PRUDENTIAL PLC
Form 20-F
June 24, 2003

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As filed with the Securities and Exchange Commission on June 24, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002

Commission File Number: 1-15040

PRUDENTIAL PUBLIC LIMITED COMPANY

(Exact Name of Registrant as Specified in its Charter)

England and Wales
(Jurisdiction of Incorporation)

Laurence Pountney Hill,
London EC4R 0HH, England
(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
American Depositary Shares, each representing 2 Ordinary Shares, 5 pence par value each	New York Stock Exchange
Ordinary Shares, 5 pence par value each	New York Stock Exchange*

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

The number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2002 was:

2,001,662,348 Ordinary Shares, 5 pence par value each

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes _X_ No ____

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 ____ Item 18 _X_

* Not for trading, but only in connection with the registration of American Depositary Shares.

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Item 3. Key Information

SELECTED HISTORICAL FINANCIAL INFORMATION OF PRUDENTIAL

The following table sets forth Prudential's selected consolidated financial data for the periods indicated. This data is derived from Prudential's audited consolidated financial statements prepared in accordance with UK GAAP under which insurance business is accounted for on the modified statutory basis ("MSB"). These accounting principles differ in certain significant respects from US GAAP. Note 35 of the notes to the Prudential audited consolidated financial statements included elsewhere in this document includes a description of the differences between UK GAAP and US GAAP that are significant to the financial statements and provides a reconciliation from UK GAAP consolidated profit and loss and consolidated shareholders' funds to US GAAP consolidated net (loss) income and consolidated shareholders' equity, respectively. Item 5, "Operating and Financial Review and Prospects US GAAP Analysis" provides a discussion of the significant differences between UK GAAP and US GAAP. This table is only a summary and should be read in conjunction with Prudential's consolidated financial statements and the related notes included elsewhere in this document, together with Item 5, "Operating and Financial Review and Prospects".

The profit and loss account and balance sheet data for and as at the years ended December 31, 1998 to 2002 have been derived from Prudential's audited consolidated financial statements. The consolidated financial statements for the year ended December 31, 1998 have been audited by PricewaterhouseCoopers, and for the four years ended December 31, 2002 by KPMG Audit Plc.

	Year Ended December 31,					
	2002(1)	**2002**	**2001**	**2000**	**1999**	**1998**
	(In $ Millions)			**(In £ Millions)**		
Profit and loss account data UK GAAP basis						
Gross premiums from continuing operations including acquisitions:						
Long-term business	**26,837**	**16,669**	15,196	14,173	14,826	10,640
Gross premiums from discontinued operations:						
Long-term business						423
General business	**530**	**329**	390	333	318	310
	530	**329**	390	333	318	733
Reinsurance and change in unearned premiums	**(877)**	**(545)**	(380)	(130)	(91)	(87)
Total earned premiums, net of reinsurance	**26,490**	**16,453**	15,206	14,376	15,053	11,286
Investment returns	**(5,854)**	**(3,636)**	(1,210)	5,046	17,232	12,612
Operating profit before amortization of goodwill and tax(2)						
Continuing operations:						
UK operations	**675**	**419**	422	438	391	355
US operations	**246**	**153**	298	466	451	411
Asian operations	**100**	**62**	25	36	27	23
European operations	**2**	**1**	(24)	(10)	6	4
Group activities	**(304)**	**(189)**	(130)	(123)	(90)	28
UK restructuring costs	**(23)**	**(14)**	(41)		(58)	
Total continuing operations	**696**	**432**	550	807	727	821
Discontinued operations(3)			72	33	49	47
Operating profit before amortization of goodwill and tax(4)	**696**	**432**	622	840	776	868
Amortization of goodwill	**(158)**	**(98)**	(95)	(84)	(54)	
Short-term fluctuations in investment returns(5)	**(330)**	**(205)**	(480)	(48)	28	24
Profit on business disposals	**571**	**355**		120		249
Merger break fee, net of related expenses			338			
Profit on Egg flotation				119		
Total profit on ordinary activities before tax	**779**	**484**	385	947	750	1,141
Profit after tax:						
	506	**314**	460	591	507	620

	Year Ended December 31,					
Operating profit (including post-tax longer term investment returns)						
Profit for the period (including post-tax actual investment returns)	**723**	**449**	389	657	472	853

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	Year Ended December 31,					
	2002[(1)]	2002	2001	2000	1999	1998
	(In $ Millions)	(In £ Millions)				
Statement of income and comprehensive income data US GAAP basis						
Insurance policy revenues	**8,374**	**5,201**	3,954	3,614	4,597	3,299
Investment results	**(2,840)**	**(1,764)**	252	4,669	12,793	8,599
Non-operating income						
Merger break fee, net of related expenses			338			
Profit on Egg flotation				119		
Other income	**1,115**	**693**	619	620	600	165
Total revenue	**6,649**	**4,130**	5,163	9,022	17,990	12,063
Net (loss) income from continuing operations (after minority interests)	**(1,087)**	**(675)**	(300)	498	869	787
Income from discontinued operations including profit on sale of UK personal lines property and casualty insurance business (net of applicable tax)	**512**	**318**	31	4	19	14
Cumulative effect of changes in accounting policies			(139)			
Total net (loss) income	**(575)**	**(357)**	(408)	502	888	801
Total comprehensive (loss) income	**(1,009)**	**(627)**	(68)	673	431	761

	At December 31,					
	2002[(1)]	2002	2001	2000	1999	1998
	(In $ Millions, Except Share Information)	(In £ Millions, Except Share Information)				
Balance sheet data UK GAAP basis						
Total assets	**244,979**	**152,161**	156,769	154,950	150,643	118,786
Long-term business provision	**159,574**	**99,114**	98,511	91,006	84,430	76,760
Technical provision for linked liabilities	**25,771**	**16,007**	17,783	18,719	19,043	9,996
Debenture loans	**3,692**	**2,293**	2,244	1,585	1,546	1,031
Total shareholders' funds	**5,905**	**3,668**	3,950	3,971	3,404	3,298
Balance sheet data US GAAP basis						
Total assets	**242,110**	**150,379**	155,668	153,024	148,922	117,762
Policyholder benefit liabilities	**143,779**	**89,304**	84,190	76,711	71,179	62,878
Separate account liabilities	**41,527**	**25,793**	29,729	32,337	33,477	23,450
Total shareholders' equity	**7,854**	**4,878**	5,964	6,455	6,046	5,997

	At December 31,					
Other data						
Long-term business						
New business from continuing operations:						
Single premium sales	**19,500**	**12,112**	10,723	9,901	10,640	6,982
New regular premium sales(6)	**1,138**	**707**	693	538	489	453
Investment product contributions	**23,857**	**14,818**	10,067	3,587	1,307	369
Funds under management	**249,550**	**155,000**	163,000	165,000	170,000	128,300
Basic earnings per share:						
Based on operating profit from continuing operations before amortization of goodwill and before tax on a UK GAAP basis	**35.0¢**	**21.7p**	27.8p	41.2p	37.3p	42.3p
Based on operating profit before amortization of goodwill and after tax and related minority interests on a UK GAAP basis	**25.5¢**	**15.8p**	23.3p	30.2p	26.0p	31.9p
Based on total profit for the financial year after tax on a UK GAAP basis	**36.4¢**	**22.6p**	19.7p	33.5p	24.2p	43.9p
Net (loss) income per share on a US GAAP basis	**(29.0)¢**	**(18.0)p**	(20.6)p	25.6p	45.6p	41.4p
Diluted earnings per share UK GAAP	**36.3¢**	**22.6p**	19.6p	33.4p	24.1p	43.6p
Diluted (loss) earnings per share US GAAP	**(28.9)¢**	**(17.9)p**	(20.6)p	25.5p	45.3p	41.0p
Dividend per share(7)	**41.9¢**	**26.0p**	25.4p	24.5p	23.0p	21.0p
Equivalent cents per share(8)		**41.8¢**	36.6¢	34.8¢	36.9¢	34.0¢
Market price at end of period	**$ 7.07**	**439.0p**	796.0p	1,077.0p	1,220.0p	908.0p
Share capital	**161**	**100**	100	99	98	98
Number of shares outstanding (in millions)		**2,002**	1,994	1,981	1,954	1,949
Average number of shares (in millions)		**1,988**	1,978	1,959	1,947	1,942

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(1) Amounts stated in US dollars have been translated from pounds sterling at the rate of $1.61 per £1.00 (the noon buying rate in New York City on December 31, 2002).

(2) Investment returns credited to operating profits for investments attributable to shareholders are determined using the longer-term rate of return. For the purposes of determining longer-term investment returns, Jackson National Life averages realized investment gains and losses over five years.

(3) Discontinued operations are restated on an annual basis in order that continuing operations reflect those operations which form part of the group as at the most recent year end date.

(4) Due to the long-term nature of Prudential's business, the basis of presentation of operating profit may not be comparable with other UK companies. See Note 4 of the notes to Prudential's consolidated financial statements for a description of the basis.

(5) Short-term fluctuations in investment returns represent the difference between the longer-term return credited to operating profit and the actual investment returns achieved for the year.

(6) New regular premium sales are reported above on an annualized basis, which represents a full year of installments in respect of regular premiums irrespective of the actual payments made during the year.

(7) The final dividend with respect to any year is paid in the following year. Final dividends are included in the year to which they relate rather than in the year paid. Annual dividends comprise both interim and final dividend payments.

(8) Translated into US dollars at the noon buying rate on the date each payment was made.

Dividend Data

Under UK company law, Prudential may pay dividends only if "distributable profits" are available for that purpose. "Distributable profits" are accumulated, realized profits not previously distributed or capitalized less accumulated, realized losses not previously written off. Even if distributable profits are available, under UK law Prudential may pay dividends only if the amount of its net assets is not less than the aggregate of its called-up share capital and undistributable reserves (such as, for example, the share premium account) and the payment of the dividend does not reduce the amount of its net assets to less than that aggregate.

As a holding company, Prudential is dependent upon dividends and interest from its subsidiaries to pay cash dividends. Many of its insurance subsidiaries are subject to regulations that restrict the amount of dividends that they can pay to Prudential. These restrictions are discussed in more detail in Item 4, "Information on the Company Supervision and Regulation of Prudential UK Supervision and Regulation Regulation of Insurance Business Distribution of Profits" and " US Supervision and Regulation General".

Historically, Prudential has declared an interim and a final dividend for each year (with the final dividend being paid in the year following the year to which it relates, after approval of the accounts at Prudential's annual general meeting). Subject to the restrictions set out above, Prudential's directors have the discretion to determine whether to pay a dividend and the amount of any such dividend but must take into account the company's financial position.

The following table shows certain information regarding the dividends that Prudential paid for the periods indicated in pounds sterling and converted into US dollars at the noon buying rate in effect on each payment date. Interim dividends for a specific year have generally had a record date in September and a payment date in November of that year, and final dividends have generally had a record date in the following March and a payment date in the following May.

Year	**Interim Dividend per Share**	**Interim Dividend per Share**	**Final Dividend per Share**	**Final Dividend per Share**
	(Pence)	**(US Dollars)**	**(Pence)**	**(US Dollars)**
1998	7.0	0.11598	14.0	0.22369
1999	7.7	0.12292	15.3	0.24620
2000	8.2	0.11652	16.3	0.23105
2001	8.7	0.12528	16.7	0.24048
2002	8.9	0.13821	17.1	0.27959

In 2002, as a result of a deteriorating economic outlook and greater geo-political risk, uncertainty in international capital markets increased, with bond and equity market confidence being adversely affected. This increased uncertainty was reflected in downgrades in credit ratings and falls in market capitalization levels across the UK insurance and other industries. On December 20, 2002, Moody's downgraded the financial strength rating of Prudential Assurance's long-term fund from Aaa to Aa1 (stable outlook). On January 29, 2003, Standard and Poor's downgraded the financial strength rating of the long-term fund from AAA (negative outlook) to AA+ (stable outlook). As a result of weak investment markets, Prudential has since September 2002 reduced bonus rates on its UK with-profit policies more quickly and to a greater extent than previously anticipated. This will directly affect the future cash payments from the UK long-term with-profits fund to the group. The impact of bonus rates on future cash payments is discussed in more detail in Item 4, "Information on the Company UK Business UK Products and Profitability".

