represents the Group's long-term insurance business for which the value of new and in-force contracts is attributable to shareholders. The EEV basis results for the Group's covered business are then combined with the IFRS basis results of the 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 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 Group's principal defined benefit pension scheme, the Prudential Staff Pension Scheme (PSPS), as described in note 6. 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.

### (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 Group's long-term business comprises:

- present value of future shareholder cash flows from in-force covered business (value of in-force business), less deductions for:
  - the cost of locked-in required capital;
  - the time value of cost of options and guarantees;
- locked-in required capital; and
- shareholders' net worth in excess of required capital (free surplus).

The value of future new business is excluded from the embedded value.

Notwithstanding the basis of presentation of results (as explained in note 1(c)(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 1(c)(i)).

Valuation of in-force and new business

The embedded value results are prepared incorporating best estimate assumptions about all relevant factors including levels of future investment returns, expenses, persistency 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.

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.

# Notes on the EEV basis results
continued

## 1 Basis of preparation, methodology and accounting presentation continued

### Principal economic assumptions
The EEV basis results for the Group's operations have been determined using economic assumptions where the long-term expected rates of return on investments and risk discount rates are set by reference to period end rates of return on government bonds.

Expected returns on equity and property asset classes are derived by adding a risk premium, based on the long-term view of Prudential's economists, to the risk-free rate.

The total profit that emerges over the lifetime of an individual contract as calculated using the embedded value basis is the same 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 period.

***New business***
The contribution from new business represents profits determined by applying operating assumptions as at the end of the period.

In determining the new business contribution for UK immediate annuity 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.

***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, broadly speaking, are held for the longer term.

Fixed income securities backing the free surplus and required capital for Jackson are accounted for at fair value. However, consistent with the treatment applied under IFRS for Jackson securities classified as available-for-sale, movements in unrealised appreciation on these securities are accounted for in equity rather than in the income statement, as shown in the movement in shareholders' equity.

***Cost of capital***
A charge is deducted from the embedded value for the cost of capital supporting the 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) on the capital.

The annual result is affected by the movement in this cost from year-to-year which comprises a charge against new business profit and generally a release in respect of the reduction in capital requirements for business in force as this runs off.

Where required capital is held within a with-profits long-term fund, the value placed on surplus assets in the fund is already discounted to reflect its release over time and no further adjustment is necessary in respect of required capital.

***Financial options and guarantees***
Nature of options and guarantees in Prudential's long-term business
*Asia 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.

There are also various non-participating long-term products with guarantees. The principal guarantees are those for whole of life contracts with floor levels of policyholder benefits that accrue at rates set at inception and do not vary subsequently with market conditions.

*US 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 1.0 per cent to 5.5 per cent for all periods throughout these results, depending on the particular product, jurisdiction where issued, and date of issue. For all periods throughout these results, 85 per cent of the account values on fixed annuities relates to policies with guarantees of 3 per cent or less. The average guarantee rate is 2.8 per cent at half year 2012 (half year 2011: 2.9 per cent; full year 2011: 2.8 per cent).

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)), as death benefits (Guaranteed Minimum Death Benefits (GMDB)) or as income benefits (Guaranteed Minimum Income Benefits (GMIB)). Jackson reinsures and 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*

For covered business the only significant financial options and guarantees in the UK insurance operations arise in the with-profits fund.

With-profits products provide returns to policyholders through bonuses that are smoothed. There are two types of bonuses – annual and final. Annual bonuses are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are guaranteed only until the next bonus declaration. The with-profits fund also held a provision on the Pillar I Peak 2 basis of £90 million at 30 June 2012 (30 June 2011: £26 million; 31 December 2011: £90 million) to honour guarantees on a small amount of guaranteed annuity option products.

Beyond the bonus-based generic features of with-profits products, 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 the non-covered business of SAIF. A provision on the Pillar I Peak 2 basis of £403 million was held in SAIF at half year 2012 (half year 2011: £327 million; full year 2011: £370 million) to honour the guarantees. As described in note 1(a) above, the assets and liabilities are wholly attributable to the policyholders of the fund. Therefore the movement in the provision has no direct impact on shareholders.

*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 time value of the financial options and guarantees.

The economic assumptions used for the stochastic calculations are consistent with those used for the deterministic calculations. Assumptions specific to the stochastic calculations reflect local market conditions and are based on a combination of actual market data, historic market data and an assessment of long-term economic conditions. Common principles have been adopted across the Group for the stochastic asset models, for example, separate modelling of individual asset classes but with an allowance for correlation between the various asset classes. Details of the key characteristics of each model are given in notes 16(iv), (v) and (vi).

# Notes on the EEV basis results
continued

## 1 Basis of preparation, methodology and accounting presentation continued

**(ii) Level of required capital**
In adopting the EEV Principles, Prudential has based required 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 required capital requirements. For shareholder-backed business the following capital requirements apply:

- Asia operations: the level of required capital has been set at the higher of local statutory requirements and the economic capital requirement;
- US operations: the level of required capital has been set to an amount at least equal to 235 per cent 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 was Pillar I for all periods throughout these results.

**(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 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 beta multiplied by an equity risk premium (as explained below). Except for UK shareholder-backed annuity business (as explained below) such an approach has been used for all of the Group's businesses.

The beta of a portfolio or product measures its relative market risk. The risk discount rates reflect the market risk inherent in each product group and hence the volatility of product cash flows. These are determined by considering how the profits from each product are affected by changes in expected returns on various asset classes. By converting this into a relative rate of return it is possible to derive a product specific beta.

Product level betas reflect the most recent product mix to produce appropriate betas and risk discount rates for each major product grouping.

***Additional credit risk allowance***
The Group's methodology is to allow appropriately for credit risk. The allowance for total credit risk is to cover:

- expected long-term defaults;
- credit risk premium (to reflect the volatility in downgrade and default levels); and
- short-term downgrades and defaults.

These allowances are initially reflected in determining best estimate returns and through the market risk allowance described above. However, for those businesses 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 opposite.

*Asia operations*
For Asia 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 (Jackson)*
For Jackson business, the allowance for long-term defaults is reflected in the Risk Margin Reserve (RMR) charge which is deducted in determining the projected spread margin between the earned rate on the investments and the policyholder crediting rate.

The risk discount rate incorporates an additional allowance for credit risk premium and short-term downgrades and defaults. In determining this allowance a number of factors have been considered. These factors, in particular, include:

- How much of the credit spread on debt securities represents an increased 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 recent statistical data; and
- Policyholder benefits for Jackson fixed annuity business are not fixed. It is possible in adverse economic scenarios to pass on a component of credit losses to policyholders (subject to guarantee features) through lower 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 related factors into account and, based on market conditions from 2009 to half year 2012, the risk discount rate for general account business includes an additional allowance of 200 basis points (half year 2011: 150 basis points; full year 2011: 200 basis points) for credit risk. For VA business, the additional allowance has been set at one-fifth (equivalent to 40 basis points (half year 2011: 30 basis points; full year 2011: 40 basis points)) of the non-VA business to reflect the proportion of the VA business that is allocated to holdings of general account debt securities. The level of the additional allowance is assessed at each reporting period to take account of prevailing credit conditions and as the business in force alters over time.

The level of allowance differs from that for UK annuity business for investment portfolio differences and to take account of the management actions available in adverse economic scenarios to reduce crediting rates to policyholders, subject to guarantee features of the products.

*UK business*
(1) Shareholder-backed annuity business
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, a credit risk premium, an allowance for a 1 notch downgrade of the portfolio subject to credit risk and an allowance for short-term 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 the remaining element of short-term downgrade and default allowances are incorporated into the risk margin included in the discount rate, as shown in note 16(iii).

(2) With-profits fund non-profit annuity business
For UK non-profit annuity business including that written by Prudential Annuities Limited (PAL) the basis for determining the aggregate allowance for credit risk is consistent with that applied for UK shareholder-backed annuity business (as described above). The allowance for credit risk 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.

(3) 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. The assumed earned rate for with-profits holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

# Notes on the EEV basis results
continued

## 1 Basis of preparation, methodology and accounting presentation continued

### 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.

A base level allowance of 50 basis points is applied to cover the non-diversifiable non-market risks associated with the Group's businesses. For the Group's US business and UK business other than shareholder-backed annuity, no additional allowance is necessary. For UK shareholder-backed annuity business a further allowance of 50 basis points is used to reflect the longevity risk which is of particular relevance. For the Group's Asia operations in China, India, Indonesia, Philippines, Taiwan, Thailand and Vietnam, additional allowances are applied for emerging market risk ranging from 100 to 250 basis points.

### (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 investment allocation decisions, levels of reversionary and terminal bonuses and credited rates. Bonus rates are projected from current levels and varied in accordance with assumed management actions applying in the emerging investment and fund solvency conditions.

In all instances, the modelled actions are in accordance with approved local practice and therefore reflect the options actually available to management. For the PAC with-profits fund, the actions assumed are consistent with those set out in the Principles and Practices of Financial Management.

### (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 per cent. The value attributed to the shareholders' interest in the estate is derived by increasing final bonus rates (and related shareholder transfers) so as to exhaust the estate over the lifetime of the in-force with-profits business. In any scenarios where the total assets of the life fund are insufficient to meet policyholder claims in full, the excess cost is fully attributed to shareholders. Similar principles apply, where appropriate, for other with-profits funds of the Group's Asia operations.

### (vi) Pension costs

The Group operates three defined benefit schemes in the UK. The largest scheme is the Prudential Staff Pension Scheme (PSPS). The other two, smaller schemes are the Scottish Amicable and M&G scheme.

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, 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 per cent 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 long-term business operations and for other defined benefit schemes the adjustments are reflected as part of 'Other operations', as shown in note 6.

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 period. Foreign currency assets and liabilities have been translated at period 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, the presentation of the EEV profit for the period is consistent with the basis that the 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 (which are determined as described in note 1(c)(ii) below) and incorporate the following:

- new business contribution, as defined in note 1(b)(i);
- unwind of discount on the value of in-force business and other expected returns, as described in note 1(c)(iv) below;
- the impact of routine changes of estimates relating to non-economic assumptions, as described in note 1(c)(iii) below; and
- non-economic experience variances, as described in note 1(c)(v) below.

Non-operating results comprise the recurrent items of 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.

In addition, for half year 2012 the Group's holding in PPM South Africa was diluted, the effect of which has been shown separately from operating profits based on longer-term investment returns.

**(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 purpose 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, asset values at the beginning of the reporting period are adjusted to remove the effects of short-term market movements as explained in note 1(c)(iv) below.

For the purpose of determining the long-term returns for debt securities of US operations for fixed annuity and other general account business, a risk margin charge is included which reflects the expected long-term rate of default based on the credit quality of the portfolio. For Jackson, interest-related realised gains and losses are amortised to the operating results over the maturity period of the sold bonds and for equity-related investments, a long-term rate of return is assumed, which reflects the aggregation of end of period risk-free rates and 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 end of period 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 period.

**(iii) Effect of changes in operating assumptions**

Operating profit includes the effect of changes to operating assumptions on the value of in-force 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 investment 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 1(c)(ii) 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.

# Notes on the EEV basis results
continued

## 1 Basis of preparation, methodology and accounting presentation continued

### (v) Operating experience variances

Operating profits include the effect of experience variances on non-economic assumptions, which are calculated with reference to the embedded value assumptions at the end of the reporting period, such as persistency, mortality and morbidity, expenses and other factors. Further details are shown in notes 16(vii), (viii) and (ix).

### (vi) 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 period are recorded within the income statement. Consistent with the basis of distribution of bonuses and the treatment of the estate described in notes 1(b)(iv) and (v), the shareholders' share incorporates 10 per cent 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 includes the movement in estimates of deficit funding requirements.

In addition, for half year 2012 the other gains include the effect of partial recognition of the PSPS surplus following revised funding arrangements after finalising the 5 April 2011 triennial valuation (as described in note 6).

These items are recorded in the income statement but, consistent with the IFRS basis of presentation, are excluded from operating results based on longer-term investment returns.

### (vii) Effect of changes in economic assumptions

Movements in the value of in-force business at the beginning of the period caused by changes in economic assumptions, net of the related change in the time value of cost of option and guarantees, are recorded in non-operating results.

### (viii) Taxation

The profit for the period 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 rates of tax applicable to the countries and periods concerned. In the UK the rate applied for half year 2012 is 24 per cent (half year 2011: 26 per cent; full year 2011: 25 per cent). For Jackson, the US federal tax rate of 35 per cent is applied to gross up movements on the value of in-force business. The overall tax rate includes the impact of tax effects determined on a local regulatory basis. For Asia, similar principles apply subject to the availability of taxable profits. Tax payments and receipts included in the projected cash flows to determine the value of in-force business are calculated using rates that have been substantively enacted by the end of the reporting period. Possible future changes of rate are not anticipated. See notes 15(b) and (c) for further details.

### (ix) 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 Group companies.

### (x) Foreign exchange rates

Foreign currency results have been translated as discussed in note 1(b)(viii), for which the principal exchange rates are as follows:

| Local currency: £ | Closing rate at 30 Jun 2012 | Average rate for the 6 months to 30 Jun 2012 | Closing rate at 30 Jun 2011 | Average rate for the 6 months to 30 Jun 2011 | Closing rate at 31 Dec 2011 | Average rate for the 12 months to 31 Dec 2011 |
|---|---|---|---|---|---|---|
| China | 9.97 | 9.97 | 10.38 | 10.57 | 9.78 | 10.37 |
| Hong Kong | 12.17 | 12.24 | 12.49 | 12.58 | 12.07 | 12.48 |
| India | 87.57 | 82.27 | 71.77 | 72.74 | 82.53 | 74.80 |
| Indonesia | 14,731.67 | 14,460.30 | 13,767.54 | 14,133.01 | 14,091.80 | 14,049.41 |
| Korea | 1,796.42 | 1,800.16 | 1,714.06 | 1,780.29 | 1,790.32 | 1,775.98 |
| Malaysia | 4.98 | 4.87 | 4.85 | 4.90 | 4.93 | 4.90 |
| Singapore | 1.99 | 1.99 | 1.97 | 2.03 | 2.02 | 2.02 |
| Taiwan | 46.87 | 46.77 | 46.11 | 47.00 | 47.06 | 47.12 |
| Vietnam | 32,788.45 | 32,937.67 | 33,048.21 | 33,110.56 | 32,688.16 | 33,139.22 |
| US | 1.57 | 1.58 | 1.61 | 1.62 | 1.55 | 1.60 |

## 2 Analysis of new business contribution note(iv)

| | Half year 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | New business premiums | | Annual premium and contribution equivalents (APE) note (i) | Present value of new business premiums (PVNBP) note (i) | Pre-tax new business contribution notes (ii), (iii) | New business margin note (i) | |
| | Single | Regular | | | | APE | PVNBP |
| | £m | £m | £m | £m | £m | % | % |
| Asia operations | 669 | 832 | 899 | 4,725 | 547 | 61 | 11.6 |
| US operations | 7,119 | 8 | 719 | 7,180 | 442 | 61 | 6.2 |
| UK insurance operations note(v) | 2,960 | 116 | 412 | 3,495 | 152 | 37 | 4.3 |
| Total | 10,748 | 956 | 2,030 | 15,400 | 1,141 | 56 | 7.4 |

| | Half year 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| | New business premiums | | Annual premium and contribution equivalents (APE) note (i) | Present value of new business premiums (PVNBP) note (i) | Pre-tax new business contribution notes (ii), (iii) | New business margin note (i) | |
| | Single | Regular | | | | APE | PVNBP |
| | £m | £m | £m | £m | £m | % | % |
| Asia operations | 744 | 668 | 743 | 3,939 | 465 | 63 | 11.8 |
| US operations | 6,615 | 10 | 672 | 6,689 | 458 | 68 | 6.8 |
| UK insurance operations note(v) | 2,520 | 157 | 409 | 3,264 | 146 | 36 | 4.5 |
| Total | 9,879 | 835 | 1,824 | 13,892 | 1,069 | 59 | 7.7 |

# Notes on the EEV basis results
continued

## 2 Analysis of new business contribution note (iv) continued

| | Full year 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| | New business premiums | | Annual premium and contribution equivalents (APE) note (i) | Present value of new business premiums (PVNBP) note (i) | Pre-tax new business contribution notes (ii), (iii) | New business margin note (i) | |
| | Single | Regular | | | | APE | PVNBP |
| | £m | £m | £m | £m | £m | % | % |
| Asia operations | 1,456 | 1,514 | 1,660 | 8,910 | 1,076 | 65 | 12.1 |
| US operations | 12,562 | 19 | 1,275 | 12,720 | 815 | 64 | 6.4 |
| UK insurance operations note (v) | 4,871 | 259 | 746 | 6,111 | 260 | 35 | 4.3 |
| Total | 18,889 | 1,792 | 3,681 | 27,741 | 2,151 | 58 | 7.8 |

| | New business margin (APE %) | | |
|---|---|---|---|
| | Half year 2012 | Half year 2011 | Full year 2011 |
| Asia operations: | | | |
| China | 41 | 40 | 46 |
| Hong Kong | 57 | 72 | 66 |
| India | 19 | 21 | 20 |
| Indonesia | 87 | 76 | 87 |
| Korea | 43 | 41 | 43 |
| Taiwan | 19 | 26 | 19 |
| Other | 70 | 73 | 76 |
| Weighted average for all Asia operations | 61 | 63 | 65 |

Notes
(i) New business margins are shown on two bases, namely the margins by reference to Annual Premium Equivalents (APE) and the Present Value of New Business Premiums (PVNBP) and are calculated as the ratio of the value of new business profit to APE and PVNBP. APE are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts. PVNBP 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.
(ii) In determining the EEV basis value of new business, premiums are included in projected cash flows on the same basis of distinguishing annual and single premium business as set out for statutory basis reporting.
(iii) New business contributions represent profits determined by applying operating assumptions as at the end of the period. 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 Group where this has a material effect is for UK shareholder-backed annuity business. For other business within the Group end of period economic assumptions are used.
(iv) The amounts shown in the tables are translated at average exchange rates for the period.
(v) The new business margin for UK operations in half year 2012 of 37 per cent (half year 2011: 36 per cent; full year 2011: 35 per cent) includes bulk annuity agreements with an APE of £27 million (half year 2011: £28 million; full year 2011: £33 million) and new business profit of £23 million (half year 2011: £24 million; full year 2011: £28 million).

## 3 Operating profit from business in force

### (i) Group summary

| | Half year 2012 £m | | | |
|---|---|---|---|---|
| | Asia operations note (ii) | US operations note (iii) | UK insurance operations note (iv) | Total |
| Unwind of discount and other expected returns | 321 | 198 | 245 | 764 |
| Effect of changes in operating assumptions | (8) | 35 | 43 | 70 |
| Experience variances and other items | 12 | 130 | 50 | 192 |
| Total | 325 | 363 | 338 | 1,026 |

| | Half year 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations note (ii) | US operations note (iii) | UK insurance operations note (iv) | Total |
| Unwind of discount and other expected returns | 333 | 203 | 289 | 825 |
| Effect of changes in operating assumptions | (18) | 14 | 46 | 42 |
| Experience variances and other items | (6) | 156 | 56 | 206 |
| Total | 309 | 373 | 391 | 1,073 |

| | Full year 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations note (ii) | US operations note (iii) | UK insurance operations note (iv) | Total |
| Unwind of discount and other expected returns | 613 | 349 | 485 | 1,447 |
| Effect of changes in operating assumptions | 10 | 14 | 79 | 103 |
| Experience variances and other items | 65 | 253 | 29 | 347 |
| Total | 688 | 616 | 593 | 1,897 |

### (ii) Asia operations

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Unwind of discount and other expected returns note (a) | 321 | 333 | 613 |
| Effect of changes in operating assumptions: | | | |
| Mortality and morbidity note (b) | 2 | – | 126 |
| Expense note (c) | – | – | 11 |
| Persistency and withdrawals note (d) | – | – | (140) |
| Other note (e) | (10) | (18) | 13 |
| | (8) | (18) | 10 |
| Experience variance and other items: | | | |
| Mortality and morbidity note (f) | 33 | 26 | 58 |
| Expense note (g) | (23) | (29) | (31) |
| Persistency and withdrawals note (h) | (18) | (10) | 10 |
| Other note (i) | 20 | 7 | 28 |
| | 12 | (6) | 65 |
| Total Asia operations | 325 | 309 | 688 |

# Notes on the EEV basis results
continued

## 3 Operating profit from business in force continued

Notes

(a) The decrease in unwind of discount and other expected returns of £(12) million from £333 million in half year 2011 to £321 million in half year 2012 reflects the £(46) million effect of lower risk discount rates driven by the reduction in interest rates, partly offset by the £34 million effect of the growth in the opening in-force value, on which the discount rates are applied.

(b) The credit of £126 million in full year 2011 for mortality and morbidity assumption changes arose as follows:

| | 2011 Full year £m |
|---|---|
| Malaysia note (1) | 69 |
| Indonesia note (2) | 33 |
| Singapore | 19 |
| Other | 5 |
| | 126 |

(1) The credit in Malaysia of £69 million relates to revised mortality and morbidity assumptions, reflecting recent experience.

(2) The credit in Indonesia of £33 million represents the effect of revised morbidity assumptions of £48 million, the revision of reinsurance rates of £8 million, offset by modelling enhancements for the cost of reinsurance of £(23) million.

(c) The overall credit of £11 million in full year 2011 for expense assumption changes mainly arose from altered assumptions for maintenance expenses, reflecting recent experience, principally in Singapore of £34 million and Indonesia of £11 million, partly offset by a charge in India of £(30) million.

(d) The charge of £(140) million in full year 2011 for persistency and withdrawals assumption changes arose as follows:

| | 2011 Full year £m |
|---|---|
| Malaysia note (1) | (106) |
| India note (2) | (21) |
| Indonesia | (13) |
| Singapore | (4) |
| Other | 4 |
| | (140) |

(1) The charge of £(106) million in Malaysia includes £(108) million for the effect of strengthening partial withdrawal assumptions on PruSaver product riders to reflect recent experience. Policyholders' pattern and frequency of withdrawals from this savings rider is different from that of the underlying 'host' contract, where both persistency and premium payment experience remains in line with assumptions.

(2) The charge in India of £(21) million mainly reflects lower persistency assumptions for paid-up policies for unit-linked business.

(e) The credit of £13 million in full year 2011 for other operating assumptions principally represents the combined effect of a favourable change in assumed asset management margins, a reduction in investment expenses for Indonesia resulting from a growth in the asset portfolio, a decrease in policyholder bonuses in the Philippines, partly offset by the effect of altered profit sharing arrangements in relation to participating business in Vietnam.

(f) The favourable effect of mortality and morbidity experience in half year 2012 of £33 million (half year 2011: £26 million; full year 2011: £58 million) reflects better than expected experience, principally arising in Hong Kong, Indonesia, Singapore and Malaysia.

(g) The negative expense experience variance of £(23) million in half year 2012 (half year 2011: £(29) million; full year 2011: £(31) million) principally reflects expense overruns for operations which are currently sub-scale (China, Malaysia Takaful and Taiwan) and in India where regulatory changes have affected the development of the book of business.

(h) The charge of £(18) million for persistency and withdrawals experience in half year 2012 principally arises in Malaysia and Korea. The positive persistency and withdrawals experience variance of £10 million in full year 2011 reflects a combination of favourable experience in Hong Kong and Indonesia, partially offset by individually small negative variances in other territories. The negative persistency and withdrawals experience of £(10) million for half year 2011 mainly arose in Malaysia of £(11) million reflecting higher partial withdrawals on unit-linked business.

(i) The credit of £20 million in half year 2012 for other experience and other items arises in Indonesia of £6 million, Hong Kong of £4 million and in other territories totalling £10 million. The credit of £28 million in full year 2011 primarily reflected a £24 million benefit in Indonesia.

### (iii) US operations

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Unwind of discount and other expected returns[note (a)] | 198 | 203 | 349 |
| Effect of changes in operating assumptions: | | | |
| Persistency[note (b)] | 45 | 29 | 29 |
| Variable annuity (VA) fees[note (c)] | (19) | 24 | 24 |
| Mortality[note (d)] | 33 | (36) | (36) |
| Other[note (e)] | (24) | (3) | (3) |
| | 35 | 14 | 14 |
| Experience variances and other items: | | | |
| Spread experience variance[note (f)] | 98 | 81 | 152 |
| Amortisation of interest-related realised gains and losses[note (g)] | 44 | 43 | 84 |
| Other[note (h)] | (12) | 32 | 17 |
| | 130 | 156 | 253 |
| Total US operations | 363 | 373 | 616 |

Notes

(a) The decrease in unwind of discount and other expected returns of £(5) million from £203 million for half year 2011 to £198 million for half year 2012 mainly reflects the £(29) million effect of lower risk discount rates driven by the reduction in the 10-year US treasury rate, which is broadly offset by the £24 million effect of the increase in opening value of in-force business, on which the discount rates are applied.

(b) The effect of changes in persistency assumptions of £45 million in half year 2012 primarily relate to variable annuity (VA) business, including £40 million for a reduction in overall lapse rates on certain VA products, £19 million for an enhancement in the dynamic lapse assumption for Guaranteed Minimum Death Benefits which are 'in-the-money', to reflect recent experience, partly offset by a charge of £(14) million for other items.

In half year and full year 2011, the credit of £29 million for the effect of changes in persistency assumptions arose on variable annuity business of a credit of £15 million and £14 million on other business. The credit of £15 million for VA business represents a credit of £32 million to reflect a decrease in lapse rates for selected product and policy duration combinations, partially offset by a charge of £(17) million to increase partial withdrawal rates in line with experience. The credit of £14 million for other business reflects updated persistency assumptions for life and fixed annuity business.

(c) 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 £(19) million for half year 2012 represents a reduction in the projected level of fees paid by policyholders, according to the current fund size and mix. The credit of £24 million for half year and full year 2011 represents an increase in the projected level of policyholder fees.

(d) The credit of £33 million in half year 2012 for the effect of updated mortality assumptions principally relates to life business, representing a credit of £86 million for the explicit modelling of projected mortality improvement, partially offset by a charge of £(53) million for other regular mortality updates to reflect recent experience.

In half year and full year 2011, the charge of £(36) million for updated mortality assumptions primarily arises on variable annuity business to reflect recent experience.

(e) The charge of £(24) million in half year 2012 for other operating assumption changes includes a charge of £(12) million for the impact of altered assumptions for Guaranteed Minimum Withdrawal Benefit utilisation and £(12) million for other items.

(f) The spread assumption for Jackson is determined on a longer-term basis, net of provision for defaults. The spread experience variance in half year 2012 of £98 million (half year 2011: £81 million; full year 2011: £152 million) includes the positive effect of transactions undertaken to more closely match the overall asset and liability duration.

(g) The 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. The realised gain or loss is amortised into the result over the period when the bonds would have otherwise matured to better reflect the long-term returns included in operating profits.

# Notes on the EEV basis results
continued

## 3 Operating profit from business in force continued

(h) Other experience variances and other items arise as follows:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| Expense experience variance[note (1)] | (1) | 7 | 12 |
| Persistency experience variance[note (2)] | 17 | 12 | 21 |
| Other[note (3)] | (28) | 13 | (16) |
| | (12) | 32 | 17 |

Notes
(1) The positive expense experience variance of £12 million in full year 2011 primarily represents favourable experience variance relating to marketing expenses.
(2) The positive persistency experience variance of £17 million in half year 2012 (half year 2011: £12 million; full year 2011: £21 million) mainly arises on annuity business.
(3) The charge of £(28) million for other items in half year 2012 comprises £(11) million of negative mortality experience variance relating to annuity and life business, reflecting recent experience, and £(17) million for other items.
The charge of £(16) million for other items in full year 2011 included £(6) million of negative mortality experience variance. This variance included a provision of £(16) million in respect of unclaimed property for deceased policyholders.

### (iv) UK insurance operations

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Unwind of discount and other expected returns[note (a)] | 245 | 289 | 485 |
| Effect of change in UK corporate tax rate[note (b)] | 43 | 46 | 79 |
| Other items[note (c)] | 50 | 56 | 29 |
| Total UK insurance operations | 338 | 391 | 593 |

Notes
(a) The decrease in unwind of discount and other expected returns of £(44) million from £289 million in half year 2011 to £245 million for half year 2012 reflects the £(35) million effect of lower risk discount rates driven by the reduction in interest rates, together with the £(9) million effect of a decrease in the opening in-force value, on which the discount rates are applied.
(b) The effect of the change in tax rate of £43 million in half year 2012 represents the benefit of the reduction in tax rate from 25 per cent to 24 per cent. Consistent with the Group's approach of grossing up the movement in the net of tax value of in-force for shareholder tax, the £43 million benefit is presented gross (half year 2011: £46 million, 27 per cent to 26 per cent; full year 2011: £79 million, 27 per cent to 25 per cent).
(c) Other items of £50 million in half year 2012 (half year 2011: £56 million; full year 2011: £29 million) include £31 million (half year 2011: £28 million; full year 2011: £45 million) for the effects of annuity portfolio rebalancing to align the asset portfolio more closely with the internal benchmark of credit quality that management applies.

## 4 Changes to Group's holdings

### PPM South Africa

On 22 February 2012, M&G completed transactions to (i) exchange bonus share rights for equity holdings with the employees of PPM South Africa and (ii) the sale of a 10 per cent holding in the majority of the business to Thesele Group, a minority shareholder, for cash. Following these transactions M&G's majority holding in the business reduced from 75 per cent to 47 per cent. Under IFRS requirements, the divestment is accounted for as the disposal of the 75 per cent holding and an acquisition of a 47 per cent holding at fair value resulting in a reclassification of PPM South Africa from a subsidiary to an associate. As a consequence of the IFRS application, the transactions give rise to a gain on dilution of £42 million. On an EEV basis, consistent with IFRS, this amount has been treated as a gain on dilution of holdings which is excluded from the Group's EEV operating profit based on longer-term investment returns.

## 5 Short-term fluctuations in investment returns

Short-term fluctuations in investment returns, net of the related change in the time value of cost of options and guarantees, arise as follows:

### (i) Group summary

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Insurance operations: | | | |
| Asia[note (ii)] | 216 | (63) | (155) |
| US[note (iii)] | (62) | (91) | (491) |
| UK[note (iv)] | 25 | 15 | (141) |
| | 179 | (139) | (787) |
| Other operations: | | | |
| Economic hedge value movement[note (v)] | (15) | – | – |
| Other[note (vi)] | 61 | 28 | (120) |
| Total | 225 | (111) | (907) |

### (ii) Asia operations

For half year 2012, the positive short-term fluctuations in investment returns of £216 million in Asia operations mainly reflect unrealised gains on bonds, principally arising in Vietnam of £59 million, Hong Kong of £51 million, Singapore of £40 million and Taiwan of £25 million, together with an unrealised gain of £13 million on the Group's 7.74 per cent stake in China Life Insurance Company of Taiwan.

For half year 2011, short-term fluctuations in investment returns of £(63) million primarily reflect the unrealised losses on bonds and equities in Vietnam of £(27) million, and unfavourable equity performance in India of £(26) million and Singapore of £(20) million, partially offset by an unrealised gain of £26 million on the Group's stake in China Life Insurance Company of Taiwan.

For full year 2011, short-term fluctuations in investment returns of £(155) million were driven by lower equity markets reducing future expected fee income, mainly arising in Singapore of £(105) million and Korea of £(22) million. The full year 2011 short-term fluctuations in investment returns also include £(28) million of adverse variance arising in other territories. This principally comprises fluctuations arising in India of £(53) million reflecting lower equity market returns, in Vietnam of £(33) million for unrealised losses on bonds and equities and Taiwan of £(30) million for losses on bonds and CDOs, partially offset by a credit in Hong Kong of £96 million primarily relating to positive returns on bonds backing participating business.

### (iii) US operations

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

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Investment return related experience on fixed income securities[note (a)] | (45) | 7 | (74) |
| Investment return related impact 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[note (b)] | (42) | (121) | (418) |
| Actual less long-term return on equity based investments and other items | 25 | 23 | 1 |
| Total Jackson | (62) | (91) | (491) |

# Notes on the EEV basis results
continued

## 5 Short-term fluctuations in investment returns continued

Notes

(a) The (charge) credit relating to fixed income securities comprises the following elements:
- the excess of actual realised (losses) gains over the amortisation of interest related realised gains and losses recorded in the profit and loss account;
- credit loss experience (versus the longer-term assumption); and
- the impact of de-risking activities within the portfolio.

(b) This item reflects the net impact of:
- variances in projected future fees arising from the effect of market fluctuations on the growth in separate account asset values in the current reporting period; and
- related hedging activity.

In half year 2012, there was an 8.25 per cent rate of return for the variable annuity separate account assets compared with an assumed longer-term rate of return of 2.6 per cent for the period (half year 2011: 5.6 per cent actual return compared to 3.3 per cent for the period). Consequently, the asset values and therefore projected future fees at 30 June 2012 were higher then assumed. However, net of the impact of related hedging effects there is a short-term fluctuation of £(42) million (half year 2011: £(121) million).

In full year 2011, there was a negative 0.5 per cent rate of return for the variable annuity separate account assets which compared to an assumed longer-term rate of return of 5.4 per cent. Consequently, the asset values and therefore projected future fees at 31 December 2011, were lower than assumed. As a consequence of this lower level of return, net of the impact of relating hedging effects, there was a short-term fluctuation of £(418) million.