Despite continuing market uncertainty, there are attractive opportunities for Prudential in growth markets, notably Asia. Accordingly, Prudential is committed to retaining its financial flexibility when determining the 2003 dividend. While recognizing the importance of cash payments to shareholders, Prudential's Board of Directors stated at the time of its preliminary announcement in February 2003 that it believed it would be inappropriate to recommit to the previous dividend policy. The dividend for 2003 will be determined taking into account a number of factors, including the outlook for profits on a modified statutory basis under UK GAAP, the cash transfer from the UK long-term fund (comprising shareholders' profit with respect to with-profits business) and the balance sheet on an achieved profits basis (a widely accepted alternative profit measure for UK life assurance companies published in the United Kingdom as supplementary information which includes the current value to shareholders of future cashflows of in force business).

Exchange Rate Information

Prudential publishes its consolidated financial statements in pounds sterling. References in this document to "US dollars", "US$", "$" or "¢" are to US currency, references to "pounds sterling", "£", "pounds", "pence" or "p" are to UK currency (there are 100 pence to each pound) and references to "euro" or "€" are to the European single currency. The following table sets forth the noon buying rate on the last business day of each year, as certified for customs purposes by the Federal Reserve Bank of New York, for pounds sterling expressed in US dollars per pound sterling for each of the five most recent fiscal years. Prudential has not used these rates to prepare its consolidated financial statements.

December 31,	Year end rate
1998	1.66
1999	1.61
2000	1.50
2001	1.46
2002	1.61

The following table sets forth the high and low noon buying rates for pounds sterling expressed in US dollars per pound sterling for each of the previous six months:

	High	Low
December 2002	1.61	1.56
January 2003	1.65	1.60
February 2003	1.65	1.57
March 2003	1.61	1.56
April 2003	1.60	1.55
May 2003	1.65	1.59

On June 20, 2003, the noon buying rate in New York City was £1.00 = $1.66.

Forward-Looking Statements

This annual report contains certain "forward-looking statements". All statements regarding Prudential's future financial condition, results of operations and businesses, strategy, plans and objectives are forward-looking. Statements containing the words "believes", "intends", "expects" and words of similar meaning are also forward-looking. Such statements involve unknown risks, uncertainties and other factors that may cause Prudential's results, performance or achievements or conditions in the markets in which it operates to differ from those expressed or implied in such statements. These factors include regulatory changes, technological development, globalization, levels of spending in major economies, the levels of marketing and promotional expenditures, actions of competitors, employee costs, future exchange and interest rates, changes in tax rates and future business combinations or dispositions, together with other factors discussed in " Risk Factors".

In particular, the following are forward-looking in nature:

- certain statements in Item 4, "Information on the Company" with regard to strategy and management objectives, trends in market shares, prices, market standing and product volumes and the effects of changes or prospective changes in regulation, and

- certain statements in Item 5, "Operating and Financial Review and Prospects" with regard to trends in results, prices, volumes, operations, margins, overall market trends, risk management and exchange rates and with regard to the effects of changes or prospective changes in regulation.

Prudential may also make or disclose written and/or oral forward-looking statements in reports filed or furnished to the US Securities and Exchange Commission, Prudential's annual report and accounts to shareholders, proxy statements, offering circulars, registration statements and prospectuses, press releases and other written materials and in oral statements made by directors, officers or employees of Prudential to third parties, including financial analysts. Prudential undertakes no obligation to update any of its forward-looking statements.

RISK FACTORS

Prudential's operating results, financial condition and trading price are affected by a number of factors including economic and market conditions, foreign currency exchange rate fluctuations, regulation, government policy and legislation, competition, credit ratings, and operational systems and processes.

Prudential's businesses are inherently subject to market fluctuations and general economic conditions.

Prudential's businesses are inherently subject to the risks associated with economic and market fluctuations.

In the United Kingdom, this is largely because Prudential's shareholders' profit is related to bonuses for policyholders declared on its with-profits products, which are broadly based on historic and current rates of return on equity, real estate and fixed income securities, as well as Prudential's expectations of future investment returns.

In the United States, fluctuations in prevailing interest rates can affect results from Jackson National Life which is predominantly a spread-based business with the majority of its assets invested in fixed income securities. In particular, fixed annuities and stable value products in Jackson National Life expose the group to the risk that changes in interest rates which are not fully reflected in the interest rates credited to customers will reduce spread. The spread is the difference between the amounts that Jackson National Life is required to pay under the contracts, and the rate of return it is able to earn on its general account investments to support the obligations under the contract. Declines in spread from these products or other spread businesses that Jackson National Life conducts could have a material impact on its businesses or results of operations.

In all markets in which Prudential operates, its businesses are susceptible to general economic conditions, which can change the level of demand for Prudential's products. The uncertain trends in international economic and investment climates prevailing over the last two years have adversely affected Prudential's business and profitability. This adverse effect has been felt principally through reduced investment returns and credit defaults in fixed interest corporate bonds, and may continue to affect the business unless conditions improve. In addition, falling investment returns could impair Prudential's operational capability, including its ability to write significant volumes of new business.

See Item 4, "Information on the Company Business of Prudential Investments" for a description of Prudential's invested assets, investment strategies and investment yields. See also Item 5, "Operating and Financial Review and Prospects Factors Affecting Results of Operations General Economic and Market Conditions".

Prudential is subject to the risk of exchange rate fluctuations owing to the geographical diversity of its business.

Due to the geographical diversity of Prudential's businesses, it is subject to the risk of exchange rate fluctuations. Prudential's international operations in the United States, Asia and Europe, which represent a significant proportion of total group income and expenses, generally write policies and invest in their local currency. Although this practice limits the effect of exchange rate fluctuations on local operating results, it can lead to 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 separately managed. Of core structural borrowings at December 31, 2002 of £2,452 million, £644 million was denominated in US dollars, partially to hedge the currency exposure arising from Prudential's investment in its US operations. The impact of gains or losses on currency translations is recorded as a component of shareholders' funds within the consolidated statement of total

recognized gains and losses. In 2002, a loss of £252 million was recorded in the consolidated statement of total recognized gains and losses. This loss primarily arises upon translation into pounds sterling of the investments in Prudential's US and Asian operations, but is after offset of exchange gains of £37 million on the carrying value of the US dollar denominated borrowings, reflecting movements in the US dollar to pounds sterling exchange rate from the beginning to end of 2002. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk".

Prudential conducts its businesses subject to regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies and interpretations in the markets in which it operates.

Changes in government policy, legislation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which Prudential operates may adversely affect Prudential's product range, distribution channels, capital requirements and, consequently, reported results and financing requirements. These changes include possible changes in the tax treatment of financial products and services, government pension arrangements and policies, the regulation of selling practices and solvency requirements. For instance, in the United Kingdom the Financial Services Authority ("FSA") consultation paper on reforming the UK polarization regime and the HM Treasury report on medium and long-term retail savings could have a significant effect on types of products sold by Prudential and how its products are priced, distributed and sold.

The EU Insurance Groups Directive, which was implemented in the United Kingdom in 2001, together with the Financial Conglomerates Directive, which will be implemented by 2005, will 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 EU is also currently reviewing future solvency requirements (the "Solvency II review"). The manner of the implementation of these directives may lead to Prudential being required to maintain a higher level of capital than currently necessary to support some of its businesses, or alternatively, to constrain the growth of those businesses. In addition, an inconsistent application of these directives by regulators in different EU member states may place Prudential at a competitive disadvantage to other 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. See Item 5, "Operating and Financial Review and Prospects Factors Affecting Results of Operations Government Policy and Legislation" and Item 4, "Information on the Company Supervision and Regulation of Prudential".

The resolution of several issues affecting the UK financial services industry, including the requirement to provide redress to past purchasers of pension and mortgage endowment policies and regulatory reviews concerning the sale of free standing additional voluntary contributions and guaranteed annuities, 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 United Kingdom and internationally. Pending legal and regulatory actions include proceedings relating to aspects of Prudential's business and operations which are specific to Prudential and proceedings which are typical of the business it operates, including in the latter case businesses it has closed. Although Prudential believes it has adequately reserved in all material aspects for the costs of litigation and regulatory matters, no assurance can be provided that such reserves are

sufficient. It is possible that Prudential's future performance could be affected by an unfavorable outcome in these matters.

Companies operating in the UK insurance and financial services industries, including Prudential, currently face a number of regulatory and legal actions, including the requirement to provide redress to past purchasers of pension and mortgage endowment policies and regulatory reviews concerning the sale of free standing additional voluntary contributions and guaranteed annuities.

In addition, Prudential has held discussions with the FSA on the status of its inherited estate. Prudential has not considered or discussed any actual distribution as its current expectation is that, for the foreseeable future, the entire inherited estate will need to be retained within the long-term fund to provide working capital. However, in the light of current market conditions the amount and timing of any re-attribution of the estate remains very uncertain. See Item 4, "Information on the Company Business of Prudential Shareholders' Interests in Prudential's Long-term Insurance Business Surplus Assets in Prudential Assurance's Long-term With-profits Fund".

Prudential's businesses are conducted in highly competitive environments and Prudential's continued profitability depends on its management's ability to respond to these pressures.

The markets for UK, US and Asian financial services are highly competitive, with several factors affecting Prudential's ability to sell its products, including price and yields offered, financial strength and ratings, range of product lines and product quality, brand strength and name recognition, investment management performance and historical bonus levels. In some of its markets Prudential faces competitors who 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.

Within the United Kingdom, Prudential's principal competitors in the life market include many of the major stock and mutual retail financial services companies including, in particular, Aviva, Legal and General and Standard Life. During 2002, Prudential maintained its position as a leading distributor of with-profits bonds through independent financial advisors, albeit in a market which contracted by over 50%

during the year, and believes it is the market leader in providing pension annuities, having increased its market share over each of the last five quarters to the end of 2002.

Jackson National Life's competitors in the United States include major stock and mutual insurance companies, mutual fund organizations, banks and other financial services companies. Jackson National Life's principal life insurance company competitors in the United States include AXA, Lincoln National Corporation, Transamerica Corporation, Nationwide Financial Services, Inc., SunAmerica, Inc. and Hartford Life, Inc. At December 31, 2002, in the United States, Jackson National Life was the tenth-largest life insurance company in terms of General Account assets, the sixth-largest provider of individual fixed annuities in terms of sales, and the sixth-largest provider of equity-indexed annuities in terms of sales.

Within Asia, Prudential's main regional competitors are international financial companies, including AIG, Allianz, ING and Manulife. By new business premiums Prudential has top five market positions in eight life markets (Singapore, Malaysia, Hong Kong, India, Vietnam, Philippines, Guangzhou China and Indonesia), two mutual fund markets (Taiwan and India) and Hong Kong's Mandatory Provident Fund market.

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. See Item 4, "Information on the Company Business of Prudential Competition".