### (iv) UK insurance operations

The short-term fluctuations in investment returns for UK insurance operations arise from the following types of business:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| With-profits[note (a)] | 58 | 9 | (201) |
| Shareholder-backed annuity[note (b)] | (1) | 5 | 56 |
| Unit-linked and other | (32) | 1 | 4 |
| | 25 | 15 | (141) |

Notes

(a) For with-profits business the amounts reflect the excess (deficit) of the actual investment return on the investments of the PAC with-profits fund (covering policyholder liabilities and unallocated surplus) against the assumed long-term rate for the period. For half year 2012, the credit of £58 million reflects the actual investment return of 3.2 per cent against the assumed long-term rate of 2.5 per cent for the period.

For half year 2011, the credit of £9 million reflects the positive 3.34 per cent actual investment return against the assumed long-term rate for the period of 3.32 per cent.

For full year 2011, the charge of £(201) million reflects the actual investment return of 3.2 per cent against the assumed long-term rate of 5.1 per cent, primarily reflecting the fall in equity markets and widening of corporate bond credit spreads, partially offset by the increase in asset values as a result of the reduction in bond yields.

(b) Short-term fluctuations in investment returns for shareholder-backed annuity business in full year 2011 of a credit of £56 million comprise: (1) gains on surplus assets reflecting reductions in corporate bond and gilt yields; (2) the difference between actual and expected default experience; and (3) the effect of mismatching for assets and liabilities of different durations and other short-term fluctuations in investment returns.

For half year 2011, the credit of £5 million primarily reflects mismatching profits of £6 million.

### (v) Economic hedge value movement

This item represents the value movement in half year 2012 on short-dated hedge contracts to provide downside protection against severe equity market falls.

### (vi) Other

Other short-term fluctuations in investment returns for other operations in half year 2012 of £61 million (half year 2011: £28 million; full year 2011: £(120) million) represent unrealised value movements on investments, including centrally held swaps to manage foreign exchange and certain macroeconomic exposures of the Group.

## 6 Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes

The gain of £103 million in half year 2012 included within the profit before tax reflects the shareholders' share of actuarial and other gains and losses on the Group's defined benefit pension schemes.

For 2011, the Prudential Staff Pension Scheme (PSPS) deficit funding liability attaching to the shareholder-backed business was included in the total for Other operations, reflecting the fact that the deficit funding is being paid for by the parent company, Prudential plc. At 30 June 2012 a £2 million deficit funding obligation remained to be paid. However, following the triennial valuation for PSPS as at 5 April 2011, the scheme has been measured as being in surplus and deficit funding is no longer required. Furthermore, as the scheme contributions for active members in service have been reduced to the minimum under the scheme rules, a portion of the surplus can be recognised as recoverable. Consequently, consistent with the IAS 19 measurement basis, the pre-tax surplus of £169 million is recoverable, allocated as £118 million to the PAC with-profits sub-fund (WPSF) and £51 million to shareholder-backed operations. On the EEV basis, reflecting the shareholders' 10 per cent economic interest in the WPSF, the shareholders' total interest in the recoverable surplus is £66 million.

The credit for the shareholders' share of actuarial and other gains and losses comprises:

| | Half year 2012 | | | Half year 2011 | Full year 2011 |
|---|---|---|---|---|---|
| | IFRS basis £m | Additional shareholders' interest £m | EEV basis total £m | £m | £m |
| Shareholders' share of partial recognition of PSPS surplus | 51 | 15 | 66 | – | – |
| Other actuarial gains and losses | 36 | 1 | 37 | (8) | 23 |
| Total | 87 | 16 | 103 | (8) | 23 |
| Representing: | | | | | |
| UK insurance operations[note 11] | | | 10 | (3) | 20 |
| Other operations[note 11] | | | 93 | (5) | 3 |
| | | | 103 | (8) | 23 |

## 7 Effect of changes in economic assumptions

The effects of changes in economic assumptions for in-force business, net of the related change in the time value of cost of options and guarantees, included within profit before tax (including actual investment returns) arise as follows:

### (i) Group summary

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Asia operations[note (ii)] | (254) | (17) | 279 |
| US operations[note (iii)] | (79) | (13) | (144) |
| UK insurance operations[note (iv)] | (38) | (81) | (293) |
| Total | (371) | (111) | (158) |

### (ii) Asia operations

The changes in economic assumptions for Asia operations for half year 2012 of £(254) million primarily reflect decreases in fund earned rates, mainly arising in Hong Kong of £(79) million and Vietnam of £(63) million due to the reduction in the assumed long-term yields (as shown in note 16(i)) and in Singapore of £(73) million for the narrowing of corporate bond spreads.

The charge of £(17) million in half year 2011 for the effect of changes in economic assumptions arises from modest changes in economic factors across the territories in the period.

The effect of changes in economic assumptions for full year 2011 of a credit of £279 million principally arises in Singapore of £160 million, Malaysia of £97 million and Indonesia of £94 million, primarily reflecting the positive impact of discounting health and protection profits at lower rates, driven by the decrease in risk-free rates. There is a partial offset arising in Hong Kong of £(57) million, primarily reflecting the reduction in fund earned rates for participating business.

# Notes on the EEV basis results
continued

## 7 Effect of changes in economic assumptions continued

### (iii) US operations

The effect of changes in economic assumptions for US operations reflects the following:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Effect of changes in 10-year treasury rates, beta and equity risk premium:note (a) | | | |
| Fixed annuity and other general account business | 28 | 20 | 282 |
| Variable annuity (VA) business | (107) | (33) | (333) |
| Increase in risk margin allowance for credit risknote (b) | – | – | (93) |
| | (79) | (13) | (144) |

Notes

(a) 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 1(b)(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. Secondary effects on the cash flows also result from changes to assumed future yield and resulting policyholder behaviour. 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 on which fees are charged. For half year 2012, the effect of these changes resulted in an overall credit for fixed annuity and other general account business of £28 million (half year 2011: £20 million; full year 2011: £282 million) and a charge for VA business of £(107) million (half year 2011: £(33) million; full year 2011: £(333) million) reflecting the 20 basis points reduction (half year 2011: a reduction of 10 basis points; full year 2011: a reduction of 140 basis points) in the risk-free rate (as shown in note 16(ii)).

(b) For full year 2011, the effect of £(93) million for the increase in the risk margin allowance within the risk discount rate for credit risk represents 50 basis points increase in the risk discount rate for spread business (from 150 basis points in half year 2011 to 200 basis points in full year 2011), and 10 basis points increase for VA business (from 30 basis points in half year 2011 to 40 basis points in full year 2011), representing the proportion of business invested in the general account (as described in note 1(b)(iii)).

### (iv) UK insurance operations

The effect of changes in economic assumptions of a charge of £(38) million for UK insurance operations for half year 2012 comprises the effect of:

| | Half year 2012 £m | | | Half year 2011 £m | | | Full year 2011 £m | | |
|---|---|---|---|---|---|---|---|---|---|
| | Shareholder-backed annuity business note (a) | With-profits and other business note (b) | Total | Shareholder-backed annuity business note (a) | With-profits and other business note (b) | Total | Shareholder-backed annuity business note (a) | With-profits and other business note (b) | Total |
| Effect of changes in expected long-term rates of return | (30) | (112) | (142) | 14 | (62) | (48) | 58 | (1,113) | (1,055) |
| Effect of changes in risk discount rates | 48 | 67 | 115 | (11) | (13) | (24) | 240 | 627 | 867 |
| Other changes | – | (11) | (11) | – | (9) | (9) | (20) | (85) | (105) |
| | 18 | (56) | (38) | 3 | (84) | (81) | 278 | (571) | (293) |

Notes

(a) For shareholder-backed annuity business the overall effect of changes in expected long-term rates of return and risk discount rates for the periods shown above reflect the combined effects of the changes in economic assumptions, which incorporate a default allowance for both best estimate defaults and in respect of the additional credit risk provisions (as shown in note 16(iii)).

(b) For with-profits and other business the charge in half year 2012 of £(56) million reflects the changes in fund earned rates and risk discount rate (as shown in note 16(iii)), driven by the 20 basis points decrease in the risk-free rate.

For half year 2011, the charge of £(84) million primarily reflects the impact of decreases in fund earned rates, primarily arising from reductions in the additional returns assumed on corporate bonds.

For full year 2011, the charge of £(1,113) million for the effect of changes in expected long-term rates of return arises from the reduction in fund earned rates, driven by the 150 basis points decrease in gilt rates and reduction in additional returns assumed on corporate bonds, reflecting changes in asset mix. The credit of £627 million for the effect of changes in risk discount rates reflects the 135 basis points reduction in the risk discount rate, driven by the 150 basis points decrease in gilt rates, partly offset by the impact of an increase in beta for with-profits business.

## 8 Shareholders' equity (excluding non-controlling interests) – segmental analysis

### (i) Group summary

| | Note | 2012 £m | 2011 £m | |
|---|---|---|---|---|
| | | 30 Jun | 30 Jun | 31 Dec |
| **Asia operations** | | | | |
| Long-term business: | | | | |
| Net assets of operations – EEV basis shareholders' equity | | 8,849 | 7,825 | 8,510 |
| Acquired goodwill[note (a)] | | 237 | 239 | 235 |
| | | 9,086 | 8,064 | 8,745 |
| Eastspring Investments:[note (a)] | | | | |
| Net assets of operations | | 202 | 212 | 211 |
| Acquired goodwill | | 61 | 61 | 61 |
| | | 263 | 273 | 272 |
| | | 9,349 | 8,337 | 9,017 |
| **US operations** | | | | |
| Jackson – EEV basis shareholders' equity (net of surplus note borrowings of £185 million (half year 2011: £172 million; full year 2011: £177 million)) | | 5,257 | 4,821 | 5,082 |
| Broker-dealer and asset management operations:[note (a)] | | | | |
| Net assets of operations | | 108 | 108 | 113 |
| Acquired goodwill | | 16 | 16 | 16 |
| | | 124 | 124 | 129 |
| | | 5,381 | 4,945 | 5,211 |
| **UK operations** | | | | |
| Insurance operations | | | | |
| Long-term business operations: | | | | |
| Smoothed shareholders' equity | | 6,305 | 6,195 | 6,097 |
| Actual shareholders' equity less smoothed shareholders' equity | | (9) | 5 | (39) |
| EEV basis shareholders' equity | | 6,296 | 6,200 | 6,058 |
| Other[note (a)] | | 13 | 48 | 29 |
| | | 6,309 | 6,248 | 6,087 |
| M&G:[note (a)] | | | | |
| Net assets of operations | | 348 | 310 | 229 |
| Acquired goodwill | | 1,153 | 1,153 | 1,153 |
| | | 1,501 | 1,463 | 1,382 |
| | | 7,810 | 7,711 | 7,469 |
| **Other operations** | | | | |
| Holding company net borrowings at market value | 10 | (2,258) | (2,364) | (2,188) |
| Other net assets[note (a)] | | 323 | 364 | 128 |
| | | (1,935) | (2,000) | (2,060) |
| Total | | 20,605 | 18,993 | 19,637 |

# Notes on the EEV basis results
continued

## 8 Shareholders' equity (excluding non-controlling interests) – segmental analysis continued

### (ii) Additional retained profit on an EEV basis – segmental analysis

| | 30 Jun 2012 £m | | | | | |
|---|---|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations | Other operations note (b) | Group Total |
| Statutory IFRS basis shareholders' equity | 2,403 | 3,919 | 2,709 | 9,031 | 261 | 9,292 |
| Additional retained profit on an EEV basis | 6,683 | 1,338 | 3,587 | 11,608 | (295) | 11,313 |
| EEV basis shareholders' equity | 9,086 | 5,257 | 6,296 | 20,639 | (34) | 20,605 |

| | 30 Jun 2011 £m note (c) | | | | | |
|---|---|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations | Other operations note (b) | Group Total |
| Statutory IFRS basis shareholders' equity | 2,224 | 3,298 | 2,294 | 7,816 | 174 | 7,990 |
| Additional retained profit on an EEV basis | 5,840 | 1,523 | 3,906 | 11,269 | (266) | 11,003 |
| EEV basis shareholders' equity | 8,064 | 4,821 | 6,200 | 19,085 | (92) | 18,993 |

| | 31 Dec 2011 £m note (c) | | | | | |
|---|---|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations | Other operations note (b) | Group Total |
| Statutory IFRS basis shareholders' equity | 2,306 | 3,761 | 2,552 | 8,619 | (55) | 8,564 |
| Additional retained profit on an EEV basis | 6,439 | 1,321 | 3,506 | 11,266 | (193) | 11,073 |
| EEV basis shareholders' equity | 8,745 | 5,082 | 6,058 | 19,885 | (248) | 19,637 |

Notes

(a) The statutory IFRS basis has been used to determine the amounts shown above for non-covered business. The other net assets of £323 million (half year 2011: £364 million; full year 2011: £128 million) includes £49 million (half year 2011: £(10) million; full year 2011: £(6) million) for the shareholders' interest in the financial position of the Prudential Staff Pension Scheme (PSPS) on an IAS 19 basis. This amount comprises £38 million (half year 2011: £(8) million; full year 2011: £(5) million) on an IFRS basis and an additional £11 million (half year 2011: £(2) million; full year 2011: £(1) million), relating to the shareholders' 10 per cent share of the IFRS basis surplus (deficit) attributable to the PAC with-profits fund.

(b) The additional retained profit on an EEV basis for Other operations primarily represents the mark to market value adjustment for holding company net borrowings of a charge of £(293) million (half year 2011: £(247) million; full year 2011: £(187) million) (as shown in note 10).

(c) For IFRS reporting purposes, the Group has adopted altered US GAAP requirements for deferred acquisition costs as an improvement to its accounting policy under IFRS 4 for those operations of the Group which measure insurance assets and liabilities substantially by reference to US GAAP principles. Accordingly, the IFRS elements and additional EEV basis shareholders' interest for the comparative results for half year and full year 2011 have been adjusted for the retrospective application of this change of IFRS accounting policy. This has resulted in a reallocation of £511 million and £553 million for half year and full year 2011 respectively, from IFRS basis shareholders' reserves to shareholders' accrued interest in the long-term business, with no overall effect on the EEV basis results.

## 9 Analysis of movement in free surplus

Free surplus is the excess of the net worth over 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. Prudential 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 1(b)(ii).

| | Half year 2012 £m | | |
|---|---|---|---|
| **Long-term business and asset management operations** note (i) | **Long-term business** note 14 | **Asset management and UK general insurance commission** note (ii) | **Free surplus of long-term business, asset management and UK general insurance commission** |
| Underlying movement: | | | |
| New business | (364) | – | (364) |
| Business in force: | | | |
| Expected in-force cash flows (including expected return on net assets) | 1,080 | 191 | 1,271 |
| Effects of changes in operating assumptions, operating experience variances and other operating items | 132 | – | 132 |
| | 848 | 191 | 1,039 |
| Changes in non-operating items note (iii) | (203) | 47 | (156) |
| Gain on dilution of Group holdings note 4 | – | 42 | 42 |
| | 645 | 280 | 925 |
| Net cash flows to parent company note (iv) | (647) | (79) | (726) |
| Exchange movements, timing differences and other items note (v) | (59) | (112) | (171) |
| **Net movement in free surplus** | (61) | 89 | 28 |
| Balance at 1 January 2012 | 2,839 | 582 | 3,421 |
| **Balance at 30 June 2012** | 2,778 | 671 | 3,449 |
| Representing: | | | |
| Asia operations | 1,058 | 202 | 1,260 |
| US operations | 1,218 | 108 | 1,326 |
| UK operations | 502 | 361 | 863 |
| | 2,778 | 671 | 3,449 |
| Balance at 1 January 2012 | | | |
| Representing: | | | |
| Asia operations | 1,067 | 211 | 1,278 |
| US operations | 1,220 | 113 | 1,333 |
| UK operations | 552 | 258 | 810 |
| | 2,839 | 582 | 3,421 |

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' equity as shown in note 8.

(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.

(iv) Net cash flows to parent company for long-term business operations reflect the flows as included in the holding company cash flow at transaction rates.

# Notes on the EEV basis results
continued

## 9 Analysis of movement in free surplus continued

(v) Exchange movements, timing differences and other items represent:

| | Half year 2012 £m | | |
|---|---|---|---|
| | Long-term business | Asset management and UK general insurance commission | Total |
| Exchange movements[note 14] | (20) | (3) | (23) |
| Mark to market value movements on Jackson assets backing surplus and required capital[note 14] | 18 | – | 18 |
| Other[note (vi)] | (57) | (109) | (166) |
| | (59) | (112) | (171) |

(vi) Other primarily reflects the effect of repayment of contingent loan funding, as shown in note 14(ii), together with timing differences, intra-group loans and other non-cash items.

## 10 Net core structural borrowings of shareholder-financed operations

| | 30 Jun 2012 £m | | | 30 Jun 2011 £m | | | 31 Dec 2011 £m | | |
|---|---|---|---|---|---|---|---|---|---|
| | IFRS basis | Mark to market value adjustment note (ii) | EEV basis at market value | IFRS basis | Mark to market value adjustment note (ii) | EEV basis at market value | IFRS basis | Mark to market value adjustment note (ii) | EEV basis at market value |
| Holding company* cash and short-term investments | (1,222) | – | (1,222) | (1,476) | – | (1,476) | (1,200) | – | (1,200) |
| Core structural borrowings – central funds[note (i)] | 3,187 | 293 | 3,480 | 3,593 | 247 | 3,840 | 3,201 | 187 | 3,388 |
| Holding company net borrowings | 1,965 | 293 | 2,258 | 2,117 | 247 | 2,364 | 2,001 | 187 | 2,188 |
| Core structural borrowings – Prudential Capital[note (iii)] | 250 | – | 250 | 250 | – | 250 | 250 | – | 250 |
| Core structural borrowings – Jackson | 159 | 26 | 185 | 155 | 17 | 172 | 160 | 17 | 177 |
| Net core structural borrowings of shareholder-financed operations | 2,374 | 319 | 2,693 | 2,522 | 264 | 2,786 | 2,411 | 204 | 2,615 |

* Including central finance subsidiaries.

Notes
(i) EEV basis holding company borrowings comprise:

| | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Perpetual subordinated capital securities (Innovative Tier 1) | 1,855 | 1,837 | 1,813 |
| Subordinated debt (Lower Tier 2) | 970 | 1,416 | 949 |
| Senior debt | 655 | 587 | 626 |
| | 3,480 | 3,840 | 3,388 |

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.

(ii) The movement in the mark to market value adjustment represents:

| Mark to market movement in balance sheet: | 2012 30 Jun £m | 2011 30 Jun £m | 2011 31 Dec £m |
|---|---|---|---|
| Beginning of period | 204 | 190 | 190 |
| Change reflected in: | | | |
| Income statement | 113 | 74 | 14 |
| Foreign exchange effects | 2 | – | – |
| End of period | 319 | 264 | 204 |

(iii) The core structural borrowing by Prudential Capital of £250 million represents a bank loan made in two tranches: £135 million maturing in June 2014 and £115 million maturing in December 2012.

## 11 Reconciliation of movement in shareholders' equity (excluding non-controlling interests)

| | Half year 2012 £m | | | | | |
|---|---|---|---|---|---|---|
| | Long-term business operations | | | | | |
| | Asia operations | US operations | UK insurance operations | Total long-term business operations | Other operations | Group Total |
| **Operating profit (based on longer-term investment returns)** | | | | | | |
| Long-term business: | | | | | | |
| New business[note 2] | 547 | 442 | 152 | 1,141 | – | 1,141 |
| Business in force[note 3] | 325 | 363 | 338 | 1,026 | – | 1,026 |
| | 872 | 805 | 490 | 2,167 | – | 2,167 |
| Asia development expenses | (3) | – | – | (3) | – | (3) |
| UK general insurance commission | – | – | – | – | 17 | 17 |
| M&G | – | – | – | – | 199 | 199 |
| Eastspring Investments | – | – | – | – | 34 | 34 |
| US broker-dealer and asset management | – | – | – | – | 17 | 17 |
| Other income and expenditure | – | – | – | – | (285) | (285) |
| Solvency II implementation costs | – | (1) | (4) | (5) | (24) | (29) |
| Restructuring costs | – | – | (8) | (8) | – | (8) |
| **Operating profit based on longer-term investment returns** | 869 | 804 | 478 | 2,151 | (42) | 2,109 |
| Short-term fluctuations in investment returns[note 5] | 216 | (62) | 25 | 179 | 46 | 225 |
| Mark to market value movements on core borrowings[note 10] | – | (9) | – | (9) | (104) | (113) |
| Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes[note 6] | – | – | 10 | 10 | 93 | 103 |
| Effect of changes in economic assumptions[note 7] | (254) | (79) | (38) | (371) | – | (371) |
| Gain on dilution of Group holdings[note 4] | – | – | – | – | 42 | 42 |
| **Profit before tax (including actual investment returns)** | 831 | 654 | 475 | 1,960 | 35 | 1,995 |
| Tax (charge) credit attributable to shareholders' profit:[note 12] | | | | | | |
| Tax on operating profit | (197) | (240) | (116) | (553) | (17) | (570) |
| Tax on short-term fluctuations in investment returns | (38) | 12 | (8) | (34) | (15) | (49) |
| Tax on shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | – | – | (2) | (2) | (23) | (25) |
| Tax on effect of changes in economic assumptions | 53 | 28 | 9 | 90 | – | 90 |
| Total tax charge | (182) | (200) | (117) | (499) | (55) | (554) |
| **Profit (loss) for the period** | 649 | 454 | 358 | 1,461 | (20) | 1,441 |
| **Other movements** | | | | | | |
| Exchange movements on foreign operations and net investment hedges:[note (i)] | | | | | | |
| Exchange movements arising during the period | (85) | (46) | – | (131) | 7 | (124) |
| Related tax | – | – | – | – | (1) | (1) |
| Intra-group dividends (including statutory transfers)[note (iii)] | (220) | (254) | (110) | (584) | 584 | – |
| External dividends | – | – | – | – | (440) | (440) |
| Reserve movements in respect of share-based payments | – | – | – | – | 52 | 52 |
| Other transfers[note (iv)] | (5) | 3 | (10) | (12) | 12 | – |
| Movement in own shares held in respect of share-based payment plans | – | – | – | – | 5 | 5 |
| Movement in Prudential plc shares purchased by unit trusts consolidated under IFRS | – | – | – | – | 3 | 3 |
| New share capital subscribed | – | – | – | – | 14 | 14 |
| Mark to market value movements on Jackson assets backing surplus and required capital: | | | | | | |
| Mark to market value movements arising during the period | – | 28 | – | 28 | – | 28 |
| Related tax | – | (10) | – | (10) | – | (10) |
| **Net increase in shareholders' equity** | 339 | 175 | 238 | 752 | 216 | 968 |
| Shareholders' equity at 1 January 2012[notes (ii) and 8] | 8,510 | 5,082 | 6,058 | 19,650 | (13) | 19,637 |
| **Shareholders' equity at 30 June 2012**[notes (ii) and 8] | 8,849 | 5,257 | 6,296 | 20,402 | 203 | 20,605 |

# Notes on the EEV basis results
continued

## 11 Reconciliation of movement in shareholders' equity (excluding non-controlling interests) continued

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 30 June 2012 and 31 December 2011 exchange rates as applied to shareholders' equity at 1 January 2012 and the difference between 30 June 2012 and average rates for the six months ended 30 June 2012.
(ii) For the purposes of the table above, goodwill related to Asia long-term operations (as shown in note 8) is included in Other operations.
(iii) Intra-group dividends (including statutory transfers) represent dividends that have been declared in the period and amounts accrued in respect of statutory transfers. For long-term business operations, the difference between the amount of £584 million for intra-group dividends (including statutory transfers) shown above and the net cash flows to parent company of £647 million (as shown in note 9) primarily relates to timing differences arising on statutory transfers, intra-group loans and other non-cash items.
(iv) Other transfers from long-term business operations to other operations in half year 2012 represent:

| | Asia 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 insurance business | (8) | (2) | (13) | (23) |
| Other adjustments | 3 | 5 | 3 | 11 |
| | (5) | 3 | (10) | (12) |

## 12 Tax attributable to shareholders' profit

The tax charge comprises:

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| **Tax charge on operating profit based on longer-term investment returns:** | | | |
| Long-term business: | | | |
| Asia operations[note] | 197 | 160 | 402 |
| US operations | 240 | 284 | 487 |
| UK insurance operations[note] | 116 | 144 | 221 |
| | 553 | 588 | 1,110 |
| Other operations | 17 | (2) | (66) |
| **Total tax charge on operating profit based on longer-term investment returns** | 570 | 586 | 1,044 |
| **Tax credit on items not included in operating profit:** | | | |
| Tax charge (credit) on short-term fluctuations in investment returns | 49 | 22 | (210) |
| Tax charge (credit) on shareholders' share of actuarial and other gains and losses on defined benefit pension schemes | 25 | (1) | 6 |
| Tax credit on effect of changes in economic assumptions | (90) | (35) | (64) |
| Total tax credit on items not included in operating profit | (16) | (14) | (268) |
| **Tax charge on profit attributable to shareholders (including tax on actual investment returns)** | 554 | 572 | 776 |

Note
Including tax relief on Asia development expenses and restructuring costs borne by UK insurance operations.

## 13 Earnings per share (EPS)

| | 2012 £m | 2011 £m | |
|---|---|---|---|
| | Half year | Half year | Full year |
| Operating EPS: | | | |
| Operating profit before tax | 2,109 | 2,147 | 3,978 |
| Tax | (570) | (586) | (1,044) |
| Non-controlling interests | – | (2) | (4) |
| Operating profit after tax and non-controlling interests | 1,539 | 1,559 | 2,930 |
| Operating EPS (pence) | 60.7p | 61.5p | 115.7p |
| Total EPS: | | | |
| Profit before tax | 1,995 | 1,843 | 2,922 |
| Tax | (554) | (572) | (776) |
| Non-controlling interests | – | (2) | (4) |
| Total profit after tax and non-controlling interests | 1,441 | 1,269 | 2,142 |
| Total EPS (pence) | 56.8p | 50.1p | 84.6p |
| Average number of shares (millions) | 2,536 | 2,533 | 2,533 |

# Notes on the EEV basis results
continued

## 14 Reconciliation of net worth and value of in-force for long-term business[note(i)]

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | Free surplus note 9 | Required capital | Total net worth | Value of in-force business note (v) | Total long-term business operations |
| **Group** | | | | | |
| **Shareholders' equity at 1 January 2012** | 2,839 | 3,447 | 6,286 | 13,364 | 19,650 |
| New business contribution[notes (iii), (iv)] | (364) | 243 | (121) | 939 | 818 |
| Existing business – transfer to net worth | 1,028 | (163) | 865 | (865) | – |
| Expected return on existing business | 52 | 42 | 94 | 475 | 569 |
| Changes in operating assumptions and experience variances | 132 | 16 | 148 | 63 | 211 |
| Changes in non-operating assumptions and experience variances | (203) | 59 | (144) | 7 | (137) |
| **Profit after tax from long-term business** | 645 | 197 | 842 | 619 | 1,461 |
| Exchange movements on foreign operations and net investment hedges | (20) | (21) | (41) | (90) | (131) |
| Intra-group dividends (including statutory transfers)[note (ii)] | (692) | – | (692) | 108 | (584) |
| Mark to market value movements on Jackson assets backing surplus and required capital | 18 | – | 18 | – | 18 |
| Other transfers from net worth | (12) | – | (12) | – | (12) |
| **Shareholders' equity at 30 June 2012** | 2,778 | 3,623 | 6,401 | 14,001 | 20,402 |
| **Representing:** | | | | | |
| **Asia operations** | | | | | |
| **Shareholders' equity at 1 January 2012** | 1,067 | 860 | 1,927 | 6,583 | 8,510 |
| New business contribution[note (iv)] | (162) | 48 | (114) | 528 | 414 |
| Existing business – transfer to net worth | 315 | (1) | 314 | (314) | – |
| Expected return on existing business | 29 | – | 29 | 224 | 253 |
| Changes in operating assumptions and experience variances | 1 | 17 | 18 | (13) | 5 |
| Changes in non-operating assumptions and experience variances | 80 | 16 | 96 | (119) | (23) |
| **Profit after tax from long-term business** | 263 | 80 | 343 | 306 | 649 |
| Exchange movements on foreign operations and net investment hedges | (10) | (8) | (18) | (67) | (85) |
| Intra-group dividends (including statutory transfers)[note (ii)] | (257) | – | (257) | 37 | (220) |
| Other transfers from net worth | (5) | – | (5) | – | (5) |
| **Shareholders' equity at 30 June 2012** | 1,058 | 932 | 1,990 | 6,859 | 8,849 |

| | Half year 2012 £m | | | | |
|---|---|---|---|---|---|
| | Free surplus note 9 | Required capital | Total net worth | Value of in-force business note (v) | Total long-term business operations |
| **US operations** | | | | | |
| **Shareholders' equity at 1 January 2012** | 1,220 | 1,371 | 2,591 | 2,491 | 5,082 |
| New business contribution note (iv) | (180) | 151 | (29) | 317 | 288 |
| Existing business – transfer to net worth | 452 | (125) | 327 | (327) | – |
| Expected return on existing business | 20 | 23 | 43 | 86 | 129 |
| Changes in operating assumptions and experience variances | 117 | – | 117 | 30 | 147 |
| Changes in non-operating assumptions and experience variances | (168) | – | (168) | 58 | (110) |
| **Profit after tax from long-term business** | 241 | 49 | 290 | 164 | 454 |
| Exchange movements on foreign operations and net investment hedges | (10) | (13) | (23) | (23) | (46) |
| Intra-group dividends (including statutory transfers) | (254) | – | (254) | – | (254) |
| Mark to market value movements on Jackson assets backing surplus and required capital | 18 | – | 18 | – | 18 |
| Other transfers from net worth | 3 | – | 3 | – | 3 |
| **Shareholders' equity at 30 June 2012** | 1,218 | 1,407 | 2,625 | 2,632 | 5,257 |
| **UK insurance operations** | | | | | |
| **Shareholders' equity at 1 January 2012** | 552 | 1,216 | 1,768 | 4,290 | 6,058 |
| New business contribution note (iv) | (22) | 44 | 22 | 94 | 116 |
| Existing business – transfer to net worth | 261 | (37) | 224 | (224) | – |
| Expected return on existing business | 3 | 19 | 22 | 165 | 187 |
| Changes in operating assumptions and experience variances | 14 | (1) | 13 | 46 | 59 |
| Changes in non-operating assumptions and experience variances | (115) | 43 | (72) | 68 | (4) |
| **Profit after tax from long-term business** | 141 | 68 | 209 | 149 | 358 |
| Intra-group dividends (including statutory transfers) note (ii) | (181) | – | (181) | 71 | (110) |
| Other transfers from net worth | (10) | – | (10) | – | (10) |
| **Shareholders' equity at 30 June 2012** | 502 | 1,284 | 1,786 | 4,510 | 6,296 |

Notes

(i) All figures are shown net of tax.

(ii) The amounts shown in respect of free surplus and the value of in-force business for Asia and UK insurance operations for intra-group dividends (including statutory transfers) include the repayment of contingent loan funding. Contingent loan funding represents amounts whose repayment to the lender is contingent upon future surpluses emerging from certain contracts specified under the arrangement. If insufficient surplus emerges on those contracts, there is no recourse to other assets of the Group and the liability is not payable to the degree of shortfall.

(iii) The movements arising from new business contribution are as follows:

| | 2012 Half year £m | 2011 Half year £m | 2011 Full year £m |
|---|---|---|---|
| Free surplus invested in new business | (364) | (297) | (553) |
| Increase in required capital | 243 | 212 | 406 |
| Reduction in total net worth | (121) | (85) | (147) |
| Increase in the value associated with new business | 939 | 841 | 1,683 |
| Total post-tax new business contribution | 818 | 756 | 1,536 |

# Notes on the EEV basis results
continued

## 14 Reconciliation of net worth and value of in-force for long-term business[note(i)] continued

(iv) Free surplus invested in new business is as follows:

| | Half year 2012 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| Pre-tax new business contribution[note 2] | 547 | 442 | 152 | 1,141 |
| Tax | (133) | (154) | (36) | (323) |
| Post-tax new business contribution | 414 | 288 | 116 | 818 |
| Free surplus invested in new business | (162) | (180) | (22) | (364) |
| Post-tax new business contribution per £1 million free surplus invested | 2.6 | 1.6 | 5.3 | 2.2 |

| | Half year 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| Pre-tax new business contribution[note 2] | 465 | 458 | 146 | 1,069 |
| Tax | (115) | (160) | (38) | (313) |
| Post-tax new business contribution | 350 | 298 | 108 | 756 |
| Free surplus invested in new business | (129) | (135) | (33) | (297) |
| Post-tax new business contribution per £1 million free surplus invested | 2.7 | 2.2 | 3.3 | 2.5 |

| | Full year 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| Pre-tax new business contribution[note 2] | 1,076 | 815 | 260 | 2,151 |
| Tax | (265) | (285) | (65) | (615) |
| Post-tax new business contribution | 811 | 530 | 195 | 1,536 |
| Free surplus invested in new business | (297) | (202) | (54) | (553) |
| Post-tax new business contribution per £1 million free surplus invested | 2.7 | 2.6 | 3.6 | 2.8 |

(v) The value of in-force business includes the value of future margins from current in-force business less the cost of holding required capital and represents:

| | 30 Jun 2012 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| Value of in-force business before deduction of cost of capital and of guarantees | 7,270 | 3,460 | 4,806 | 15,536 |
| Cost of capital | (383) | (139) | (240) | (762) |
| Cost of time value of guarantees[note (vi)] | (28) | (689) | (56) | (773) |
| Net value of in-force business | 6,859 | 2,632 | 4,510 | 14,001 |

| | 30 Jun 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| Value of in-force business before deduction of cost of capital and of guarantees | 6,285 | 2,851 | 4,681 | 13,817 |
| Cost of capital | (340) | (181) | (238) | (759) |
| Cost of time value of guarantees[note (vi)] | (15) | (309) | (78) | (402) |
| Net value of in-force business | 5,930 | 2,361 | 4,365 | 12,656 |

| | 31 Dec 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| Value of in-force business before deduction of cost of capital and of guarantees | 6,922 | 3,222 | 4,598 | 14,742 |
| Cost of capital | (317) | (135) | (241) | (693) |
| Cost of time value of guarantees | (22) | (596) | (67) | (685) |
| Net value of in-force business | 6,583 | 2,491 | 4,290 | 13,364 |

(vi) The change in the cost of time value of guarantees for US operations from £309 million in half year 2011 to £689 million in half year 2012 primarily relates to variable annuity business, mainly arising from the new business written in the second half of 2011 and first half of 2012, together with the effect of the reduction in the expected long-term rate of return for US equities of 1.5 per cent between half year 2011 and half year 2012, driven by the decrease in US 10-year treasury bond rate (as shown in note 16(ii)).