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 intended 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 could have an adverse effect on its ability to market products and retain current policyholders. In addition, the interest rates Prudential pays on its borrowings are affected by its debt credit ratings, which are in place to measure Prudential's ability to pay its contractual obligations. On December 20, 2002, Moody's downgraded the financial strength rating of Prudential Assurance's long-term fund from Aaa (on review for possible downgrade) to Aa1 (stable outlook). On January 29, 2003, Standard and Poor's downgraded the financial strength rating of Prudential Assurance's long-term fund from AAA (negative outlook) to AA+ (stable outlook). Prudential believes the downgrades that it, and the rest of the UK insurance industry, experienced have not to date had a discernible impact on its performance.

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. Further, because of the long-term nature of much of Prudential's business, accurate records have to be maintained for significant periods. Prudential's systems and processes are designed to ensure that the operational risks associated with its activities are appropriately controlled, but any weakness in the systems could have a negative impact on its results of operations during the effective period. Other than each of the items discussed in the risk factor concerning several issues affecting the UK financial services industry, Prudential has not experienced or identified any operational risks in its systems or processes which have caused, or are expected to cause, a significant negative impact on its results or operations. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk Operational, Compliance and Fiscal Risk" and Item 4, "Business of Prudential UK Business Compliance".

Changes in mortality experienced by Prudential's UK pension annuity policyholders could significantly affect Prudential's results of operations.

Prudential is a major participant in the UK pensions annuity market. In exchange for a premium equal to the capital value of their accumulated pension fund, each pension annuity policyholder receives a guaranteed payment, usually monthly, for as long as they are alive. For a smaller monthly payment, certain annuity contracts extend the right to the payment to surviving spouses. As part of its pension annuity pricing and reserving policy Prudential assumes that current rates of mortality continuously improve over time. Prudential currently assumes a 1.84% annual mortality improvement in its pricing, and reserves on the basis of an average 2.90% annual improvement. If mortality rate improvements significantly exceed the improvement assumed, Prudential's results of operations could be adversely affected.

Item 4. Information on the Company

BUSINESS OF PRUDENTIAL

Overview

Prudential is a leading international financial services group, providing retail financial services and fund management in its chosen markets: the United Kingdom, the United States, Asia and continental Europe. At December 31, 2002, Prudential was one of the 30 largest public companies in the United Kingdom in terms of market capitalization on the London Stock Exchange. Prudential is not affiliated with Prudential Financial, Inc. or its subsidiary, The Prudential Insurance Company of America.

Prudential has been writing life insurance in the United Kingdom for over 150 years and has had the largest long-term fund in the United Kingdom for over a century. Prudential began writing property and casualty insurance in 1915, and expanded its business into British Commonwealth countries, including Singapore and Malaysia, in the 1920s and 1930s. In 1986, Prudential acquired Jackson National Life Insurance Company, a US insurance company writing life and fixed annuity business. A group strategy review in the early 1990s identified significant opportunities for Prudential in the Asian life sector and Prudential Corporation Asia (referred to as PCA) was established in 1994 to develop a material and profitable Asian business. In 1998, Prudential launched Egg, now a leading e-commerce retail financial services provider, and in 1999, Prudential acquired M&G, a leading UK fund manager. In June 2000, Prudential completed its listing on the New York Stock Exchange and completed an initial public offering of Egg plc on the London Stock Exchange. In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance business to Winterthur Insurance and the Churchill Group, its UK subsidiary, for consideration of £353 million. The sale was completed on January 4, 2002.

In the United Kingdom, Prudential offers a range of retail financial products and services, including long-term insurance and asset accumulation products (life insurance, pensions and pension annuities), retail investment and unit trust products, fund management services and banking products. Prudential primarily distributes these products through independent financial advisers, referred to as IFAs, bank branches, and direct marketing, by telephone, mail and the internet.

At December 31, 2002, in the United Kingdom, Prudential was:

- the second-largest life insurance group in terms of market capitalization,
- the proprietor of the largest long-term fund of investment assets supporting long-term insurance products,
- one of the top three largest retail fund managers in terms of funds under management,
- through Egg, the world's largest pure on-line bank, and
- rated AAA (negative outlook) by Standard & Poor's and Aa1 (stable outlook) by Moody's in terms of financial strength rating for the long-term fund of Prudential Assurance Company ("Prudential Assurance"). At the time of publication Standard and Poor's had revised their rating of Prudential Assurance's long-term fund from AAA (negative outlook) to AA+ (stable outlook).

In the United States, Prudential offers a range of products through Jackson National Life Insurance Company, including fixed, equity-indexed and variable annuities, life insurance, guaranteed investment contracts and funding agreements. Prudential distributes these products through independent insurance agents, securities broker-dealers and banks, credit unions and other financial institutions. At December 31, 2002, in the United States, Jackson National Life was:

- the tenth-largest life insurance company in terms of General Account assets, the sixth-largest provider of individual fixed annuities in terms of sales,

the sixth-largest provider of equity-indexed annuities in terms of sales, and

rated AAA (negative outlook) by Standard & Poor's, AA+ (negative outlook) by Fitch Ratings, A+ (stable outlook) by A.M. Best Co. and A1 (stable outlook) by Moody's in terms of financial strength rating. At the time of publication, Standard & Poor's had revised its rating to AA (negative outlook) and Fitch to AA (stable outlook).

PCA is the leading European-based life insurer in Asia, with 23 operations in 12 Asian countries. PCA offers life insurance with accident and health options, selected personal lines property and casualty insurance and mutual funds, a product range tailored to suit the individual country markets in which PCA operates. Its insurance products are distributed mainly through an agency sales-force and complementary bancassurance agreements while the majority of mutual funds are sold through banks and brokers.

At December 31, 2002 PCA had:

top five new business market positions in eight life markets (Singapore, Malaysia, Hong Kong, India, Vietnam, the Philippines, Guangzhou (China) and Indonesia), two mutual fund markets (Taiwan and India) and Hong Kong's Mandatory Provident Fund market,

over 89,000 agents and 18 bank distribution agreements covering ten countries, and

over four million customers.

Prudential's operating profit under UK GAAP on the modified statutory basis before amortization of goodwill and tax for the periods indicated is set forth in the table below.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
UK Insurance Operations	**368**	435	468
M&G	**71**	75	125
Egg	**(20)**	(88)	(155)
Total UK operations	**419**	422	438
US operations	**153**	298	466
Asian operations	**62**	25	36
European operations	**1**	(24)	(10)
Group activities	**(189)**	(130)	(123)
UK restructuring costs	**(14)**	(41)	
Continuing operations	**432**	550	807
Discontinued operations			

	Year Ended December 31,		
UK personal lines property and casualty insurance operations		79	33
UK restructuring costs		(7)	
Total discontinued operations		72	33
Total operating profit before amortization of goodwill and tax[(1)]	**432**	622	840

(1) For the purpose of this annual report, operating profit is determined on a long-term investment return basis, before: amortization of goodwill and tax; the profit on business disposals; the American General merger break fee in 2001; and the flotation of Egg in 2000.

Strategy

Shareholder Focus

Prudential's strong mix of business around the world positions it well to benefit from the growth in customer demand for asset accumulation and income in retirement. Prudential believes that its international reach and diversity of earnings will continue to give it a significant advantage.

Prudential's commitment to its shareholders is to maximize the value over time of their investment. Prudential does this by investing for the long-term to develop and bring out the best in its people, and its business to produce superior products and services, and hence superior financial returns. Prudential's aim is to deliver top quartile performance among its international peer group in terms of total shareholder returns.

Prudential's aim is to develop lasting relationships with its customers and policyholders, through products and services that offer value for money and security. Prudential seeks to continually enhance its reputation, built over 150 years, for integrity and for acting responsibly within society.

Building the Platform

In recent years, the global retail financial services industry has undergone significant change. Changes in underlying demographics, government attitudes, regulatory requirements, technology and customer demands are all driving fundamental change in the industry. Prudential is committed to delivering superior returns to its shareholders and has therefore reconfigured its business to compete more effectively in this changing environment.

Over the past five years, Prudential has transformed itself from a business with a narrow product range and limited distribution channels focus into a multi-channel, multi-brand business with a broad product range and a clear retail financial services focus. At the same time, Prudential has withdrawn from those operations or markets that did not meet its target returns or that did not offer the opportunities to achieve critical mass in the desired timeframe.

Prudential has significantly restructured its operations in both the United Kingdom and the United States to improve its customer focus and management accountability, and to broaden its product range and distribution reach.

In the United Kingdom, Prudential has restructured its long-term savings business into a single integrated business combining Prudential's UK businesses with that of Scottish Amicable, which was acquired in 1997, to form Prudential UK Insurance Operations. The new simplified organizational structure was effective from January 1, 2002. This has resulted in improved operational effectiveness through removal of duplication, greater customer focus and reduced operating costs. Meanwhile, Egg has added banking products to Prudential's product range and has an on-line market leading position in providing banking and insurance products through its website. Meanwhile the acquisition of M&G in 1999 has enhanced Prudential's retail, institutional and internal fund management capability.

In the United States, Prudential has significantly diversified its product range and distribution strategy. Prudential has launched and developed its own equity-based, index-linked and stable value product ranges complementing its fixed annuity products, successfully entered the broker-dealer market and significantly grown its presence in the bank channel.

In Asia, building on a solid base of established operations in Singapore, Hong Kong and Malaysia, Prudential has followed since 1994 a clear, value creating strategy of entering new markets, building and diversifying distribution and launching innovative products through targeting profitable market segments.

The cost of development initiatives has adversely impacted, and will continue to adversely impact, short-term earnings, but Prudential believes that each of these investments is building long-term shareholder value.

This value is clearly demonstrated by the scale and mix of Prudential's new business sales. In 2002, new business inflows exceeded £27.6 billion with approximately half coming from mutual fund sales, and over 73% coming from outside the United Kingdom.

This transformation has created a strong platform to pursue strategic initiatives for future growth and shareholder value creation.

Growing the Business

Prudential is conscious that the retail financial services industry continues to evolve, and it expects to continue to adapt its business to maintain a strong advantage over its competitors while delivering returns to shareholders. Prudential's goal is to pursue its key strategic themes of maintaining focus on its customers, investing in technology to improve further customer access and service, driving down costs and driving growth in new and expanding markets. In furtherance of these themes, Prudential has already restructured and broadened its UK distribution channels to become more customer focused, expanded Egg's on-line presence in the United Kingdom while launching Egg's operations in France, and in Asia entered new life insurance markets in Japan and South Korea and new mutual fund markets throughout Asia.

The initial public offering of a minority stake in Egg in June 2000 was an important step towards ensuring that Prudential realizes the full potential of this business. This flotation was designed to provide Egg with the ability to grow and expand with its own acquisition currency and to enhance its ability to recruit, retain and incentivize staff.

Driving Growth in New and Expanding Markets

Within its existing major markets of the United Kingdom, the United States and Asia, Prudential believes fundamental shifts in demographics and in the manner of pension provision will create significant opportunities for future profitable growth.

At the same time as pursuing growth in its existing markets, Prudential continues to seek new markets in which it believes it can create value for its shareholders. Prudential has adopted a multi-branded strategy in Europe, choosing either the M&G, Prudential or Egg brand depending on the specific characteristics of the market and products in question.

In February 2002, M&G announced the launch of M&G International, focused initially on the distribution of M&G branded mutual funds to retail investors in Germany, Austria, Luxembourg and Italy through large IFAs and other institutions.

In January 2002, Egg announced its acquisition of 100% of Zebank, a French direct financial services company, and in October 2002 launched a credit card, "la Carte Egg", its first retail financial services product in France.

In early 2002, Prudential reviewed the strategy for its Prudential and Scottish Amicable branded long-term business within continental Europe. The review concluded that an organic growth strategy based on investment in the German and French markets would be too slow and expensive to create value in these markets and would require significant acquisitions to create scale. Further, the analysis indicated that the returns achievable from any available acquisition would be too low to justify the investment of capital. As a consequence, in November 2002, Prudential agreed to sell its German long-term business to Canada Life for €129m (£82 million). This sale was completed in January 2003.