## 15 Sensitivity of results to alternative assumptions

### (a) Sensitivity analysis – economic assumptions

The tables below show the sensitivity of the embedded value as at 30 June 2012 (31 December 2011) and the new business contribution after the effect of required capital for half year 2012 and full year 2011 to:

- 1 per cent increase in the discount rates;
- 1 per cent 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 per cent rise in equity and property yields;
- 10 per cent fall in market value of equity and property assets (embedded value only);
- holding company statutory minimum capital (by contrast to required capital), (embedded value only);
- 5 basis point increase in UK long-term expected defaults; and
- 10 basis point increase in the liquidity premium for UK shareholder-backed annuities.

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions.

| | Half year 2012 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| **New business profit** note 2 | 547 | 442 | 152 | 1,141 |
| Discount rates – 1% increase | (67) | (22) | (19) | (108) |
| Interest rates – 1% increase | 18 | 56 | 2 | 76 |
| Interest rates – 1% decrease | (68) | (91) | (3) | (162) |
| Equity/property yields – 1% rise | 24 | 56 | 6 | 86 |
| Long-term expected defaults – 5 bps increase | – | – | (5) | (5) |
| Liquidity premium – 10 bps increase | – | – | 10 | 10 |

# Notes on the EEV basis results
continued

## 15 Sensitivity of results to alternative assumptions continued

| | Full year 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| **New business profit** note 2 | 1,076 | 815 | 260 | 2,151 |
| Discount rates – 1% increase | (139) | (45) | (36) | (220) |
| Interest rates – 1% increase | 2 | 81 | 5 | 88 |
| Interest rates – 1% decrease | (72) | (117) | (6) | (195) |
| Equity/property yields – 1% rise | 50 | 92 | 11 | 153 |
| Long-term expected defaults – 5 bps increase | – | – | (8) | (8) |
| Liquidity premium – 10 bps increase | – | – | 16 | 16 |

| | 30 Jun 2012 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| **Embedded value of long-term business operations** note 11 | 8,849 | 5,257 | 6,296 | 20,402 |
| Discount rates – 1% increase | (801) | (145) | (456) | (1,402) |
| Interest rates – 1% increase | (353) | (16) | (296) | (665) |
| Interest rates – 1% decrease | 192 | (14) | 339 | 517 |
| Equity/property yields – 1% rise | 348 | 220 | 200 | 768 |
| Equity/property market values – 10% fall | (175) | 48 | (322) | (449) |
| Statutory minimum capital | 118 | 95 | 4 | 217 |
| Long-term expected defaults – 5 bps increase | – | – | (104) | (104) |
| Liquidity premium – 10 bps increase | – | – | 208 | 208 |

| | 31 Dec 2011 £m | | | |
|---|---|---|---|---|
| | Asia operations | US operations | UK insurance operations | Total long-term business operations |
| **Embedded value of long-term business operations** note 11 | 8,510 | 5,082 | 6,058 | 19,650 |
| Discount rates – 1% increase | (771) | (147) | (443) | (1,361) |
| Interest rates – 1% increase | (376) | (106) | (343) | (825) |
| Interest rates – 1% decrease | 253 | 58 | 400 | 711 |
| Equity/property yields – 1% rise | 329 | 185 | 205 | 719 |
| Equity/property market values – 10% fall | (159) | 16 | (326) | (469) |
| Statutory minimum capital | 114 | 92 | 4 | 210 |
| Long-term expected defaults – 5 bps increase | – | – | (98) | (98) |
| Liquidity premium – 10 bps increase | – | – | 196 | 196 |

The sensitivities shown above are for the impact of instantaneous changes on the embedded value of long-term business operations and include the combined effect on the value of in-force business and net assets at the balance sheet dates indicated. If the change in assumption shown in the sensitivities were to occur, then the effect shown above would be recorded within two components of the profit analysis for the following year. These are for the effect of economic assumption changes and, to the extent that asset value changes are included in the sensitivities, within short-term fluctuations in investment returns. In addition to the sensitivity effects shown above, the other components of the profit for the following period would be calculated by reference to the altered assumptions, for example new business contribution and unwind of discount, together with the effect of other changes such as altered corporate bond spreads. In addition for Jackson, the fair value movements on assets backing surplus and required capital which are taken directly to shareholders' equity would also be affected by changes in interest rates.

### (b) Effect of proposed changes in UK corporation tax rates

The half year 2012 results include the effect of the change in the UK corporation tax rate that has been enacted to revise the rate to 24 per cent from 1 April 2012 as described in note 3(iv)(b). Additionally, the reduction in the UK corporation tax rate to 23 per cent from 1 April 2013 was enacted on 17 July 2012 in the 2012 Finance Act, the impact of which would be an increase in the net of tax value of in-force business of UK insurance operations at 30 June 2012 by around £30 million.

The subsequent proposed rate change to 22 per cent announced on 21 March 2012 in the 2012 Budget, which is expected to be effective 1 April 2014, would have the impact of increasing the net of tax value of in-force business of UK insurance operations at 30 June 2012 by around a further £30 million.

### (c) Effect of changes to UK life tax regime

The half year 2012 results have been prepared on the basis of the UK tax regime which applied at 30 June 2012. Changes to the UK life insurance tax regime were enacted on 17 July 2012 and will be effective 1 January 2013. If the half year 2012 EEV results had been prepared on the basis of the new tax rules, the net of tax value of in-force business of UK insurance operations at 30 June 2012 would have been lower by around £40 million.

## 16 Assumptions

### Deterministic assumptions

The tables below summarise the principal financial assumptions:

Assumed investment returns reflect the expected future returns on the assets held and allocated to the covered business at the valuation date.

### (i) Asia operations notes (a),(b),(d)

| | 30 Jun 2012 % | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | China | Hong Kong notes (b), (d) | India | Indonesia | Japan | Korea | Malaysia notes (c), (d) | Philippines | Singapore note (d) | Taiwan | Thailand | Vietnam |
| Risk discount rate: | | | | | | | | | | | | |
| New business | 9.9 | 3.7 | 13.35 | 11.15 | – | 7.05 | 6.3 | 12.4 | 3.9 | 4.9 | 10.3 | 17.0 |
| In force | 9.9 | 3.5 | 13.35 | 11.15 | 4.6 | 7.1 | 6.4 | 12.4 | 4.6 | 5.0 | 10.3 | 17.0 |
| Expected long-term rate of inflation | 2.5 | 2.25 | 4.0 | 5.0 | 0.0 | 3.0 | 2.5 | 4.0 | 2.0 | 1.0 | 3.0 | 5.5 |
| Government bond yield | 3.4 | 1.7 | 8.35 | 6.25 | 0.8 | 3.65 | 3.5 | 5.6 | 1.6 | 1.2 | 3.5 | 10.3 |

| | 30 Jun 2011 % | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | China | Hong Kong notes (b), (d) | India | Indonesia | Japan | Korea | Malaysia notes (c), (d) | Philippines | Singapore note (d) | Taiwan | Thailand | Vietnam |
| Risk discount rate: | | | | | | | | | | | | |
| New business | 10.4 | 5.0 | 13.5 | 12.9 | – | 7.8 | 7.1 | 13.6 | 4.8 | 5.3 | 10.7 | 19.7 |
| In force | 10.4 | 4.9 | 13.5 | 12.9 | 4.9 | 7.8 | 7.2 | 13.6 | 5.7 | 5.25 | 10.7 | 19.7 |
| Expected long-term rate of inflation | 2.5 | 2.25 | 4.0 | 5.0 | 0.0 | 3.0 | 2.5 | 4.0 | 2.0 | 1.0 | 3.0 | 6.5 |
| Government bond yield | 3.9 | 3.2 | 8.5 | 7.7 | 1.1 | 4.3 | 4.0 | 6.9 | 2.3 | 1.6 | 3.9 | 12.9 |

| | 31 Dec 2011 % | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | China | Hong Kong notes (b), (d) | India | Indonesia | Japan | Korea | Malaysia notes (c), (d) | Philippines | Singapore note (d) | Taiwan | Thailand | Vietnam |
| Risk discount rate: | | | | | | | | | | | | |
| New business | 10.0 | 3.85 | 13.75 | 11.15 | – | 7.1 | 6.4 | 12.2 | 3.9 | 5.0 | 10.1 | 19.6 |
| In force | 10.0 | 3.7 | 13.75 | 11.15 | 4.7 | 7.1 | 6.5 | 12.2 | 4.65 | 5.0 | 10.1 | 19.6 |
| Expected long-term rate of inflation | 2.5 | 2.25 | 4.0 | 5.0 | 0.0 | 3.0 | 2.5 | 4.0 | 2.0 | 1.0 | 3.0 | 6.5 |
| Government bond yield | 3.5 | 1.9 | 8.75 | 6.1 | 1.0 | 3.8 | 3.7 | 5.4 | 1.6 | 1.3 | 3.3 | 12.9 |

# Notes on the EEV basis results
continued

## 16 Assumptions continued

| | Asia total % | | |
|---|---|---|---|
| | 30 Jun 2012 | 30 Jun 2011 | 31 Dec 2011 |
| Weighted risk discount rate:note (a) | | | |
| New business | 7.5 | 8.2 | 7.4 |
| In force | 6.6 | 7.9 | 6.9 |

Equity risk premiums in Asia range from 3.25 to 8.7 per cent for all periods throughout these results.

Notes
(a) The weighted risk discount rates for Asia 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. The risk discount rates for individual Asia territories reflect the movement in government bond yields, together with the effects of movements in the allowance for market risk and changes in product mix.
(b) For Hong Kong the assumptions are shown for US dollar denominated business which comprises the largest proportion of the in-force business. For other territories, the assumptions are for local currency denominated business which reflects the largest proportion of the in-force business.
(c) The risk discount rate for Malaysia reflects both the Malaysia life and Takaful operations.
(d) The mean equity return assumptions for the most significant equity holdings in the Asia operations were:

| | 2012 30 Jun % | 2011 30 Jun % | 2011 31 Dec % |
|---|---|---|---|
| Hong Kong | 5.7 | 7.2 | 5.9 |
| Malaysia | 9.5 | 10.0 | 9.7 |
| Singapore | 7.7 | 8.35 | 7.7 |

### (ii) US operations

| | 2012 % | 2011 % | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| Assumed new business spread margins:note (d) | | | |
| Fixed Annuity business* note (a) | 1.40† | 1.9 | 1.75† |
| Fixed Index Annuity business note (b) | 1.75† | 2.5 | 2.25 |
| Institutional business | 1.25 | – | 1.0 |
| Risk discount rate:note (e) | | | |
| Variable annuity | 6.5 | 7.8 | 6.7 |
| Non-variable annuity | 4.4 | 5.5 | 4.6 |
| Weighted average total:note (c) | | | |
| New business | 6.3 | 7.7 | 6.5 |
| In force | 5.7 | 7.0 | 6.0 |
| US 10-year treasury bond rate at end of period | 1.7 | 3.2 | 1.9 |
| Pre-tax expected long-term nominal rate of return for US equities | 5.7 | 7.2 | 5.9 |
| Equity risk premium | 4.0 | 4.0 | 4.0 |
| Expected long-term rate of inflation | 2.1 | 2.5 | 2.0 |

* Including the proportion of variable annuity business invested in the general account.
† Grading up 25 basis points to the long-term assumption over five years.

Notes

(a) For new business issuances from full year 2011, the assumed spread margin for fixed annuity business and for the proportion of variable annuity business and invested in the general account is assumed to grade over five years. For new business issuances in half year 2011 the assumed spread margin for this business applies from inception.

(b) For fixed index annuity new business issuances in half year 2012 the assumed spread margin grades to the long-term assumption over five years. For new business issuances in half year and full year 2011 the assumed spread margin for this business applies from inception.

(c) The weighted average risk discount rates reflect the mix of business between variable annuity and non-variable annuity business. The decrease in the weighted average risk discount rates from half year 2011 to half year 2012 primarily reflects the decrease in the US 10-year treasury bond rate of 150 basis points, partly offset by the effect of the increase in additional allowance for credit risk (as described in note (d) below) and the impact of the increase in allowance for market risk.

(d) 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 on the reinvested assets of 1.25 per cent over 10 years. The yield also reflects an allowance for a risk margin reserve which for half year 2012 is 27 basis points (half year 2011: 25 basis points; full year 2011: 27 basis points) for long-term defaults (as described in note 1(b)(iii)), which represents the allowance as at the valuation date applied in the cash flow projections of the value of the in-force business.

In the event that long-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.

(e) For US operations, the risk discount rates shown above include an additional allowance for a combination of credit risk premium and short-term downgrade and default allowance for general account business of 200 basis points (half year 2011: 150 basis points; full year 2011: 200 basis points) and for variable annuity business of 40 basis points (half year 2011: 30 basis points; full year 2011: 40 basis points) to reflect the fact that a proportion of the variable annuity business is allocated to the general account (as described in note 1(b)(iii)).

### (iii) UK insurance operations

| | 2012 % | 2011 % | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| **Shareholder-backed annuity business:**[note (d)] | | | |
| Risk discount rate: | | | |
| New business[note (a)] | 7.3 | 7.35 | 7.7 |
| In force[note (b)] | 8.4 | 9.9 | 8.6 |
| Pre-tax expected long-term nominal rate of return for shareholder-backed annuity business: | | | |
| **New business:** | | | |
| Fixed annuities | 4.6 | 5.2 | 4.95 |
| Inflation-linked annuities | 4.2 | 5.0 | 4.4 |
| **In force:**[note (b)] | | | |
| Fixed annuities | 4.3 | 5.1 | 4.5 |
| Inflation-linked annuities | 4.0 | 5.4 | 4.1 |
| **Other business:**[note (d)] | | | |
| Risk discount rate:[note (c)] | | | |
| New business | 5.2 | 7.0 | 5.3 |
| In force | 5.45 | 7.1 | 5.65 |
| Equity risk premium | 4.0 | 4.0 | 4.0 |
| Pre-tax expected long-term nominal rates of investment return: | | | |
| UK equities | 6.3 | 8.0 | 6.5 |
| Overseas equities | 5.7 to 9.7 | 7.2 to 10.1 | 5.9 to 9.9 |
| Property | 5.05 | 6.8 | 5.2 |
| Gilts | 2.3 | 4.0 | 2.5 |
| Corporate bonds | 3.9 | 5.6 | 4.0 |
| Expected long-term rate of inflation | 2.8 | 3.7 | 3.0 |
| Post-tax expected long-term nominal rate of return for the PAC with-profits fund: | | | |
| Pension business (where no tax applies) | 5.0 | 6.6 | 5.1 |
| Life business | 4.3 | 5.8 | 4.4 |

# Notes on the EEV basis results
continued

## 16 Assumptions continued

Notes

(a) The new business risk discount rate for shareholder-backed annuity business incorporates an allowance for best estimate defaults and additional credit risk provisions, appropriate to the new business assets, over the projected lifetime of this business. These additional provisions comprise of a credit risk premium, which is derived from Moody's data from 1970 to 2009, an allowance for a 1 notch downgrade of the portfolio subject to credit risk and an allowance for short-term defaults. The decrease in the new business risk discount rate from full year 2011 to half year 2012 reflects changes in the profile of the release of these additional credit risk provisions over the lifetime of the business.

(b) For shareholder-backed annuity business, the movements in the pre-tax long-term nominal rates of return and the risk discount rates for in-force business mainly reflect the effect of changes in asset yields.

(c) 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.

(d) 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. The assumed earned rate for with-profit holdings of corporate bonds is defined as the risk-free rate plus an assessment of the long-term spread over gilts, net of expected long-term defaults. This approach is similar to that applied for equities and properties for which the projected earned rate is defined as the risk-free rate plus a long-term risk premium.

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. For Prudential Retirement Income Limited (PRIL), which has approximately 90 per cent of UK shareholder-backed annuity business, the allowance for credit risk for the in-force business at 30 June 2012 is made up of:

(1) 16 basis points for fixed annuities and 15 basis points for inflation-linked annuities in respect of long-term expected defaults. This is derived by applying Moody's data from 1970 to 2009 and the definition of the credit rating used is the second highest credit rating published by Moody's, Standard and Poor's and Fitch.

(2) 51 basis points for fixed annuities and 49 basis points for inflation-linked annuities in respect of additional provisions which comprise a credit risk premium, which is derived from Moody's data from 1970 to 2009, an allowance for a 1 notch downgrade of the portfolio subject to credit risk and an allowance for short-term defaults.

The credit assumptions used and the residual liquidity premium element of the bond spread over swap rates is as follows:

| New business* | 2012 30 Jun bps | 2011 30 Jun bps | 2011 31 Dec bps |
|---|---|---|---|
| Bond spread over swap rates | 163 | 130 | 139 |
| Total credit risk allowance† | 33 | 36 | 35 |
| Liquidity premium | 130 | 94 | 104 |

| In-force business | 2012 30 Jun bps | 2011 30 Jun bps | 2011 31 Dec bps |
|---|---|---|---|
| Bond spread over swap rates | 191 | 151 | 201 |
| Credit risk allowance: | | | |
| Long-term expected defaults | 16 | 16 | 15 |
| Additional provisions | 50 | 51 | 51 |
| Total credit risk allowance† | 66 | 67 | 66 |
| Liquidity premium | 125 | 84 | 135 |

* The new business liquidity premium is based on the weighted average of the point of sale liquidity premium.

† Specific assets are allocated to the new business for the period with the appropriate allowance for credit risk which was 33 basis points (half year 2011: 36 basis points; full year 2011: 35 basis points). The reduced allowance for new business in comparison to that for the in-force book reflects the assets held and other factors that influence the necessary level of provision.

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.

**(iv) Asia operations**

- The same asset return models as described for UK insurance operations below, appropriately calibrated, have been used for Asia operations. 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 ranges from 18 per cent to 35 per cent, and the volatility of government bond yields ranges from 0.9 per cent to 2.4 per cent for all periods throughout these results.

**(v) US operations (Jackson)**

- Interest rates are projected using a log-normal generator calibrated to historical US treasury yield curves;
- 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 returns and bond interest rates have been stochastically generated using a log-normal model with parameters determined by reference to historical data. The volatility of equity fund returns ranges from 19 per cent to 32 per cent for all periods throughout these results, depending on the risk class and the class of equity, and the standard deviation of interest rates ranges from 2.2 per cent to 2.5 per cent (half year 2011: 2.0 per cent to 2.4 per cent; full year 2011: 2.1 per cent to 2.4 per cent).

**(vi) 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 risk-free 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 for each period are as follows:

| | 2012 % | 2011 % | |
|---|---|---|---|
| | 30 Jun | 30 Jun | 31 Dec |
| Equities: | | | |
| UK | 20 | 18 | 20 |
| Overseas | 18 | 18 | 18 |
| Property | 15 | 15 | 15 |

**(vii) 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.

# Notes on the EEV basis results
continued

## 16 Assumptions continued

### (viii) Expense assumptions

Expense levels, including those of service companies that support the 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. For mature business, it is Prudential's policy not to take credit for future cost reduction programmes until the savings have been delivered. For businesses which are currently sub-scale (China, Malaysia Takaful and Taiwan) and India (where regulatory changes have affected the development of the book of business), expense overruns are permitted, provided these are short-lived.

For Asia 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. Development expenses are charged as incurred.

Corporate expenditure comprises:

- Expenditure for Group head office, to the extent not allocated to the PAC with-profits funds, together with Solvency II implementation and restructuring costs, which are charged to the EEV basis results as incurred; and
- Expenditure of the Asia regional head office that is not allocated to the covered business or asset management operations, and is charged as incurred. These costs are primarily for corporate-related activities and included within corporate expenditure.

### (ix) Taxation and other legislation

Current taxation and other legislation have been assumed to continue unaltered except where changes have been announced and substantively enacted in the period.

The sensitivity of the embedded value as at 30 June 2012 to the effect of the forthcoming changes in UK corporate tax rates and the UK life insurance tax regime are shown in notes 15(b) and (c).

## 17 Other developments

### Acquisition of Reassure America Life Insurance Company ('REALIC')

On 30 May 2012, Jackson National Life Insurance Company (JNLI), an indirect wholly-owned subsidiary of Prudential plc, entered into an agreement to buy SRLC America Holding Corp. (SRLC), a life insurance business, from Swiss Re. The primary operating subsidiary of SRLC is REALIC. Swiss Re will retain a portion of the SRLC business through reinsurance arrangements to be undertaken prior to closing. JNLI will pay US$621 million (£398 million) in cash for the business financed from its own resources. The price is subject to adjustment to reflect the actual value of SRLC according to its balance sheet at closing. The transaction is subject to regulatory approval and is expected to close in the third quarter of 2012.

Consistent with the £398 million purchase price, it is estimated that the embedded value of the acquired business at 30 June 2012 will be £865 million before taking into account future cost and capital synergies (net of implementation costs), which are expected to further enhance the value of the acquired business. The estimated embedded value at acquisition will change to reflect any purchase price adjustment, which is not expected to exceed £60 million.

# Total insurance and new investment products new business

**Total insurance and new investment products new business** notes (i),(v)

| | Single | | | Regular | | | Annual premium and contribution equivalents (APE) | | | Present value of new business premiums (PVNBP) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 £m Half year | 2011 £m Half year | 2011 £m Full year | 2012 £m Half year | 2011 £m Half year | 2011 £m Full year | 2012 £m Half year | 2011 £m Half year | 2011 £m Full year | 2012 £m Half year | 2011 £m Half year | 2011 £m Full year |
| **Group insurance operations** | | | | | | | | | | | | |
| Asia | **669** | 744 | 1,456 | **832** | 668 | 1,514 | **899** | 743 | 1,660 | **4,725** | 3,939 | 8,910 |
| US | **7,119** | 6,615 | 12,562 | **8** | 10 | 19 | **719** | 672 | 1,275 | **7,180** | 6,689 | 12,720 |
| UK | **2,960** | 2,520 | 4,871 | **116** | 157 | 259 | **412** | 409 | 746 | **3,495** | 3,264 | 6,111 |
| **Group Total** | **10,748** | 9,879 | 18,889 | **956** | 835 | 1,792 | **2,030** | 1,824 | 3,681 | **15,400** | 13,892 | 27,741 |
| **Asia insurance operations** | | | | | | | | | | | | |
| Hong Kong | **43** | 76 | 180 | **173** | 143 | 313 | **177** | 151 | 331 | **998** | 883 | 2,023 |
| Indonesia | **159** | 85 | 250 | **190** | 150 | 338 | **206** | 158 | 363 | **831** | 573 | 1,435 |
| Malaysia | **46** | 42 | 79 | **93** | 87 | 215 | **98** | 91 | 223 | **609** | 526 | 1,225 |
| Philippines | **89** | 49 | 95 | **12** | 9 | 20 | **21** | 14 | 30 | **123** | 73 | 153 |
| Singapore | **164** | 173 | 371 | **125** | 86 | 198 | **141** | 103 | 235 | **1,029** | 778 | 1,855 |
| Thailand | **6** | 5 | 11 | **19** | 10 | 26 | **19** | 11 | 27 | **71** | 42 | 102 |
| Vietnam | **–** | – | 1 | **18** | 19 | 42 | **18** | 19 | 42 | **63** | 65 | 143 |
| **SE Asia operations inc. Hong Kong** | **507** | 430 | 987 | **630** | 504 | 1,152 | **680** | 547 | 1,251 | **3,724** | 2,940 | 6,936 |
| China note (iii) | **17** | 35 | 46 | **32** | 31 | 54 | **33** | 35 | 59 | **156** | 173 | 294 |
| Korea | **15** | 44 | 71 | **43** | 51 | 94 | **45** | 55 | 101 | **235** | 292 | 542 |
| Taiwan | **86** | 127 | 217 | **79** | 46 | 126 | **88** | 59 | 148 | **380** | 285 | 672 |
| India note (iv) | **44** | 108 | 135 | **48** | 36 | 88 | **53** | 47 | 101 | **230** | 249 | 466 |
| **Total Asia operations** | **669** | 744 | 1,456 | **832** | 668 | 1,514 | **899** | 743 | 1,660 | **4,725** | 3,939 | 8,910 |
| **US insurance operations** | | | | | | | | | | | | |
| Fixed annuities | **312** | 229 | 472 | **–** | – | – | **31** | 23 | 47 | **312** | 229 | 472 |
| Fixed index annuities | **503** | 415 | 934 | **–** | – | – | **50** | 42 | 93 | **503** | 415 | 934 |
| Life | **4** | 6 | 10 | **8** | 10 | 19 | **8** | 11 | 20 | **65** | 80 | 168 |
| Variable annuities | **6,114** | 5,892 | 10,909 | **–** | – | – | **611** | 589 | 1,091 | **6,114** | 5,892 | 10,909 |
| Wholesale | **186** | 73 | 237 | **–** | – | – | **19** | 7 | 24 | **186** | 73 | 237 |
| **Total US insurance operations** | **7,119** | 6,615 | 12,562 | **8** | 10 | 19 | **719** | 672 | 1,275 | **7,180** | 6,689 | 12,720 |
| **UK and Europe insurance operations** | | | | | | | | | | | | |
| Direct and partnership annuities | **139** | 184 | 328 | **–** | – | – | **14** | 18 | 33 | **139** | 184 | 328 |
| Intermediated annuities | **249** | 117 | 241 | **–** | – | – | **25** | 12 | 24 | **249** | 117 | 241 |
| Internal vesting annuities | **657** | 561 | 1,223 | **–** | – | – | **66** | 56 | 122 | **657** | 561 | 1,223 |
| **Total individual annuities** | **1,045** | 862 | 1,792 | **–** | – | – | **105** | 86 | 179 | **1,045** | 862 | 1,792 |
| Corporate pensions | **134** | 121 | 184 | **91** | 135 | 215 | **104** | 147 | 233 | **551** | 750 | 1,224 |
| Onshore bonds | **1,060** | 835 | 1,779 | **–** | – | – | **106** | 84 | 178 | **1,060** | 836 | 1,781 |
| Other products | **449** | 421 | 780 | **25** | 22 | 44 | **70** | 64 | 122 | **567** | 535 | 978 |
| Wholesale note (vi) | **272** | 281 | 336 | **–** | – | – | **27** | 28 | 34 | **272** | 281 | 336 |
| **Total UK and Europe insurance operations** | **2,960** | 2,520 | 4,871 | **116** | 157 | 259 | **412** | 409 | 746 | **3,495** | 3,264 | 6,111 |
| **Group Total** | **10,748** | 9,879 | 18,889 | **956** | 835 | 1,792 | **2,030** | 1,824 | 3,681 | **15,400** | 13,892 | 27,741 |

# Total insurance and new investment products new business continued

## Investment products – funds under management notes (ii),(v),(vii),(viii)

| | Half year 2012 £m | | | | | |
|---|---|---|---|---|---|---|
| | 1 Jan 2012 | Changes to Group holdings note (viii) | Market gross inflows | Redemptions | Market exchange translation and other movements | 30 Jun 2012 |
| Eastspring Investments | 15,036 | – | 3,787 | (3,361) | 99 | 15,561 |
| M&G | 91,948 | (3,783) | 14,701 | (9,760) | 1,537 | 94,643 |
| **Group total** | 106,984 | (3,783) | 18,488 | (13,121) | 1,636 | 110,204 |

| | Half year 2011 £m | | | | | |
|---|---|---|---|---|---|---|
| | 1 Jan 2011 | Changes to Group holdings note (viii) | Market gross inflows | Redemptions | Market exchange translation and other movements | 30 Jun 2011 |
| Eastspring Investments | 18,165 | – | 4,278 | (4,290) | (1,602) | 16,551 |
| M&G | 89,326 | – | 13,390 | (10,468) | 1,102 | 93,350 |
| **Group total** | 107,491 | – | 17,668 | (14,758) | (500) | 109,901 |

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 (APE) are calculated as the aggregate of regular new business amounts and one-tenth of single new business amounts and are subject to roundings. The Present Value of New Business Premiums (PVNBP) 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 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.

New business premiums reflect those premiums attaching to covered business, including premiums for contracts classified as investment products for IFRS basis reporting.

The format of the tables shown above is consistent with the distinction between insurance and investment products as applied for previous financial reporting periods. With the exception of some US institutional business, products categorised as 'insurance' refer to those classified as contracts of long-term insurance business for regulatory reporting purposes, ie falling within one of the classes of insurance specified in Part II of Schedule 1 to the Regulated Activities Order under 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 tables for funds under management above are unit trust, 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) New business in China is included at Prudential's 50 per cent interest in the China life operation.

(iv) New business in India is included at Prudential's 26 per cent interest in the India life operation.

(v) New business and market gross inflows and redemptions have been translated at an average exchange rate for the period applicable. Funds under management at points in time are translated at the exchange rate applicable to those dates.

(vi) UK wholesale sales for half year 2012 include amounts for a small number of bulk annuity buy-in insurance agreements with an APE of £27 million (half year 2011: £28 million; full year 2011: £33 million).

(vii) Investment flows for the half year exclude Eastspring Money Market Funds gross inflows of £25,355 million (half year 2011: £35,199 million) and net inflows of £103 million (half year 2011: net outflows of £383 million).

(viii) From 1 January 2012, Prudential Portfolio Managers South Africa (Pty) Limited is no longer a subsidiary of M&G following the restructuring transaction whereby M&G's ownership has been diluted as explained in note 4.

Section 4

# Additional information

# Risk factors

A number of factors (risk factors) affect Prudential's operating results and financial condition and, accordingly, the trading price of its shares. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. The information given is as of the date of this document, is not updated, and any forward looking statements are made subject to the reservations specified below under 'Forward Looking Statements'.

Prudential's approaches to managing risks are explained in the 'Business review' section under 'Risk and capital management'.

## Risks relating to Prudential's business

### Prudential's businesses are inherently subject to market fluctuations and general economic conditions

Prudential's businesses are inherently subject to market fluctuations and general economic conditions. Uncertainty or negative trends in international economic and investment climates could adversely affect Prudential's business and profitability. Since 2008 Prudential has had to operate against a challenging background of periods of unprecedented volatility in global capital and equity markets, interest rates and liquidity, and widespread economic uncertainty. Government interest rates have also fallen to historic lows in the US and UK, and some Asian countries in which Prudential operates. These factors have, at times during this period, had a material adverse effect on Prudential's business and profitability.

In the future, the adverse effects of such factors would be felt principally through the following items:

- investment impairments or reduced investment returns, which could impair Prudential's ability to write significant volumes of new business and would have a negative impact on its assets under management and profit;
- higher credit defaults and wider credit and liquidity spreads resulting in realised and unrealised credit losses;
- Prudential in the normal course of business enters 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 Prudential's results; and
- estimates of the value of financial instruments being 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 judgment, 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.

Global financial markets have experienced, and continue to experience, significant volatility brought on, in particular, by concerns over European and US sovereign debt, as well as concerns about a general slowing of global demand reflecting an increasing lack of confidence among consumers, companies and governments. Upheavals in the financial markets may affect general levels of economic activity, employment and customer behaviour. For example, insurers may experience an elevated incidence of claims, lapses, or surrenders of policies, and some policyholders may choose to defer or stop paying insurance premiums. The demand for insurance products may also be adversely affected. If sustained, this environment is likely to have a negative impact on the insurance sector over time and may consequently have a negative impact on Prudential's business and profitability. New challenges related to market fluctuations and general economic conditions may continue to emerge.

For some non-unit-linked investment products, in particular those written in some of the Group's Asia 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 Prudential'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 Prudential to the risk that changes in interest rates, which are not fully reflected in the interest rates credited to customers, will reduce spread. The spread is the difference between the rate of return Jackson is able to earn on the assets backing the policyholders' liabilities and the amounts that are credited to policyholders in the form of benefit increases, subject to minimum crediting rates.

Declines in spread from these products or other spread businesses that Jackson conducts 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 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 Prudential's results.

A significant part of the profit from Prudential's UK insurance operations is related to bonuses for policyholders declared on with-profits products, which are broadly based on historical and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns. This profit could be lower in a sustained low interest rate environment.

### Prudential is subject to the risk of potential sovereign debt credit deterioration owing to the amounts of sovereign debt obligations held in its investment portfolio

Prudential is subject to the risk of potential sovereign debt credit deterioration and default. During 2011 and 2012, this risk has heightened, particularly in relation to European and US sovereign debt. 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. Investment in sovereign debt obligations involves risks not present in debt obligations of corporate issuers. In addition, the issuer of the debt or the governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or pay interest when due in accordance with the terms of such debt, and Prudential may have limited recourse to compel payment in the event of a default. A sovereign debtor's willingness or ability to repay principal and to pay interest in a timely manner may be affected by, among other factors, its cash flow situation, its relations with its central bank, the extent of its foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the sovereign debtor's policy toward local and international lenders, and the political constraints to which the sovereign debtor may be subject. 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 Prudential's financial condition and results of operations.

### Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its businesses

Due to their geographical diversity, Prudential's businesses are subject to the risk of exchange rate fluctuations. Prudential'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 Prudential'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 other comprehensive income. Consequently, this could impact on Prudential's gearing ratios (defined as debt over debt plus shareholders' funds).

### Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations and any accounting standards in the markets in which it operates

Changes in government policy, legislation (including tax) or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates, which in some circumstances may be applied retrospectively, may adversely affect Prudential's product range, distribution channels, profitability, capital requirements and, consequently, reported results and financing requirements. Also, regulators in jurisdictions in which Prudential operates 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 Prudential needs to maintain a 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 regulatory framework for insurance companies, referred to as 'Solvency II'. The new approach is based on the concept of three pillars: Pillar 1 consists of the quantitative requirements, for example, the amount of capital an insurer should hold; Pillar 2 sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers; and Pillar 3 focuses on disclosure and transparency requirements.

# Risk factors

The Directive covers 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 are intended to be aligned more closely with economic capital methodologies, and may allow Prudential to make use of its internal economic capital models, if approved by the Financial Services Authority (FSA) or other relevant supervisory authority. The Solvency II Directive was formally approved by the Economic and Financial Affairs Council in November 2009. Representatives from the European Parliament, the European Commission and the Council of the European Union are currently discussing the Omnibus II Directive which, once approved, will amend certain aspects of the original Solvency II Directive. In addition, the European Commission is continuing to develop the detailed rules that will complement the high-level principles of the Directive, referred to as 'implementing measures'. The Omnibus II Directive is scheduled to be finalised in late 2012 while the implementing measures are not currently expected to be finalised until early-mid 2013. There is 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 Prudential, including potentially a significant increase in capital required to support its business and that Prudential may be placed at a competitive disadvantage to other European and non-European financial services groups.

Various jurisdictions in which Prudential operates have created investor compensation schemes that require mandatory contributions from market participants in some instances in the event of a failure of a market participant. As a major participant in the majority of its chosen markets, circumstances could arise where Prudential, along with other companies, may be required to make such contributions.

The Group's accounts are prepared in accordance with current International Financial Reporting Standards (IFRS) applicable to the insurance industry. The International Accounting Standards Board (IASB) introduced a framework that it described as Phase I, which permitted insurers to continue to use the statutory basis of accounting for insurance assets and liabilities that existed in their jurisdictions prior to January 2005. In July 2010, the IASB published an Exposure Draft for its Phase II on insurance accounting, which would introduce significant changes to the statutory reporting of insurance entities that prepare accounts according to IFRS. The IASB continues its deliberation on the exposure draft principles but it remains uncertain whether the proposals in the Exposure Draft will become the final IASB standard and when 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.

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

Prudential is, and in the future may be, subject to legal and regulatory actions in the ordinary course of its business, both in the UK and internationally. These actions could involve a review of business sold in the past under acceptable market practices at the time, such as the requirement in the UK to provide redress to certain past purchasers of 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 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 annuity and insurance product industries. This focus includes new regulations in respect of the suitability of 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 challenge current practices, or are retrospectively applied to sales made prior to their introduction.

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

Prudential is, and may be in the future, subject to legal actions, disputes and regulatory investigations in the ordinary course of its insurance, investment management and other business operations. These legal actions, disputes and investigations may relate to aspects of Prudential's businesses and operations that are specific to Prudential, or that are common to companies that operate in Prudential's markets. Legal actions and disputes may arise under contracts, regulations (including tax) or from a course of conduct taken by Prudential, and may be class actions. Although Prudential believes that it has adequately provided in all material 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 Prudential's results of operations or cash flows.

### Prudential's businesses are 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 Prudential's ability to sell its products and continued profitability, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance, historical bonus levels, developing demographic trends and customer appetite for certain savings products. In some of its markets, Prudential faces competitors that are larger, have greater financial resources or a greater market share, offer a broader range of products or have higher bonus rates or claims-paying ratios. Further, heightened competition for talented and skilled employees and agents with local experience, particularly in Asia, may limit Prudential's potential to grow its business as quickly as planned.

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

Within the UK, Prudential'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., Prudential Financial, Lincoln National, MetLife and TIAA-CREF.

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

### Downgrades in Prudential's financial strength and credit ratings could significantly impact its competitive position and hurt its relationships with creditors or trading counterparties

Prudential's financial strength and credit ratings, which are used by the market to measure its ability to meet policyholder obligations, are an important factor affecting public confidence in most of Prudential's products, and as a result its competitiveness. Downgrades in Prudential's ratings, as a result of, for example, decreased profitability, increased costs, increased indebtedness or other concerns, could have an adverse effect on its ability to market products, retain current policyholders, and on the Group's financial flexibility. In addition, the interest rates Prudential pays on its borrowings are affected by its debt credit ratings, which are in place to measure the Group's ability to meet its contractual obligations.

Prudential's long-term senior debt is rated as A2 by Moody's, A+ by Standard & Poor's and A by Fitch. These ratings have a stable outlook.

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

The Prudential Assurance Company Limited's financial strength is rated Aa2 by Moody's, AA by Standard & Poor's and AA by Fitch. These ratings have a stable outlook.

Jackson's financial strength is rated AA by Standard & Poor's and Fitch, A1 by Moody's, and A+ by AM Best. These ratings have a stable outlook.

In addition, changes in methodologies and criteria used by rating agencies could result in downgrades that do not reflect changes in the general economic conditions or Prudential's financial condition.

### Adverse experience in the operational risks inherent in Prudential's business could have a negative impact on its results of operations

Operational risks are present in all of Prudential'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. Prudential's business is 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, Prudential outsources 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 Group's business, accurate records have to be maintained for significant periods. Prudential'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. Prudential has not experienced or identified any operational risks in its systems or processes during the first half of 2012, which have subsequently caused, or are expected to cause, a significant negative impact on its results of operations.

# Risk factors

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

Prudential needs 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 Prudential 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. 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'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, Prudential's results of operations could be adversely affected.

A further example is the assumption that Prudential makes about future expected levels of the rates of early termination of products by its customers (persistency). This is particularly relevant to its lines of business other than its UK annuity business. Prudential's persistency assumptions reflect recent past experience for each relevant line of business. Any expected deterioration in future persistency is also reflected in the assumption. If actual levels of future persistency are significantly lower than assumed (that is, policy termination rates are significantly higher than assumed), the 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 cannot be predicted. The effectiveness of external parties, including governmental and non-governmental organisations, in combating the spread and severity of any epidemics could have a material impact on the Group's loss experience.

In common with other industry participants, the profitability of the 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.

### As a holding company, Prudential is dependent upon its subsidiaries to cover operating expenses and dividend payments

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

As a holding company, Prudential's principal sources of funds are remittances from subsidiaries, shareholder-backed funds, the shareholder transfer from long-term funds and any amounts that may be raised through the issuance of equity, debt and commercial paper. Certain of the subsidiaries 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 Group.

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

Prudential operates, and in certain markets is required by local regulation to operate, through joint ventures (including in China and India). For the Group's joint venture operations, management control is exercised jointly with the venture participants. The level of control exercisable by the Group 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. Prudential may also face financial or other exposure in the event that any of its joint venture partners fails to meet its obligations under the joint venture or encounters financial difficulty. In addition, a significant proportion of the Group's product distribution is carried out through arrangements with third parties not controlled by Prudential and is dependent upon continuation of these relationships. A temporary or permanent disruption to these distribution arrangements could adversely affect the results of operations of Prudential.

### Prudential's Articles of Association contain an exclusive jurisdiction provision

Under Prudential's Articles of Association, certain legal proceedings may only be brought in the courts of England and Wales. This applies to legal proceedings by a shareholder (in its capacity as such) against Prudential and/or its directors and/or its professional service providers. It also applies to legal proceedings between Prudential and its directors and/or Prudential and Prudential's professional service providers that arise in connection with legal proceedings between the shareholder and such professional service provider. This provision could make it difficult for US and other non-UK shareholders to enforce their shareholder rights.

### Changes in tax legislation may result in adverse tax consequences

Tax rules, including those relating to the insurance industry, and their interpretation, may change, possibly with retrospective effect, in any of the jurisdictions in which Prudential operates. Significant tax disputes with tax authorities, and any change in the tax status of any member of the Group or in taxation legislation or its scope or interpretation could affect Prudential's financial condition and results of operations.

# Corporate governance

## Hong Kong listing obligations

The directors confirm that the Company has also complied with the Corporate Governance Code in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited throughout the reporting period, other than in respect of the Terms of Reference of the Remuneration Committee as regards making recommendations to the Board in respect of the remuneration of the non-executive directors. It would be inconsistent with the principles of the UK Corporate Governance Code for the Remuneration Committee to be involved in setting the fees of non-executive directors.

The directors also confirm that the half year results have been reviewed by the Group Audit Committee.

The Company confirms that it has adopted a code of conduct regarding securities transactions by directors on terms no less exacting than required by Appendix 10 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, and that the directors of the Company have complied with this code of conduct throughout the period.

## Going concern

After making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue their operations for the foreseeable future and therefore consider it appropriate to continue to adopt the going concern basis of accounting in preparing the financial statements.

The UK's Financial Reporting Council (FRC) has published guidance concerning directors' considerations of the Company as a going concern, in particular the guidance pertaining to half year statements. The directors have addressed all relevant procedures and considerations as outlined in the FRC's guidance document.

The Company's business activities, together with the factors likely to affect its future development, successful performance and position in the current economic climate, are set out in the Business Review.

In this context, the directors have considered liquidity risk, capital and related sensitivities, which are discussed in the 'Risk and Capital Management' section of the Business Review. Specifically, in making their going concern assessment, the directors have considered:

- the Group's capital position;
- the Group's capital commitments;
- the market risk and liquidity profile of the Group's assets and liabilities;
- the maturity profile of the Group's core and operational borrowings;
- various liquidity stress scenarios; and
- the capital and liquidity positions of its subsidiaries.

The Group's IFRS financial statements include cash flow details in the 'Condensed consolidated statement of cash flows' and borrowings information in notes V and W.

# Significant shareholdings

As at 30 June 2012, Prudential had received notifications in accordance with Rule 5.1.2R of the Disclosure and Transparency Rules of the Financial Services Authority from the following companies, disclosing their direct or indirect interests in three per cent or more of Prudential's issued ordinary share capital:

| Shareholder | Interest |
|---|---|
| Legal and General Group Plc | 3.99% |
| Norges Bank | 4.03% |
| BlackRock, Inc | 5.08% |
| Capital Research and Management Company | 9.91% |

# Disclosure of interests of directors

The following table sets out the share options held by the directors in the UK savings related share option scheme as at the end of the period. No other directors held shares in any other option scheme.

| | Date of grant | Exercise price | Market price at 30 Jun 2012 | Exercise period Beginning | Exercise period End | Number of options Beginning of period | Granted | Exercised | Cancelled | Forfeited | Lapsed | End of period |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| John Foley | 25 Apr 08 | 551 | 738 | 01 Jun 13 | 29 Nov 13 | 2,953 | – | – | – | – | – | 2,953 |
| Tidjane Thiam | 16 Sep 11 | 465.8666 | 738 | 01 Dec 14 | 29 May 15 | 965 | – | – | – | – | – | 965 |
| Nic Nicandrou | 16 Sep 11 | 465.8666 | 738 | 01 Dec 16 | 31 May 17 | 3,268 | – | – | – | – | – | 3,268 |
| Rob Devey | 16 Sep 11 | 465.8666 | 738 | 01 Dec 16 | 31 May 17 | 3,268 | – | – | – | – | – | 3,268 |

## Directors' shareholdings

The Company and its directors, chief executives and shareholders have been granted a partial exemption from the disclosure requirements under Part XV of the Securities and Futures Ordinance (SFO). As a result of this exemption, directors, chief executives and shareholders do not have an obligation under the SFO to notify the Company of shareholding interests, and the Company is not required to maintain a register of directors' and chief executives' interests under section 352 of the SFO nor a register of interests of substantial shareholders under section 336 of the SFO. The Company is, however, required to file with the Hong Kong Stock Exchange any disclosure of interests notified to it in the United Kingdom.

The following table sets out the interests of directors in the issued share capital of Prudential including the interests of persons connected with directors for the purposes of DTR 3.1.2 of the Disclosure and Transparency Rules as at the end of the period. This includes shares acquired under the Share Incentive Plan (SIP), and deferred annual bonus awards and interests in shares awarded on appointment as detailed in the table on other share awards on page 238.

| | 1 January 2012 | 30 June 2012 |
|---|---|---|
| Keki Dadiseth | 32,196 | **32,196** |
| Howard Davies | 3,083 | **3,160** |
| Rob Devey | 126,006 | **274,218** |
| John Foley | 364,378 | **414,282** |
| Michael Garrett | 39,233 | **39,233** |
| Ann Godbehere | 15,914 | **15,914** |
| Alistair Johnston(note 1) | – | **–** |
| Paul Manduca | 2,500 | **2,500** |
| Harvey McGrath(note 2) | 300,636 | **300,636** |
| Michael McLintock | 595,363 | **680,748** |
| Kaikhushru Nargolwala(note 3) | 16,000 | **16,000** |
| Nic Nicandrou(note 4) | 167,655 | **349,516** |
| Kathleen O'Donovan(note 5) | 24,425 | **–** |
| Barry Stowe(note 6) | 274,575 | **509,697** |
| Tidjane Thiam | 650,116 | **919,781** |
| Lord Turnbull | 16,624 | **16,624** |
| Mike Wells(note 7) | 438,718 | **589,874** |

Notes

1 Alistair Johnston was appointed to the Board on 1 January 2012.
2 Harvey McGrath retired from the Board on 2 July 2012.
3 Kaikhushru Nargolwala was appointed to the Board on 1 January 2012.
4 Nic Nicandrou's interest in shares on 30 June 2012 includes his monthly purchases made under the SIP plan in the period from January to June 2012.
5 Kathleen O'Donovan retired from the Board on 31 March 2012.
6 Part of Barry Stowe's interest in shares is made up of 207,196 ADRs (representing 414,392 ordinary shares) and 95,305 ordinary shares. 8,513.73 of these ADRs are held within an investment account which secures premium financing for a life assurance policy).
7 Mike Wells' interest in shares is made up of 294,937 ADRs (representing 589,874 ordinary shares).