Prudential believes that Asia offers significant long-term growth opportunities and its strategy is designed to create material and sustainable value in Asia by focusing on three dimensions: entering countries with opportunities to leverage its strengths, building and diversifying distribution and providing innovative customer-focused products. At present Prudential is not looking to expand the number of countries in Asia in which it operates. Prudential will however continue to diversify both channels and products within existing territories and increase its coverage within countries where it is already operating.

In March 2003, Prudential and its Chinese joint venture partner CITIC were granted a life insurance license for Beijing in addition to the existing life insurance license for Guangzhou where operations commenced in the last quarter of 2000.

Prudential continues to consider opportunities to acquire businesses to further the strategy of growing its business, particularly in new and expanding markets. Prudential may finance these acquisitions with bank borrowings, debt or equity issuances or a combination of such financings.

Focusing on Customers

Prudential's goal is to deliver products that its customers want to buy, through the distribution channels they wish to use. Prudential is continually exploring opportunities to expand its distribution reach and broaden its product offering.

In the United Kingdom, Prudential has complementary businesses and market-leading positions in key product areas, enabling it to deliver sustained growth in the low margin environment in which it now operates. The businesses comprising Prudential's UK Insurance Operations have undergone enormous strategic transformations in recent years, bringing together several operating units under the powerful Prudential brand and improving service to over seven million customers. In 2002, Prudential's UK Insurance Operations announced the development of an outsourced customer service operation in Mumbai, India, which is expected to lead to a further improvement in customer services.

M&G's market position, investment capabilities and brand strength make it one of the leading fund managers in the United Kingdom. At December 31, 2002 M&G had £112 billion of funds under management, of which £9 billion were retail funds.

During 2002, Egg acquired 610,000 net new customers, giving it a total of almost 2.6 million customers by the end of the year. Of the 2.6 million customers, 1.9 million relate to its "Egg Card" credit card business.

In the United States, Prudential, through Jackson National Life, is one of the few providers to have a significant market position across the range of fixed, variable and equity-indexed annuity products. It also offers life and stable value products. Jackson National Life has expanded its distribution channels to include independent agents, broker-dealers, banks and other financial institutions. Prudential will continue to seek opportunities to expand its product range and distribution capability in the United States.

In Asia, Prudential has a reputation for developing customer-focused and innovative savings and insurance products. It leverages UK and US product expertise and works with Asian regulators to bring new products to market, achieving particular success with unit-linked products. While Prudential believes it can best manage customer service quality in Asia through ownership of distribution channels, it also gives customers the choice to access its products through complementary bancassurance arrangements.

Summary

Prudential's strategic initiatives over the past few years have significantly changed the shape and focus of the group and have built a platform for further growth and value generation. Prudential believes that by continuing to implement its strategy of product innovation for the benefit of its customers, improve efficiency and develop new distribution channels, it will maximize value for its shareholders over the long term.

Significant Subsidiaries

The table below sets forth Prudential's significant subsidiaries.

Name of Company	Percentage Owned[(1)]	Country of Incorporation

The Prudential Assurance Company Limited	100%	England and Wales
Prudential Annuities Limited[2]	100%	England and Wales
Prudential Retirement Income Limited[2]	100%	Scotland
M&G Investment Management Limited[2]	100%	England and Wales
Egg Banking plc[2][3]	79%	England and Wales
Jackson National Life Insurance Company[2]	100%	United States
Prudential Assurance Company Singapore (Pte) Limited[2]	100%	Singapore

(1) Percentage of equity owned by Prudential directly or indirectly. The percentage of voting power held is the same as the percentage owned. Each subsidiary has one class of ordinary shares and operates mainly in its country of incorporation.

(2) Owned by a subsidiary of Prudential.

(3) Egg Banking plc is a subsidiary of Egg plc, a listed subsidiary of Prudential. The ordinary shares of Egg plc, of which there is only one class, are 79% owned by Prudential and 21% owned by shareholders external to the Prudential group.

UK Business

Introduction

Prudential's UK business is structured into business units, each focusing on its respective target customer markets. Prudential's UK business units are UK Insurance Operations, M&G and Egg.

The following discussion describes:

- the UK retail financial services market,
- Prudential's UK business units and products,
- Prudential's reinsurance arrangements and reserving practices,
- shareholders' participation in Prudential's long-term insurance business, and
- compliance matters, including pension mis-selling.

In 2002, Prudential's UK business generated operating profit from continuing operations before amortization of goodwill and tax of £419 million and total UK new business insurance premiums of £6,051 million. As of December 31, 2002, M&G had £112 billion funds under management. Meanwhile, as at December 31, 2002, Egg had deposits of £8,016 million, a mortgage book of £2,360 million and a credit card book of £2,338 million.

UK Retail Financial Services Market Overview

The United Kingdom is one of the world's largest life insurance markets in terms of premiums and is one of the largest retail banking markets. In recent years, the UK insurance and banking markets have changed significantly and are continuing to evolve as a result of changes in regulation and government policy, demographics, technological development and consumer awareness and attitudes. Retail financial services providers are adapting to these changes to meet consumer needs by broadening the range of products that they offer and the means by which those products are distributed to and accessed by customers.

The historical divisions between insurance, banking and other financial products are being eroded. It is increasingly common for providers to offer a range of pension products, life products and services, property and casualty insurance, banking products and retail investment products and services. Consumers are increasingly being offered access to these products through direct marketing and e-commerce, as well as through the traditional company salesforce, independent financial advisors, or IFAs, and bank branch distribution channels. However, for more complicated products, detailed "fact finds" are often required and consequently face-to-face advice is still preferred.

Competition among retail financial service companies is focused on product range, distribution reach, brand, investment performance and the specific benefits offered by products, charges and financial strength.

UK Products and Profitability

In common with other UK long-term insurance companies, Prudential's products are structured as either with-profits (participating) or non-participating, including unit-linked. Depending on the structure, the level of shareholders' interest in the value of policies, and the related profit or loss, varies.

With-profits policies are supported by a with-profits fund and can be single premium (for example, the Prudence Bond) or regular premium (for example, certain corporate pension products). Prudential's primary with-profits fund is part of the long-term fund of Prudential Assurance. The return to shareholders on with-profits products is in the form of a statutory transfer from the Prudential Assurance long-term with-profits fund to Prudential Assurance shareholders' funds (analogous to a dividend) which

is dependent upon the bonuses credited or declared on policies in that year. Prudential's with-profits policyholders currently receive 90% of that distribution as bonus additions to their policies while shareholders receive 10% as a statutory transfer.

In 2002, profits distributed from Prudential's primary with-profits fund amounted to £2.7 billion, of which £2.45 billion (90%) was added to policies as bonuses, and £273 million (10%) was available for distribution to shareholders.

The majority of Prudential branded non-participating business is written in Prudential Assurance's long-term fund or by subsidiaries owned by the fund. Prudential's principal non-participating business is Prudential Annuities Limited, which is wholly owned by Prudential Assurance's long-term fund. The profits from this business accrue to the long-term with-profits fund. In 2001, Prudential started to write certain annuity business through Prudential Retirement Income Limited, from which the profits are distributed solely to shareholders.

Products

The traditional life insurance product offered by UK life insurance companies was a long-term savings product with a life insurance component. The life insurance element conferred tax advantages that distinguished the traditional life insurance products offered in the United Kingdom from the savings products offered by banks, building societies and unit trust companies. The gradual reduction of these tax advantages and increasing sales of single premium life products have resulted in the distinction between life insurance and other long-term savings products becoming less important. Pension products remain tax-advantaged within certain limits.

Demand for private personal pension and savings products has increased during recent years, in part reflecting a change in the UK government's approach to social security that has encouraged long-term savings through tax advantages, but also in reaction to the growing realization that state-provided pensions are unlikely to provide sufficient retirement income. An ageing population is focusing on asset-accumulation and other retirement products to supplement their state benefits, while younger generations are focusing on pension and long-term savings products as well as health and income protection cover.

During the late 1980s, the UK government began encouraging individuals to invest in equities, with particular emphasis on UK equities. The UK government's privatization program and the introduction of tax-advantaged Personal Equity Plans, referred to as PEPs, in 1988 considerably widened the UK equity investor base. The current UK government replaced PEPs in April 1999 with Individual Savings Accounts, referred to as ISAs, a new tax-advantaged product that offers equity, insurance and deposit investment options.

The UK government introduced "stakeholder pensions" in April 2001 with the intention of creating a pension for individuals identified as earning enough to be able to afford to make a contribution towards a pension but who are not currently doing so. This initiative built on previous changes, such as the introduction of personal pensions in 1988.

The majority of the life and pensions business traditionally written in the United Kingdom is with-profits business. However, in response to regulatory scrutiny and subsequent changes in the regulatory environment and customer requirements, with-profits products are being supplemented by simpler unit-linked products. For a detailed description of Prudential's with-profits products and policies, see Item 4, " Shareholders' Interests in Prudential's Long-term Insurance Business With-profits Products".

Distribution

Retail financial services and products are distributed face-to-face, through branches, tied agents, company salesforces and IFAs, or directly by mail, telephone and over the internet. Tied agents are exclusive agents who represent only one insurer and must offer customers the products most suitable to their needs, but only from the range of products offered by that insurer. In recent years the high costs of company salesforces and tied agency networks, combined with customers perceiving a lack of choice, have meant that salesforces and tied agents lost significant market share to IFAs, with the result that many insurers, including Prudential, have chosen to close these tied agents and direct salesforce networks.

Increasingly, consumers require wider access to financial products than agents can provide. IFAs, banks, direct marketing and, to a lesser extent, e-commerce distribution are gaining market share at the expense of traditional company salesforces. Direct and e-commerce distribution methods are generally lower-cost than other methods but have not been conducive to providing financial advice to the consumer to date. Accordingly, products distributed directly are generally more straightforward and have lower, often fee-based, charges.

IFAs are required by the UK polarization laws to provide the best advice to customers, considering all of the products available in the market and the customer's particular circumstances, and are legally responsible for their own advice. In contrast, company salesforces may only sell the products of the company of which they are employed, but must nevertheless provide the best advice in light of the customer's particular circumstances. A company has legal responsibility for the advice its salesforce provides and the conduct of its tied agents.

The FSA announced the relaxation of the polarization rules in March 2001 with respect to stakeholder pension schemes and direct offer financial promotions for packaged products (which include life policies other than pure protection policies, pensions, regulated collective investment schemes and investment trust savings schemes). As a result of these changes, tied sales forces and appointed representatives of product provider firms are now free to market stakeholder pensions manufactured by any other company.

Further relaxation of the polarization rules is expected following the publication in January 2003 of FSA Consultation Paper 166, "Reforming Polarisation: Removing the Barriers to Choice", in which the FSA makes a number of proposals for the reform of polarization which, if adopted, would fundamentally alter the relationship between product manufacturers and distributors. See Item 4, " Supervision and Regulation of Prudential UK Supervision and Regulation FSA Conduct of Business Rules".

UK Business Units

UK Insurance Operations

In 2002, operating profit before taxation and restructuring from Prudential's long-term UK Insurance Operations was £368 million. This represented 88% of the total £419 million operating profit before taxation and restructuring recorded by Prudential in the United Kingdom from long-term and other operations.

Products

Prudential offers a wide range of products, which traditionally have been marketed under the "Prudential" and "Scottish Amicable" brands. From January 2003, however, products have only been sold under the Prudential brand. See " UK Restructurings". The products distributed include long-term products consisting of:

life insurance savings-type products and pure protection products,

individual and corporate pensions, and

pension annuities.

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Until December 2001, Prudential also offered personal lines property and casualty insurance through its UK Insurance Operations. However it transferred this business in January 2002 to Winterthur Insurance and the Churchill Group, Winterthur's UK subsidiary. This business is still branded as "Prudential". See " Transfer of Business to Winterthur".

Long-term Products

Prudential's long-term products in the United Kingdom consist of life insurance, pension products and pensions annuities. The following table shows Prudential's UK Insurance Operations new business insurance and investment premiums by product line for the periods indicated. New business premiums include deposits for policies with limited or no life contingencies.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Life insurance			
With-profits	**1,875**	2,222	2,047
Unit-linked	**396**	339	212
Total life insurance	**2,271**	2,561	2,259
Pensions			
With-profits individual	**57**	153	181
Unit-linked individual	**88**	186	163
Department of Work and Pensions rebates	**305**	249	234
Corporate	**865**	701	953
Total pensions	**1,315**	1,289	1,531
Pension annuities			
Fixed	**2,055**	1,265	1,022
Retail Price Index	**293**	439	75
With-profits	**117**	131	157
Total pension annuities	**2,465**	1,835	1,254
	6,051	5,685	5,044
Investment products	**101**	91	159
Total new business premiums	**6,152**	5,776	5,203

Of total new business premiums of £6,152 million in 2002, £4,078 million were sold through IFAs, an increase of 3% from the £3,948 million of sales through this channel in 2001.

Life Insurance Products

Prudential's UK life insurance products are predominantly medium to long-term savings products with life cover attached, and also include pure protection (term) products. The main savings products Prudential offers are investment bonds.

Savings Products Investment Bonds

Prudential's investment bonds are single premium products that may be with-profits or unit-linked products, although the with-profits bonds represent the majority of its new business premiums. See " Shareholders' Interests in Prudential's Long-term Insurance Business With-profits Products" for more information on Prudential's with-profits products.

The Prudence Bond, a single premium, unitized with-profits policy with no fixed term, is one of the United Kingdom's leading investment bond products. In 2002, total new business premiums attributable to the Prudence Bond and to the Prudential Investment Bond, a similar product, were in excess of £1.8 billion.

These products aim to provide capital growth over the medium to long-term, and access to different investment areas without the costs and risks associated with direct investment into these areas. Capital growth for the policyholder on with-profits bonds is achieved by the addition of reversionary or regular bonuses, which are credited to the bond on a daily basis from investment returns achieved within Prudential Assurance's long-term with-profits fund. A final bonus may also be added when the bond is surrendered. The capital return on unit-linked bonds reflects the movement in the value of the assets underlying those funds. When funds invested in Prudential Assurance's long-term with-profits fund are either fully or partially withdrawn, Prudential may apply a market value adjustment to the amount paid out.

Structured ISAs

In October 2002, Prudential entered the structured ISA market, launching the first offer of the Prudential Growth and Income Plan which offers a range of structured income and investment choices. Further series of offers are planned for 2003, the first of which was launched in January 2003. See " M&G Individual Savings Accounts" for more information about ISAs.

Pension Products

Prudential provides both individual and corporate pension products. In 2002, new business premiums totaled £145 million for individual pensions and £865 million for corporate pensions. Pension products are tax-advantaged long-term savings products that comply with rules established by the UK Inland Revenue and are designed to supplement state-provided pensions. These rules require that, upon retirement, maturity benefits are used to purchase pension annuities by policyholder election at, or by the age of, 75, although they do permit a portion to be taken as a tax-free lump sum. Prior to retirement, these products typically have minimal mortality risk to Prudential and are primarily considered investment products. An exception is where a guaranteed annuity option has been offered on the product, with an element of risk to Prudential both in underlying mortality and investment assumptions.

Many of the pension products Prudential offers are with-profits products or offer the option to have all or part of the contributions allocated to a with-profits fund. Where funds invested in the with-profits fund are withdrawn prior to the pension date specified by the policyholder, Prudential may apply a market value adjustment to the amount paid out. The remaining pension products are non-participating products, which include unit-linked products.

Individual Pensions

Prudential's individual pension range offers unit-linked and unitized with-profits products.

In 2001, Prudential introduced products that meet the criteria of the UK government's stakeholder pension program. The stakeholder pension is intended for individuals earning enough to be able to afford to make contributions to a pension but who are not currently doing so. The introduction of stakeholder pensions has had implications for, among other things, how Prudential designs, administers, charges for and distributes pension products. The most significant requirements involve capped charges and a minimum acceptable contribution. The government has capped charges at 1% of the policyholder account balance per annum for stakeholder pensions, which is significantly below the charges on personal pension products previously offered by the UK pensions industry.

Department of Work and Pensions Rebates

Prudential also provides individual personal pension products through the "DWP Rebate" arrangement. Under this arrangement, individuals may elect to contract out of the UK's State Earnings Related Pension Scheme (referred to as SERPS), administered by the UK Department of Work and Pensions. If an individual elects to contract out, then he or she will designate a pensions provider, such as Prudential. Premiums on products sold in this manner are paid through "rebates" from the Department of Work and Pensions, which represent the amount that would be otherwise paid into SERPS. Rebate amounts are invested to provide benefits to the individual. Premiums from Department of Work and Pensions rebates are typically reported in the first quarter of each year. In 2002, Prudential recorded total premiums of £305 million from Department of Work and Pensions rebates.

Corporate Pensions

There are two categories of corporate pension products: defined benefit and defined contribution. Prudential has an established defined benefit plan client base that ranges from small unlisted companies to some of the largest companies in the United Kingdom. In addition, Prudential offers defined contribution products through additional voluntary contribution plans (UK regulations require that all companies that offer an occupational pension plan must also offer a group additional voluntary contribution plan to their employees). Additional voluntary contribution plans enable employees to make additional pension contributions, either regularly or as a lump sum, to supplement their occupational pension plans.

Defined benefit plans and products continue to dominate the corporate pensions market in terms of funds under management. In recent years, however, most new plans established have been defined contribution products. In addition, there is an increasing trend among companies to convert existing schemes from defined benefit to defined contribution in order to reduce potential pension liabilities.

The products Prudential offers to the corporate pensions market are group unit-linked policies and with-profits policies. Prudential's defined contribution products are additional voluntary contribution plans, money purchase plans, grouped personal pension plans, group stakeholder pension plans and executive pension plans.

Pension Annuities

Prudential offers immediate annuities that are either fixed or retail price-indexed (referred to as RPI), where annuity payments are guaranteed from the outset, or with-profits annuities, where annuity payments are variable. Prudential also offers bulk annuities, whereby it manages the assets and accepts the assets and liabilities, of a company pension scheme, usually when they are in the process of winding up. Due to the nature of the product, the volume of Prudential's bulk annuity sales is unpredictable as it depends on the decision of scheme trustees. In 2002, Prudential sold £710 million of bulk annuities, including £389 million in respect of the C&A pension scheme in the final quarter of the year. Internal vestings of individual pensions (annuity sales arising from maturing in force Prudential pension policies) represented almost half of Prudential-branded annuity sales in 2002.

Prudential's immediate annuity products provide guaranteed income for a specified time, usually the life of the policyholder, in exchange for a lump-sum capital payment. No surrender value is available under any of these products. The primary risk to Prudential from fixed annuity products, therefore, is mortality and credit risk. In 2002, Prudential built upon the successful launch in 2001 of the innovative Flexible Lifetime Annuity, by launching the Flexible Income Drawdown Plan.

Fixed Annuities

Prudential's fixed annuities include fixed-increase and RPI annuities. Prudential's fixed-increase annuity incorporates automatic increases by fixed amounts over the lifetime of the policyholder. The RPI annuities Prudential offers provide for a regular payment to which an additional amount based on the increase in the UK Retail Prices Index is added periodically. In 2002, sales of RPI annuities were £293 million (including £234 million of bulk annuities). In 2002, sales of fixed-increase annuities amounted to £2,055 million (including £476 million of bulk annuities).

With-profits Annuities

Prudential is one of only a few companies in the United Kingdom writing with-profits annuities. In 2002, Prudential wrote £87 million of this business (excluding £30 million of the Flexible Lifetime Annuity). Prudential's with-profits annuities combine the income features of annuity products with the smoothing features of with-profits products and enable policyholders to obtain equity-type returns. Policyholders select an "anticipated bonus" from the specific range Prudential offers for the particular product. The value of the annuity payment each year depends upon the anticipated bonus rate selected by the policyholder when the product is purchased and the bonuses Prudential declares each year during the term of the product. If bonus rates fall below the anticipated rate, then the annuity income falls.

Transfer of Business to Winterthur

In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance operations to Winterthur and the Churchill Group, its UK subsidiary. On December 31, 2001, the insurance liabilities were almost wholly reassured to Winterthur Insurance. The related cash transfer for this reinsurance was offset in January 2002 against the sales proceeds of this business. The sale was completed on January 4, 2002 for a consideration of £353 million. After allowing for the costs of the sale and other related items, the profit on sale recorded in the 2002 results was £355 million before tax. Profits from this business have been classified as discontinued operations throughout this report.

As part of the arrangements for the handover of the operations, new personal lines property and casualty insurance business for the 3 months to April 1, 2002, was written by Prudential with full reinsurance to Winterthur. After April 1, 2002, all new Prudential branded personal lines property and casualty insurance business has been wholly reinsured to the Churchill Group.

On June 11, 2003 Royal Bank of Scotland plc announced it had reached an agreement to purchase the Churchill Group for £1.1 billion.

Other Closed Businesses

Prior to 1993, Prudential wrote a wide range of commercial lines property and casualty insurance business, which it sold through brokers and its company salesforce. Prudential also had a London Market operation and specialist marine and aviation insurance operations. Prudential had withdrawn from all of these areas by the end of 1993 and, consequently, these businesses are now in run-off. The total claims provisions established for these closed businesses amounted to £143 million, comprising net claims provisions of £105 million and a closure provision of £38 million, at December 31, 2002. Prudential believes these provisions are prudent and does not currently anticipate that it will need to make any further provisions in respect of these closed businesses.

UK Restructurings

In 2002, Prudential incurred a total restructuring charge for its UK Insurance Operations of £38 million, of which £10 million related to the establishment of an offshore customer contact center in

Mumbai, India and £28 million related to additional costs for the simplification of its organizational structure (each as described in greater detail below).

In September 2002, Prudential announced plans to establish an offshore service center in India to improve customer contact service levels for its UK Insurance Operations customers and to achieve further cost savings to those announced in November 2001. The new processing center will be established in Mumbai and is expected to be operational in 2003. The initiative is expected to incur a restructuring charge of approximately £20 million, with £10 million charged in 2002. However, the charge will generate expected future gross cost savings from 2006 of approximately £16 million per annum, of which approximately £4 million per annum is expected to be attributable to shareholders. As part of these restructurings Prudential planned to make 850 customer services jobs in the United Kingdom redundant. Termination did not commence until 2003.

In February 2001, Prudential announced the restructuring of the direct salesforce and customer service channels of its UK Insurance Operations. In November 2001, Prudential announced further details of changes to the future structure of those operations, in particular the intention to pursue a single brand strategy for life and pensions business, including the integration of its Scottish Amicable operations under the Prudential brand. The changes also included a simplification of the organizational structure and plans for a significant reduction in operating costs. The total cost in 2001 of this restructuring was £200 million with an additional £28 million charged in 2002. However the charge is anticipated to be offset by expected annual gross cost savings of £200 million (increased in July 2002 from the original target of £175 million) by the end of 2004. As part of these restructurings Prudential plans to make 4,100 jobs redundant, of which approximately 3,200 had been completed by December 31, 2002.