## Directors' outstanding long-term incentive awards

### Share-based long-term incentive awards

The section below sets out the outstanding share awards under the Group Performance Share Plan and the awards made under additional long-term plans (Business Unit Performance Plan and JNL Performance Share Plan) for the executive directors with regional responsibilities.

| Plan name | Year of award | Conditional share awards outstanding at 1 Jan 2012 (number of shares) | Conditional awards in 2012 (number of shares) | Market price at date of award (pence) | Dividend equivalents on vested shares (number of shares released) (note 2) | Rights exercised in 2012 | Rights lapsed in 2012 | Conditional share awards outstanding at 30 June 2012 (number of shares) | Date of end of performance period |
|---|---|---|---|---|---|---|---|---|---|
| **Rob Devey** | | | | | | | | | |
| GPSP | 2009 | 120,898 | | 639 | 15,361 | 136,259 | | – | 31 Dec 11 |
| BUPP | 2009 | 120,897 | | 639 | 15,361 | 136,258 | | – | 31 Dec 11 |
| GPSP | 2010 | 104,089 | | 568.5 | | | | 104,089 | 31 Dec 12 |
| BUPP | 2010 | 104,089 | | 568.5 | | | | 104,089 | 31 Dec 12 |
| GPSP | 2011 | 76,242 | | 733.5 | | | | 76,242 | 31 Dec 13 |
| BUPP | 2011 | 76,242 | | 733.5 | | | | 76,242 | 31 Dec 13 |
| GPSP | 2012 | | 88,273 | 678 | | | | 88,273 | 31 Dec 14 |
| BUPP | 2012 | | 88,273 | 678 | | | | 88,273 | 31 Dec 14 |
| | | 602,457 | 176,546 | | 30,722 | 272,517 | | 537,208 | |
| **John Foley** | | | | | | | | | |
| GPSP | 2011 | 152,484 | | 733.5 | | | | 152,484 | 31 Dec 13 |
| GPSP | 2012 | | 199,433 | 678 | | | | 199,433 | 31 Dec 14 |
| | | 152,484 | 199,433 | | | | | 351,917 | |
| **Michael McLintock** | | | | | | | | | |
| GPSP | 2009 | 92,022 | | 455.5 | 11,691 | 103,713 | | – | 31 Dec 11 |
| GPSP | 2010 | 66,238 | | 568.5 | | | | 66,238 | 31 Dec 12 |
| GPSP | 2011 | 48,517 | | 733.5 | | | | 48,517 | 31 Dec 13 |
| GPSP | 2012 | | 47,079 | 678 | | | | 47,079 | 31 Dec 14 |
| | | 206,777 | 47,079 | | 11,691 | 103,713 | | 161,834 | |
| **Nic Nicandrou** | | | | | | | | | |
| GPSP | 2009 | 316,328 | | 639 | 40,197 | 356,525 | | – | 31 Dec 11 |
| GPSP | 2010 | 208,179 | | 568.5 | | | | 208,179 | 31 Dec 12 |
| GPSP | 2011 | 152,484 | | 733.5 | | | | 152,484 | 31 Dec 13 |
| GPSP | 2012 | | 185,374 | 678 | | | | 185,374 | 31 Dec 14 |
| | | 676,991 | 185,374 | | 40,197 | 356,525 | | 546,037 | |
| **Barry Stowe**(note 1) | | | | | | | | | |
| GPSP | 2009 | 196,596 | | 455.5 | 22,868 | 219,464 | | – | 31 Dec 11 |
| BUPP | 2009 | 196,596 | | 455.5 | 19,780 | 189,836 | 26,540 | – | 31 Dec 11 |
| GPSP | 2010 | 129,076 | | 568.5 | | | | 129,076 | 31 Dec 12 |
| BUPP | 2010 | 129,076 | | 568.5 | | | | 129,076 | 31 Dec 12 |
| GPSP | 2011 | 88,270 | | 733.5 | | | | 88,270 | 31 Dec 13 |
| BUPP | 2011 | 88,270 | | 733.5 | | | | 88,270 | 31 Dec 13 |
| GPSP | 2012 | | 95,642 | 678 | | | | 95,642 | 31 Dec 14 |
| BUPP | 2012 | | 95,642 | 678 | | | | 95,642 | 31 Dec 14 |
| | | 827,884 | 191,284 | | 42,648 | 409,300 | 26,540 | 625,976 | |
| **Tidjane Thiam** | | | | | | | | | |
| GPSP | 2009 | 299,074 | | 455.5 | 38,004 | 337,078 | | – | 31 Dec 11 |
| GPSP | 2010 | 510,986 | | 568.5 | | | | 510,986 | 31 Dec 12 |
| GPSP | 2011 | 374,279 | | 733.5 | | | | 374,279 | 31 Dec 13 |
| GPSP | 2012 | | 523,103 | 678 | | | | 523,103 | 31 Dec 14 |
| | | 1,184,339 | 523,103 | | 38,004 | 337,078 | | 1,408,368 | |

# Disclosure of interests of directors continued

## Share-based long-term incentive awards continued

| Plan name | Year of award | Conditional share awards outstanding at 1 Jan 2012 (number of shares) | Conditional awards in 2012 (number of shares) | Market price at date of award (pence) | Dividend equivalents on vested shares (number of shares released) (note 2) | Rights exercised in 2012 | Rights lapsed in 2012 | Conditional share awards outstanding at 30 June 2012 (number of shares) | Date of end of performance period |
|---|---|---|---|---|---|---|---|---|---|
| Mike Wells(notes 1&3) | | | | | | | | | |
| JNL PSP | 2008 | 84,900 | | 546 | | 84,900 | | – | 31 Dec 11 |
| JNL PSP | 2009 | 218,100 | | 455.5 | | | | 218,100 | 31 Dec 12 |
| JNL PSP | 2010 | 141,000 | | 568.5 | | | | 141,000 | 31 Dec 13 |
| GPSP | 2011 | 197,648 | | 733.5 | | | | 197,648 | 31 Dec 13 |
| BUPP | 2011 | 197,648 | | 733.5 | | | | 197,648 | 31 Dec 13 |
| GPSP | 2012 | | 199,256 | 678 | | | | 199,256 | 31 Dec 14 |
| BUPP | 2012 | | 199,256 | 678 | | | | 199,256 | 31 Dec 14 |
| | | 839,296 | 398,512 | | | 84,900 | | 1,152,908 | |

Notes
1 The awards for Barry Stowe and Mike Wells were made in ADRs (1 ADR = 2 Prudential plc shares). The figures in the table are represented in terms of Prudential shares.
2 In 2009 and 2010 a scrip dividend equivalent and in 2011 and 2012 a DRIP dividend equivalent were accumulated on these awards.
3 The table above reflects the maximum number of shares (150 per cent of the original number awarded) which may be released to Mike Wells under the JNL Performance Share Plan. This maximum number of shares may be released if stretch performance targets are achieved.

### 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 number of shares is calculated using the average share price over the three business days commencing on the day of the announcement of the Group's annual financial results for the relevant year. For the awards from the 2011 annual incentives, made in 2012, the average share price was 776 pence.

| | Year of grant | Conditional share awards outstanding at 1 Jan 2012 (number of shares) | Conditionally awarded in 2012 (number of shares) | Dividends accumulated (number of shares) (note 2) | Shares released in 2012 (number of shares) | Conditional share awards outstanding at 30 June 2012 (number of shares) | Date of end of restricted period | Date of release | Market price at original date of award (pence) | Market price at date of vesting or release (pence) |
|---|---|---|---|---|---|---|---|---|---|---|
| **Rob Devey** | | | | | | | | | | |
| Awards under appointment terms | 2009 | 50,575 | | | 50,575 | – | 31 Mar 12 | 29 Mar 12 | 639 | 750 |
| Deferred 2009 annual incentive award | 2010 | 28,737 | | 716 | | 29,453 | 31 Dec 12 | | 552.5 | |
| Deferred 2010 annual incentive award | 2011 | 46,694 | | 1,164 | | 47,858 | 31 Dec 13 | | 721.5 | |
| Deferred 2011 annual incentive award | 2012 | | 41,136 | 1,025 | | 42,161 | 31 Dec 14 | | 750 | |

| | Year of grant | Conditional share awards outstanding at 1 Jan 2012 (number of shares) | Conditionally awarded in 2012 (number of shares) | Dividends accumulated (number of shares) (note 2) | Shares released in 2012 (number of shares) | Conditional share awards outstanding at 30 June 2012 (number of shares) | Date of end of restricted period | Date of release | Market price at original date of award (pence) | Market price at date of vesting or release (pence) |
|---|---|---|---|---|---|---|---|---|---|---|
| **John Foley** | | | | | | | | | | |
| Deferred 2009 deferred PruCap award | 2010 | 172,993 | | 4,314 | | 177,307 | 14 Dec 12 | | 612 | |
| Deferred 2011 annual incentive award | 2012 | | 44,481 | 1,109 | | 45,590 | 31 Dec 14 | | 750 | |
| **Michael McLintock** | | | | | | | | | | |
| Deferred 2008 annual incentive award | 2010 | 137,700 | | | 137,700 | – | 31 Dec 11 | 15 Mar 12 | 519.5 | 780 |
| Deferred 2009 annual incentive award | 2010 | 74,840 | | 1,866 | | 79,706 | 31 Dec 12 | | 552.5 | |
| Deferred 2010 annual incentive award | 2011 | 77,988 | | 1,945 | | 79,933 | 31 Dec 13 | | 721.5 | |
| Deferred 2011 annual incentive award | 2012 | | 36,008 | 898 | | 36,906 | 31 Dec 14 | | 750 | |
| **Nic Nicandrou** | | | | | | | | | | |
| Awards under appointment terms | 2009 | 68,191 | | | 68,191 | – | 31 Mar 12 | 29 Mar 12 | 639 | 750 |
| Deferred 2009 annual incentive award | 2010 | 26,342 | | 657 | | 26,999 | 31 Dec 12 | | 552.5 | |
| Deferred 2010 annual incentive award | 2011 | 48,155 | | 1,201 | | 49,356 | 31 Dec 13 | | 721.5 | |
| Deferred 2011 annual incentive award | 2012 | | 43,518 | 1,085 | | 44,603 | 31 Dec 14 | | 750 | |

# Disclosure of interests of directors continued

## Other share awards continued

| | Year of grant | Conditional share awards outstanding at 1 Jan 2012 (number of shares) | Conditionally awarded in 2012 (number of shares) | Dividends accumulated (number of shares) (note 2) | Shares released in 2012 (number of shares) | Conditional share awards outstanding at 30 June 2012 (number of shares) | Date of end of restricted period | Date of release | Market price at original date of award (pence) | Market price at date of vesting or release (pence) |
|---|---|---|---|---|---|---|---|---|---|---|
| **Barry Stowe** | | | | | | | | | | |
| Deferred 2008 annual incentive award | 2009 | 22,643 | | | 22,643 | – | 31 Dec 11 | 15 Mar 12 | 349.5 | 780 |
| Deferred 2009 annual incentive award | 2010 | 39,088 | | 976 | | 40,064 | 31 Dec 12 | | 552.5 | |
| Deferred 2010 annual incentive award | 2011 | 56,316 | | 1,406 | | 57,722 | 31 Dec 13 | | 721.5 | |
| Deferred 2011 annual incentive award | 2012 | | 50,648 | 1,266 | | 51,914 | 31 Dec 14 | | 750 | |
| **Tidjane Thiam** | | | | | | | | | | |
| Deferred 2008 annual incentive award | 2010 | 69,924 | | | 69,924 | – | 31 Dec 11 | 15 Mar 12 | 552.5 | 780 |
| Deferred 2009 annual incentive award | 2010 | 63,240 | | 1,577 | | 64,817 | 31 Dec 12 | | 552.5 | |
| Deferred 2010 annual incentive award | 2011 | 221,657 | | 5,528 | | 227,185 | 31 Dec 13 | | 721.5 | |
| Deferred 2011 annual incentive award | 2012 | | 101,134 | 2,522 | | 103,656 | 31 Dec 14 | | 750 | |
| **Mike Wells**(note 1) | | | | | | | | | | |
| 2009 After Tax Deferral Program award(note 3) | 2010 | 32,250 | | | | 32,250 | 15 Mar 13 | | 520 | |
| Deferred 2010 Group Deferred Bonus Plan award | 2011 | 90,854 | | 2,270 | | 93,124 | 31 Dec 13 | | 721.5 | |
| Deferred 2011 annual incentive award | 2012 | | 93,034 | 2,324 | | 95,358 | 31 Dec 14 | | 750 | |

Notes
1 The Deferred Share Awards in 2010, 2011 and 2012 for Barry Stowe and Mike Wells were made in ADRs (1 ADR = 2 Prudential plc shares). The figures in the table are represented in terms of Prudential shares.
2 In 2009 and 2010 a scrip dividend equivalent and in 2011 and 2012 a DRIP dividend equivalent were accumulated on these awards.
3 This award attracts dividends in the form of cash rather than shares.

## Shares acquired under the Share Incentive Plan

| | Year of initial grant | Share Incentive Plan awards held in trust at 1 January 2012 (number of shares) | Partnership shares accumulated in 2012 (number of shares) | Matching shares accumulated in 2012 (number of shares) | Dividend shares accumulated in 2012 (number of shares) | Share Incentive Plan awards held in trust at 30 June 2012 (number of shares) |
|---|---|---|---|---|---|---|
| **Nic Nicandrou** | | | | | | |
| Shares held in trust | 2010 | 596 | 107 | 27 | 16 | 746 |

The table above provides information about shares purchased under the SIP together with Matching Shares (awarded on a 1:4 basis) and dividend shares. The total number of shares will only be released if Nic Nicandrou remains in employment for five years.

## Cash-settled long-term incentive awards

This information has been prepared in line with the reporting requirements of the Hong Kong Stock Exchange and sets out executive directors' outstanding share awards and share options. For details of the cash-settled long-term incentive awards held by some executive directors, please see our Annual Report.

# Shareholder information

## Financial calendar

| 2012 interim dividend | Shareholders registered on the UK register and Irish branch register | Shareholders registered on the Hong Kong branch register | Holders of US American Depository Receipts | Shareholders with ordinary shares standing to the credit of their CDP securities accounts |
|---|---|---|---|---|
| Ex dividend date | 22 August 2012 | 23 August 2012 | 22 August 2012 | 22 August 2012 |
| Record date | 24 August 2012 | 24 August 2012 | 24 August 2012 | 24 August 2012 |
| Payment of 2012 interim dividend | 27 September 2012 | 27 September 2012 | On or about 5 October 2012 | On or about 4 October 2012 |

## Dividend mandates

Shareholders may have their dividends paid directly to their bank or building society account. If you wish to take advantage of this facility, please call Equiniti and request a Cash Dividend Mandate form. Alternatively, you may download a form from www.prudential.co.uk/prudential-plc/investors/shareholder_services/forms

## Cash dividend alternative

The Company operates a Dividend Re-investment Plan (DRIP). Shareholders who have elected for the DRIP will automatically receive shares for all future dividends in respect of which a DRIP alternative is offered. The election may be cancelled at any time by the shareholder. Further details of the DRIP and the timetable are available on the Company's website at www.prudential.co.uk/prudential-plc/investors

### Shareholder enquiries

For enquiries about shareholdings, including dividend and lost share certificates, please contact the Company's registrars:

**By post**
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA

**By telephone**
Tel: 0871 384 2035
Fax: 0871 384 2100
Textel: 0871 384 2255
(for hard of hearing)

Calls to 0871 numbers are charged at 8p per minute from a BT landline. Other telephone providers' costs may vary. Lines are open from 8.30am to 5.30pm, Monday to Friday.

International shareholders tel: +44 (0)121 415 7026

## Electronic communications

Shareholders are encouraged to elect to receive shareholder documents electronically by registering with Shareview at www.shareview.co.uk – this will save on printing and distribution costs, and create environmental benefits. Shareholders who have registered, will be sent an email notification whenever shareholder documents are available on the Company's website and a link will be provided to that information. When registering, you will need your shareholder reference number which can be found on your share certificate or proxy form. The option to receive shareholder documents electronically is not available to shareholders holding shares through The Central Depository (Pte) Limited (CDP). Please contact Equiniti if you require any assistance or further information.

## Share dealing services

The Company's Registrars, Equiniti, offer a postal dealing facility for buying and selling Prudential plc ordinary shares; please see the Equiniti address opposite or telephone 0871 384 2248. They also offer a telephone and internet dealing service, Shareview, which provides a simple and convenient way of selling Prudential plc shares. For telephone sales call 0871 384 2780 between 8.30am and 4.30pm, Monday to Friday, and for internet sales log on to www.shareview.co.uk/dealing

## ShareGift

Shareholders who have only a small number of shares the value of which makes them uneconomic to sell them may wish to consider donating them to ShareGift (Registered Charity 1052686). The relevant share transfer form may be obtained from our website www.prudential.co.uk/prudential-plc/investors/shareholder_services/forms or from Equiniti. Further information about ShareGift may be obtained on +44 (0)20 7930 3737 or from www.ShareGift.org

There are no implications for capital gains tax purposes (no gain or loss) on gifts of shares to charity and it is also possible to obtain income tax relief.

## Hong Kong branch register

The Company operates a branch register for shareholders in Hong Kong. All enquiries regarding Hong Kong branch register accounts should be directed to Computershare Hong Kong Investor Services Limited, 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong. Telephone +852 2862 8555

## Singapore shareholder enquiries

Shareholders who have shares standing to the credit of their securities accounts with CDP in Singapore may refer queries to the CDP at 4 Shenton Way, #02-01, SGX Centre 2, Singapore 068807. Telephone +65 6535 7511. Enquiries regarding shares held in Depository Agent Sub-accounts should be directed to your Depository Agent or broker.

## Irish branch register

The Company operates a branch register for shareholders in Ireland. All enquiries regarding Irish branch register accounts should be directed to Capita Registrars (Ireland) Limited, Unit 5, Manor Street Business Park, Manor Street, Dublin 7, Ireland. Telephone + 353 1 810 2400

## American Depositary Receipts (ADRs)

The Company's ordinary shares are listed on the New York Stock Exchange in the form of American Depositary Shares, evidenced by ADRs and traded under the symbol PUK. Each American Depositary Share represents two ordinary shares. All enquiries regarding ADR holder accounts should be directed to JP Morgan, the authorised depositary bank, at JP Morgan Chase & Co, PO Box 64504, St. Paul, MN 55164-0504, USA. Telephone +1 800 990 1135 or from outside the US +1 651 453 2128; or log on to www.adr.com

# How to contact us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Chairman

**Tidjane Thiam**
Group Chief Executive

**Nic Nicandrou**
Chief Financial Officer

**John Foley**
Group Chief Risk Officer

**Margaret Coltman**
Group General Counsel & Company Secretary

**Peter Goerke**
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**John Murray**
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**Prudential public limited company**
Incorporated and registered in England and Wales

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Laurence Pountney Hill
London EC4R 0HH
Registered number 1397169

**www.prudential.co.uk**

Prudential plc is a company incorporated, some of whose subsidiaries are authorised and regulated by the Financial Services Authority (FSA).

**Forward-looking statements**

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