Distribution

Prudential's UK Insurance Operations have a multi-channel distribution capability relying on direct to consumer, business to business, intermediaries and affinities channels.

Direct to Consumer

The direct to consumer distribution channel is primarily charged with increasing revenue from existing Prudential customers and by seeking new customers. The channel builds on the success of the Service Related Sales Units and the Annuities Advice Center, through which customers are served and advised using the internet and telephone.

Business to Business

The business to business distribution channel focuses on the maximization of the value of the existing book of corporate pension schemes and winning new schemes. This channel targets Prudential's strong base of corporate pensions through workplace cross-selling. Prudential UK Insurance Operations corporate pension products are marketed through consulting actuaries, benefits advisers and its company employer and employee relationship management teams. Consulting actuaries and benefits advisers are IFAs, but are not generally the same as the retail IFAs being targeted via the intermediary channel discussed below.

Intermediaries

The intermediary channel focuses on the distribution of products to individual customers via retail IFAs. This channel was restructured during 2001 to be closely aligned to the needs of Prudential UK Insurance Operations' key intermediary customers, focusing on the formation of closer relationships with the intermediaries that provide greatest value. A new infrastructure has been created to customize the levels of support required by each key customer group in line with the value that each group generates.

This realignment resulted in an increase in the number of telephone-based account managers and a fall in the number of field-based account managers.

Affinities

The newly formed affinities channel focuses on developing relationships with banks, other distributors and retail brands. In October 2002, Prudential's UK Insurance Operations announced an agreement with Abbey National for an initial four-year period to distribute the Prudence Bond through Abbey National's 700 specialist investment advisors based in its 756 branches through the United Kingdom.

M&G

M&G is Prudential's fund management business in the United Kingdom and continental Europe. In 2002, M&G accounted for £71 million of Prudential's total 2002 UK operating profit before taxation and UK restructuring costs of £419 million. The business comprises retail, institutional and internal fund management activities.

M&G Group plc was acquired by Prudential in 1999 and merged with its existing UK fund management operation, Prudential Portfolio Managers (referred to as PPM).

2002 proved another challenging year for the fund management industry, both globally and in the United Kingdom. UK equity markets, in particular, fell during the year by 25% (as measured by the FTSE 100 share index) and closed lower for the third consecutive year. Investment Management Association data show that total UK retail sales of unit linked savings products fell during the year, with gross retails sales 4% lower and a 20% reduction in net retail sales, in each case compared with 2001. However the M&G group countered this market trend, with gross retail sales 12% higher and net retail sales 175% higher than in 2001. This improvement is partially attributable to sales of funds distributed through IFAs, where M&G is a leading UK provider. During 2002, M&G branded products comprised 3.5% of all sales and 7.7% of ISA and PEP sales through this distribution channel (up from 3.2% and 6.1%, respectively, in 2001).

M&G's sales performance during 2002 enabled it to consolidate its position as one of the top three retail fund managers in the United Kingdom, measured in terms of total funds under management.

In 2000, M&G sold its segregated equities pension fund management business to concentrate on managing fixed income and pooled pension mandates. In 2002, M&G acquired £1.2 billion of new money into new segregated pensions mandates and a further £477 million into new initiatives in project finance and securitized vehicles. In addition, £240m of net new institutional equity mandates were received via PPM South Africa.

For the third successive year, the internal funds managed by M&G (which include Prudential Assurance's long-term funds) out-performed their strategic benchmarks. This resulted in M&G earning a significant performance related fee and in the addition of further added value to the long-term funds. See "Item 5 Operating and Financial Review and Propects Analysis by Geographic Region UK Operating Results M&G".

The following table shows funds managed by M&G at the dates indicated.

	At December 31,		
	2002	**2001**	**2000**
	(In £ Billions)		
Retail fund management	**9**	10	12
Institutional fund management	**11**	9	9
Internal fund management	**92**	101	109
Total	**112**	120	130

Retail Fund Management

M&G's retail fund management business comprises management and distribution of retail investment products. In its most important market, the United Kingdom, distribution is primarily via IFAs, though it also sells directly to customers and increasingly through internet-based fund supermarkets. M&G also markets to retail customers in certain European markets (via M&G International) and South Africa (via PPM South Africa).

During 2001 and 2002, M&G converted most of its UK retail product range from Unit Trusts (referred to as UTs) to Open Ended Investment Companies (referred to as OEICs). Although similar in structure, OEICs offer greater flexibility compared to UTs and can more easily be marketed to European customers, for reasons of regulation and tradition. M&G also manages a range of Investment Trusts (referred to as ITs).

Open Ended Investment Companies and Unit Trusts

OEICs and UTs are the UK equivalent of the US mutual fund. They are designed for medium to long-term savings and either lump sum or regular contributions may be made. Investors purchase shares (OEICs) or units (UTs), the cash proceeds from which are invested by M&G, principally in equities and fixed interest securities. The return to investors is determined by the performance of these underlying investments.

Investment Trusts

Investment trusts are similar to closed-end mutual funds and are listed on the London Stock Exchange. The trusts invest in specified investments, typically equities and fixed income securities. Investors purchase shares in the trusts, and their return is based on the trading price of the shares.

Individual Savings Accounts

ISAs are investment "wrappers" of equity and corporate bond based OEIC, UT and IT products that provide a tax advantage to the investor insofar as income and capital gains arise tax free. Contributions are currently subject to a £7,000 cap per investor, per tax year. M&G offers a range of ISAs investing in the underlying OEIC, UT and IT product ranges described above.

Outsourced Retail Administration

Following a review of its retail IT systems platform, M&G entered an agreement with International Financial Data Services (IFDS) in November 2002 to outsource all of M&G's retail administration. The migration is expected to be completed towards the end of 2003.

M&G International

In February 2002, M&G announced the launch of M&G International, focused initially on the distribution of M&G branded OEICs to retail investors in Germany, Austria, Italy and Luxembourg. Distribution in these markets will be primarily via large IFAs and other institutions.

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Institutional Fund Management

Following the disposal of its segregated equities pension fund management business in 2000, M&G's institutional business is focused on fixed income and pooled pension mandates. Clients are typically large institutional investors, primarily pension funds and insurance companies. M&G believes that falls and increased volatility in global equity markets may cause many institutional investors to re-allocate assets away from equities and into alternate asset classes, such as fixed income.

Internal Fund Management

M&G's internal fund management activities are based in the United Kingdom. Total internal funds under management at December 31, 2002 were £92 billion. Internal funds are invested by M&G in equities, fixed income securities, property and private equity.

Where M&G chooses to invest internal funds in the United States or Asia, this is done through PPM America in the United States and Prudential Asset Management (based in Asia). M&G monitors global investment and economic conditions, while regional fund management offices provide M&G with local knowledge and experience. See " US Business PPM America" and " Asian Business Products Funds Management" for descriptions of PPM America and Prudential Asset Management, respectively.

Egg

Egg had a total loss on ordinary activities before taxation in 2002 of £17 million, against a loss of £88 million in 2001. In 2002, Egg booked an exceptional profit of £3 million from the sale of 15% of Fundsdirect, a subsidiary of Egg, to Prudential. Upon consolidation, this gain is eliminated and pre-tax losses of £20 million are included in the Prudential group results.

In the United Kingdom, Egg delivered a profit of £35 million before tax in 2002, compared with a £76 million loss in 2001. Its total UK customer base increased by 610,000 to almost 2.6 million.

In June 2000, Prudential offered approximately 21% of the shares of Egg plc in an initial public offering. The offering was intended to enable Egg to maximize potential growth in the UK domestic market and, over time, internationally. Egg has continued to develop and enhance its range of products and services, adopting new technologies for the benefit of customers while growing rapidly.

The following table shows the product balances for both Egg and Prudential branded products at the dates indicated.

	At December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Customer deposits	**8,016**	5,945	7,128
Mortgage loans	**2,360**	2,429	2,406
Credit card receivables	**2,338**	1,769	929
Personal loans	**973**	597	445

Egg currently offers banking products and intermediated services on the internet (*www.egg.com*). It was launched in October 1998 with the goal of attracting a new segment of customers and developing a direct distribution channel. Egg has designed its products and services for more affluent customers who manage their own financial affairs, seek consistently good value and simple products and prefer the flexibility offered by remote access.

At Egg's launch, the initial business plan predicted £5 billion in deposits in the first five years. That goal was achieved within the first seven months of operation, principally through a combination of a successful brand launch and market-leading pricing. By April 1999, Egg began accepting new applications for deposit accounts exclusively through the internet and, since then, its business model has remained internet-led, supported by the telephone.

Products

Egg's own-branded banking product portfolio includes credit cards, deposit savings accounts, mortgages and personal loans. At December 31, 2002, Egg branded deposits totaled £7,780 million. In addition to its traditional deposit account, which can be serviced both over the internet and by telephone, in 1999 Egg launched an internet-only deposit account that may be applied for and serviced only over the internet and offers better rates of interest than its other deposit accounts. At December 31, 2002, Egg's own-branded mortgage loan book amounted to £1,233 million and its personal loan book was £973 million. Both mortgages and personal loans can be applied for over the internet.

Egg Card, the UK's first credit card designed for the internet, was launched in September 1999. Since launch, Egg has achieved a 5% market share of outstanding UK credit card balances and, at December 31, 2002, the balance outstanding on credit cards was £2,338 million. Egg also launched an independent, execution-only unit trust supermarket on its website in March 2000 and, as at December 31, 2002, had £124 million of related funds under management. Egg also offers motor, travel, home and contents and life assurance, with each product type underwritten by a different insurer. Egg receives commission for selling these policies. There were 85,000 customers insured under such policies at December 31, 2002.

Egg also manufactures and sells Prudential branded products. These Prudential product balances, included in the above table, were £1,127 million of mortgage loans and total deposits of £236 million at December 31, 2002.

Prudential believes that Egg has gained a significant advantage in the provision of internet-based financial services by being among the first to the market with the services and products it offers. Egg has developed into an on-line marketplace, enabling clients to obtain products and services ranging from core banking products and related financial services to intermediated financial and non-financial products and services, and continues to investigate opportunities in several markets and product sectors in the United Kingdom and internationally. See "   Acquisitions" below.

Acquisitions

In January 2002, Egg announced that, subject to regulatory approval, it would acquire 100% of Zebank, a French direct financial services company, for £22.8 million in cash (€36 million). The fair value of Zebank's net assets on May 22, 2002, the date the transaction was completed, was £20.3 million (€32 million).

On November 1, 2002, Egg launched its first retail financial services product in France, an international VISA card, "la Carte Egg". By December 31, 2002 69,000 potential customers had applied for the card and by March 31, 2003, Egg had 27,000 cards in issue. In addition, Egg has built a presence in the French market, with 55% brand awareness in those two months. It plans to launch other new products during 2003. The start-up costs in preparing for launch and the building of the brand led to a loss of £46.7 million in the period from acquisition to December 31, 2002.

In January 2002, Egg announced it had acquired Fundsdirect for £2.9 million. The merger of Egg Invest with Fundsdirect represents the consolidation of two of the United Kingdom's leading fund supermarkets, combining Egg's leading edge, scale, digital services capability and consumer offering with Fundsdirect's proven ability to serve the business to business marketplace. The fair value of the net assets acquired on the date of acquisition was £0.9 million.

Reinsurance

Long-term Insurance

In view of the size and spread of Prudential Assurance's long-term insurance fund, there is little need for reinsurance to protect this business. Some limited reinsurance is maintained and treaties relating to critical illness and permanent health insurance and term insurance are in place.

Reserves

In the United Kingdom, a long-term insurance company's reserve requirements are determined by its appointed actuary, subject to minimum reserve requirements. These minimum reserve requirements are established by the rules of the Interim Prudential Sourcebook for Insurers and have been interpreted by mandatory professional guidance notes.

The reserves are published in annual returns to the UK supervisory authority. In practice similar provisions are included in the life insurance company's statutory accounts with limited adjustments. Whether an employee of, or consultant to, an insurance company, an appointed actuary must give due regard to policyholders' reasonable expectations in making recommendations to a company's board of directors. Mandatory professional guidance notes require an appointed actuary to report directly to the UK supervisory authority any serious concerns regarding a company's ability to meet the reasonable expectations of its policyholders.

Prudential's reserving for with-profits products as required by UK regulation, takes into account annual bonuses/annual interest credited to policyholders because these are "attached" to the policies and are guaranteed. The reserve also includes an element in respect of final bonuses including a reserve for claims expected in the period for which final bonuses have been declared. Solvency requirements also include the establishment of a resilience reserve which makes prudent allowance for potential future adverse movements in investment values. See " Financial Strength of Prudential Assurance's Long-term Fund" for further information on solvency.

Prudential reserves for unit-linked products on the basis of the value of the unit fund and additional reserves are held for expenses and mortality where this is required by the contract design.

Financial Strength of Prudential Assurance's Long-term Fund

A common measure of financial strength in the United Kingdom for long-term insurance business is the free asset ratio. The free asset ratio represents the ratio of assets less liabilities to liabilities, and is expressed as a percentage of liabilities. On a comparable basis to 2001, the free asset (or Form 9) ratio of the Prudential Assurance long-term fund was approximately 8.8% at December 31, 2002, compared with 12.2% at December 31, 2001. The reduction during the year principally reflects the significant fall in global equity markets, together with lower bond yields and price earnings ratios. At the end of 2002, a reorganization of Prudential's long-term funds saw the transfer of the Scottish Amicable Life plc (referred to as SAL) long-term fund into the Prudential Assurance long-term fund. The impact of this transfer reduced the Prudential Assurance free asset ratio to 8.4%.

This valuation has been prepared on a conservative basis in accordance with the FSA valuation rules, and without the use of implicit items such as future profits, subordinated debt and contingent loans. No allowance has been taken for the present value of future profits, which are profits to be earned in the future from business already on the books. The Prudential Assurance long-term fund has not entered into any financial reinsurance contracts, with the exception of certain treaties with a value of approximately £74 million which were transferred from SAL under the previously mentioned reorganization. On the "realistic" basis for solvency the fund is very strong. See " Realistic Financial Strength Reporting" below.

Solvency requirements in the United Kingdom include the establishment of a resilience reserve which makes prudent allowance for potential future movements in investment values. As at December 31, 2002, Prudential's overall liability was determined based on the following resilience scenario required by regulation:

- a fall in equity values of 14%,
- a fall in property values of 15%, and
- a rise in bond interest rates of 2% equivalent to a fall in bond values of 13%.

The long-term funds remain well capitalized and the Prudential Assurance long-term fund is rated AA+ (stable outlook) by Standard & Poor's and Aa1 (stable outlook) by Moody's.

The table below shows the change in the investment mix of the Prudential Assurance long-term fund:

	At December 31,		
	2002	**2001**	**2000**
	%	**%**	**%**
UK equities	**32**	39	46
International equities	**13**	14	15
Fixed income securities	**33**	28	20
Cash and other asset classes	**4**	4	5
Property	**18**	15	14
Total	**100**	100	100

For the Prudential Assurance long-term with-profits fund at December 31, 2002, 88% of the fixed income securities investments were investment grade with 30% rated AA or above. For Prudential Annuities Limited, 97% of the fixed income securities investments were investment grade with 40% rated AA or above. For Prudential Retirement Income Limited, 100% of total assets were investment grade with 59% rated AA or above.

With-profits contracts are long-term contracts with relatively low guaranteed amounts, the nature of which permits Prudential to invest primarily in equities and real estate. However, over the period from 1999 to mid-2001 Prudential Assurance's long-term with-profits fund reduced its exposure to equities. There was also a re-weighting within equities out of the United Kingdom and into overseas equities. This change in asset mix reflected Prudential's view that equity valuations were high and that other assets, particularly corporate bonds, were relatively attractive. The change within equities improved diversification and reduced expected fund volatility. The change in asset mix in recent years has had a substantial beneficial impact on investment returns. The broad asset mix will continue to be reviewed as the economic environment and market valuations change. The fall in the proportion of investments held in equities in 2002 compared to 2001 reflects the decline in value of the holdings during the year.

The investment return on the Prudential Assurance long-term with-profits fund was negative 8.1% in the year to December 31, 2002 compared with the falls in the FTSE 100 share index and the FTSE All-Share share index of 24.5% (22.2% including reinvestment and income) and 25.0%, respectively, over the same period.

Realistic Financial Strength Reporting

The FSA's view is that the current regulations for determining with-profits reserves on a statutory basis are prudent, but can be overly prudent and the degree of prudence is not robustly related to risk. A specific issue is that the degree of prudence increases as market values decline. The result is that

companies can come under pressure to sell equities to meet the existing solvency regulations, even though this may not be in the best long-term interests of policyholders.

In order to address these issues, the FSA plans to amend the statutory basis of valuation to a more "realistic" basis from early 2004, possibly with effect from December 31, 2003. In the meantime, companies can move towards the revised valuation basis by applying to the FSA for waivers, and indeed the FSA has encouraged companies to do so. Waivers relax the existing rules leading to lower statutory reserves, and hence higher quoted financial strength, giving headroom over the existing solvency hurdle.

Waivers will only be granted if companies have:

clearly documented methodologies of their calculation including those for asset shares and bonus smoothing costs, adequate systems and procedures to put the methodology into practice, and

demonstrated that they have sufficient financial resources to meet their realistic liabilities not only under normal circumstances but also under stressed circumstances. In other words, companies must still retain a safety margin in their assets.

Prudential supports the FSA's objective of moving as rapidly as possible to a more realistic basis of solvency reporting. This will make companies' financial health more transparent to policyholders, IFAs and regulators alike, and enable more informed choices to be made by policyholders.

In addition, Prudential believes that it will relieve some of the pressure on companies from making decisions on an overly prudent "unrealistic" basis. In particular, a company that is financially strong on a realistic basis will not find itself unnecessarily restricted from pursuing an appropriate investment strategy, for example holding or buying equities where the company reasonably considers this to be prudent and good value for policyholders in the longer term.

Following the FSA's initiative to bring forward the implementation of realistic solvency, Prudential Assurance's long-term fund, along with a number of other insurers, has received waivers from the FSA allowing it to move towards this new basis. Prudential has managed the Prudential Assurance long-term fund on the realistic basis for a number of years and, as a result, does not expect any significant changes to the operation or investment strategy of the fund. Under the realistic basis, the fund remains among the strongest in the United Kingdom and comfortably within statutory limits.

Shareholders' Interests in Prudential's Long-term Insurance Business

In common with other UK long-term insurance companies, Prudential's products are structured as either with-profits products or non-participating (including unit-linked) products. For statutory and management purposes, Prudential Assurance's long-term fund consists of a number of sub-funds in which shareholders and policyholders have varying interests.

With-profits Products

With-profits products provide an equity-type return to policyholders through bonuses that are "smoothed". There are two types of bonuses: "annual" and "final". Annual bonuses, often referred to as reversionary bonuses, are declared once a year and, once credited, are guaranteed in accordance with the terms of the particular product. Unlike annual bonuses, final bonuses are only guaranteed until the next bonus declaration. Final bonuses are only credited on a product's maturity or surrender or on the death of the policyholder. Final bonuses can represent a substantial portion of the ultimate return to policyholders.

With-profits policies are supported by a with-profits fund. Prudential's primary with-profits fund is part of Prudential Assurance's long-term fund. With-profits products provide benefits that are generally

either the value of the premiums paid, less charges, fees and declared bonuses, or the guaranteed death benefit, (plus the bonuses declared). Smoothing of investment returns is an important feature of with-profits products. It is designed to reduce the impact of fluctuations in investment return from year to year and is accomplished predominantly through the level of final bonuses declared.

The return to Prudential's shareholders in respect of with-profits business Prudential writes is currently an amount equal to up to one-ninth of the value of the bonuses Prudential credits or declares to policyholders in that year. Prudential has a large block of in-force with-profits business with varying maturity dates that generates a relatively stable stream of shareholder profits from year to year.

Prudential Assurance's board of directors, with the advice of its appointed actuary, determines the amount of annual and final bonuses to be declared each year on each group of contracts.

When determining policy payouts, including final bonuses, Prudential follows an actuarial practice of considering "asset shares" for specimen policies. Asset shares broadly reflect the value of premiums paid in respect of a policy accumulated at the investment return on the assets Prudential notionally attributes to the policy. In calculating asset shares, Prudential takes into account the following items:

the cost of mortality risk and other guarantees (where applicable),

the effect of taxation,

management expenses, charges and commissions,

the proportion of the amount determined to be distributable to shareholders, and

the surplus arising from surrenders and non-participating business included in the with-profits fund.

However, Prudential does not take into account the surplus assets of the long-term fund, or their investment return, in calculating asset shares. Asset shares are used in the determination of final bonuses together with policyholders' reasonable expectations, the need to smooth claim values and payments from year to year and competitive considerations.

Prudential is required by UK law and regulation to consider the reasonable expectations of its policyholders in setting bonus levels. The concept of policyholders' reasonable expectations is established by statute but is not defined. In practice, it provides one of the guiding principles for decision-making in respect of with-profits products.

The overall return to policyholders is an important competitive measure for attracting new business. The ability to declare competitive bonuses depends, in part, on the financial strength of Prudential Assurance's long-term fund, enabling it to maintain high levels of investment in equities and real estate, if it wishes to do so. Equities and real estate have historically over the long-term provided a return in excess of fixed interest securities.

In 2002, Prudential declared total bonuses of £2,724 million from Prudential Assurance's long-term fund, of which £2,451 million was added to with-profits policies and £273 million was distributed to shareholders. This includes annual bonus rates of 3.25% for the Prudence Bond and 3.5% for personal pensions. In 2001, Prudential declared total bonuses of £3,100 million from Prudential Assurance's long-term fund, of which £2,790 million was added to with-profits policies and £310 million was distributed to shareholders. This included annual bonus rates of 4% for the Prudence Bond and 4.5% for personal pensions. In 2000, Prudential declared total bonuses of £3,103 million, of which £2,796 million was added to with-profits policies and £307 million was distributed to shareholders. This included annual bonus rates of 4.5% for the Prudence Bond and 5% for personal pensions. Along with the rest of the UK insurance industry, Prudential has reduced its bonus rates over the last three years reflecting the lower investment returns expected in the future, and the returns earned by its long-term funds.

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The closed Scottish Amicable Insurance Fund (referred to as SAIF) declared total bonuses in 2002 of £601 million, compared to £690 million in 2001 and £641 million in 2000. Shareholders have no interest in profits from the SAIF fund, although they are entitled to the investment management fees paid by this business. For greater detail on the SAIF fund, see " The SAIF Sub-fund and Accounts" below.

The FSA and HM Treasury are currently conducting independent reviews of with-profits business in the United Kingdom. See "Supervision and Regulation of Prudential UK Supervision and Regulation".

Surplus Assets in Prudential Assurance's Long-term With-profits Fund

In order to support Prudential's with-profits business, Prudential Assurance Company (referred to as PAC) holds a substantial amount of working capital in its long-term with-profits fund. Without such working capital, Prudential could not provide the benefits associated with smoothing and guarantees, or have investment freedom for the primary with-profits fund's assets, for the benefit of both policyholders and shareholders.

To meet PAC's obligations to existing policyholders, it expects to have to pay out, over time, assets equal to policyholders' accumulated "asset shares" plus any additional payments that may be required, by way of smoothing or to meet guarantees. At any time the balance of the PAC long-term with-profits fund, which is not expected to be paid out to the current generation of with-profits policyholders as claim values, represents the major part of Prudential Assurance's working capital and is known as surplus assets or "inherited estate".

To ensure that policyholders' benefits are secure, PAC is required by the regulator to hold a substantial amount of capital in its long-term with-profits fund, so that it can demonstrate at all times that it is solvent and able to meet its obligations to all policyholders. The inherited estate provides most of this solvency capital.

In addition, PAC can use the inherited estate to absorb the costs of significant events, such as fundamental strategic change in its long-term business and, to the extent that the UK regulator is content, the cost of providing redress for past pension mis-selling, without affecting the level of distributions to policyholders and shareholders. The costs of fundamental strategic change may include investment in new technology, redundancy and restructuring costs, cost overruns on new business and the funding of other appropriate long-term insurance related activities including acquisitions.

The size of the inherited estate, by its nature as working capital, fluctuates from year to year depending on investment returns, and the extent to which the capital is required to meet smoothing costs, guarantees and any unforeseen events. Prudential estimates that at December 31, 2002, the inherited estate, after taking into account pension mis-selling costs and anticipated costs of fundamental strategic change, was around £5 billion.

In the normal course of events the inherited estate is required to support the in force business, so neither policyholders nor shareholders can have any expectation that they will receive any distribution of the inherited estate, other than through the normal process of smoothing and meeting guarantees in adverse investment conditions.

However, Prudential believes that it would be beneficial if there were to be greater clarity as to the status of the inherited estate. With that in mind, Prudential has been considering the principles that would apply to any re-attribution of the inherited estate to either policyholders or shareholders. Discussions have been held with the FSA to this end. Prudential has not considered or discussed any actual distribution as its current expectation is that, for the foreseeable future, the entire inherited estate will need to be retained within PAC's long-term with-profits fund to provide working capital. However, in the light of current market conditions the amount and timing of any re-attribution of the estate remains very uncertain.

Depletion of Surplus Assets and Shareholders' Contingencies

As a proprietary insurance company, Prudential remains liable to meet its obligations to policyholders even if the assets of its long-term fund are insufficient to do so. The surplus assets in Prudential Assurance's long-term with-profits fund could be materially depleted over time, by, for example, a further significant or sustained equity market downturn, significant fundamental strategic change costs, or material increases in the pension mis-selling provision. In the unlikely circumstance that the depletion of the surplus assets within the long-term fund was such that Prudential believed that its ability to satisfy policyholders' reasonable expectations was adversely affected, it might become necessary to restrict the annual distribution to shareholders or for Prudential to contribute shareholders' funds to the long-term fund to provide financial support.

The SAIF Sub-fund and Accounts

The SAIF sub-fund is a ring-fenced sub-fund of Prudential Assurance's long-term fund and was formed following the acquisition of the mutual Scottish Amicable in 1997. No new business may be written in SAIF, although regular premiums are still being paid on policies in force at the time of the acquisition and "top-ups" are permitted on these policies.

This fund is solely for the benefit of those Scottish Amicable Life Assurance Society policyholders whose policies were transferred to SAIF. Shareholders have no interest in the profits of this fund, although they are entitled to the investment management fees paid on this business. The brand name and rights to profit on new business were transferred to a new Prudential subsidiary, Scottish Amicable Life plc, which operates for the benefit of shareholders.

At the time of the acquisition, Prudential Assurance's long-term fund made payments of £276 million to the SAIF sub-fund for the unit-linked life business and non-participating life business and the future profits from unitized with-profits life business. Prudential Assurance also agreed to set up a memorandum account of £1.3 billion that is considered in determining SAIF's investment policy. The SAIF sub-fund pays an annual charge to the other part of Prudential Assurance's long-term fund in respect of this memorandum account.

Prudential Assurance's long-term fund made a further payment of £185 million to qualifying Scottish Amicable Life Assurance Society policyholders for the use of the Scottish Amicable brand and future expense synergies. This payment will be recovered by the long-term fund by means of a combination of a service agreement and a license fee agreement with Craigforth Services Limited, a shareholder-owned service company set up at the time of the acquisition.

In addition to the payments described above, shareholders paid £415 million to qualifying Scottish Amicable Life Assurance Society policyholders, representing goodwill, and £70 million for certain Scottish Amicable Life Assurance Society strategic investments.

The SAIF sub-fund has been unaffected by the decision to no longer sell under the Scottish Amicable brand. See " UK Restructurings".

Non-participating Business

The majority of Prudential-branded non-participating business is written in Prudential Assurance's long-term fund or by subsidiaries owned by the fund. Prudential's principal non-participating business is Prudential Annuities Limited. The profits on this business are attributable to the fund and not to shareholders, although indirectly shareholders get one ninth of additional amounts paid to policyholders. In 2001, Prudential started to write new bulk annuity and individual external annuity business through Prudential Retirement Income Limited (referred to as PRIL), from which the profits are attributed solely to shareholders.

The unit-linked business written by Scottish Amicable Life plc (which was transferred into Prudential Assurance on December 31, 2002) and Prudential International Assurance is written with capital provided by shareholders. All profit from these businesses is attributed to shareholders.

Compliance

From December 1, 2001, the FSA took formal responsibility for the regulation and supervision of all Prudential's authorized UK insurance, investment and banking businesses under the Financial Services and Markets Act 2000, described in greater detail under " Supervision and Regulation of Prudential UK Supervision and Regulation".

Within Prudential's UK businesses, matters arise from time to time as a result of inspection visits or other regulatory activity, which need to be discussed or resolved with the regulators. At any one time, there are a number of these issues and Prudential ensures that programs of corrective activity are discussed and agreed with the regulator, that such programs are properly planned, managed and resourced (using external resources as necessary), that, where appropriate, policyholders who have been disadvantaged are properly compensated and that progress is reported to the regulators on a regular basis. The issues currently affecting Prudential are set out below. Some of these are industry-wide.

Mortgage Endowment Products Review

One industry issue concerns low-cost endowments related to repayment of residential mortgages. At sale, the initial sum assured is set at a level such that the projected benefits, including an estimate of the annual bonus receivable over the life of the policy, and allowing for an estimate of the expenses to be charged, will equal or exceed the mortgage debt. Because of a decrease in expected future investment returns since relevant policies were sold, the UK regulator is concerned that the maturity value of some policies will be less than the mortgage debt. The UK regulator has worked with industry representatives to devise a program whereby companies will write to customers indicating if they may have a possible shortfall, and outline the actions customers can take to prevent this possibility.

Prudential's main exposure to mortgage endowment products is through business written by Scottish Amicable. The FSA issued a report in March 2001 raising concerns regarding Scottish Amicable's conduct of sales of these products by its tied agents and in March 2003 it fined Scottish Amicable £750,000 in respect of cases where advisers did not place appropriate emphasis on identifying whether a customer was prepared to take the risk that their mortgage might not be repaid at the end of the term. A provision of £25 million was made in 2001 in the shareholders' fund for cases that may require redress, which the directors are satisfied continues to be adequate. The costs of the fine and policyholder redress will be met from this provision. Scottish Amicable withdrew from the mortgage endowment product market in April 2001 and disbanded its network of tied agents in October 2001. No provision is required in respect of mortgage endowments sold by PAC.

Pension Mis-selling

In 1988, the UK government introduced new pensions legislation intended to encourage more individuals to make their own arrangements for their pensions. During the period from April 1988 to June 1994, many individuals were advised by insurance companies, IFAs and other intermediaries not to join, transfer from, or opt out of their occupational pension schemes in favor of private pension products introduced under the UK Income and Corporation Taxes Act 1988. The UK insurance regulator (previously the Personal Investment Authority, now the FSA) subsequently determined that many individuals were incorrectly advised and would have been better off not purchasing the private pension products sold to them. Industry participants are responsible for compensating the persons to whom private pensions were mis-sold. As a result, the UK regulator has required all UK life insurance companies to review their potential cases of pension mis-selling and pay compensation to policyholders where necessary and, as a consequence, record a provision for the estimated costs. Prudential met the requirement of the FSA to issue offers to all Phase 1 (priority) cases and Phase 2 (non-priority) cases by June 30, 2002.

Provisions in respect of the costs associated with the review have been included in the change in the long-term technical provision in Prudential's profit and loss account. Within the long-term technical provisions, the transfer from the FFA has been determined accordingly. See Item 5 "Operating and Financial Review and Prospects Analysis by Geographic Region Fund for Future Appropriations" for more information on the FFA. Prudential established an initial provision in 1994 that was increased to £1,700 million by January 1, 2000. Subsequent movements in the pension mis-selling provision, including internal and external legal and administrative costs, have been as follows:

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Balance at January 1	**1,065**	1,475	1,700
Changes to actuarial assumptions and method of calculation	**(50)**	(89)	(117)
Increase in provision for administrative expenses			50
Discount accretion	**53**	89	102
Redress to policyholders	**(292)**	(273)	(134)
Payments of administrative expenses	**(46)**	(137)	(126)
Balance at December 31	**730**	1,065	1,475

In 2002, the provision for pension mis-selling decreased by £335 million as well as decreasing by £410 million and £225 million in 2001 and 2000, respectively. The reasons for this movement are highlighted below.

In 2002, 2001 and 2000, the provision was decreased by £50 million, £89 million and £117 million, respectively, to reflect changes in the method of calculation resulting from new requirements issued by the UK regulator and changes in the interest rate and mortality assumptions used.

The increase in the provision for administrative expenses of £50 million in 2000 reflected the additional administrative costs to be incurred predominantly due to the shortening of Prudential's deadline for completing the Phase 2 cases by the UK regulator from December 2004 to June 2002.

The pension mis-selling provision represents the discounted value of future expected payments and, as a consequence, to the extent that amounts have not been paid, the provision increases each year reflecting the shorter period of the discount. The increase in the provision relating to the accretion of the discount amounted to £53 million in 2002, £89 million in 2001 and £102 million in 2000.

Management believes that, based on current information, the pension mis-selling provision, together with future investment return on the assets backing the provision, will be adequate to cover the costs of pension mis-selling as well as the costs and expenses of Prudential's pension review unit established to identify and settle such cases. Such provision presents the best estimate of probable costs and expenses. However, there can be no assurance that the current provision level will not need to be increased.

The calculation of the pension mis-selling provision is dependent upon a number of assumptions and requirements provided by the FSA. The costs associated with the pension mis-selling review have been met from Prudential Assurance's inherited estate. Given the strength of Prudential Assurance's with-profits fund, management believes that charging the costs to the inherited estate will not have an adverse effect on the level of bonuses paid to policyholders or on their reasonable expectations. In the unlikely event of this proving not to be the case, an appropriate contribution to the with-profits fund would be made from the shareholders' funds. In view of the uncertainty, it is not practicable to estimate the level of any potential contribution.

Free Standing Additional Voluntary Contribution Business

In February 2000, the UK regulator ordered a review of Free Standing Additional Voluntary Contribution ("FSAVC") business, which constitutes sales of personal pensions to members of company pension schemes. Individuals who have purchased these pensions instead of the Additional Voluntary Contributions ("AVC") scheme connected to their company's pension scheme may have been in a better financial position investing their money and any matching contributions from their employers in their company's AVC scheme. The UK regulator's review is to ensure that any employees disadvantaged due to not being properly informed of the benefits foregone from not investing in their AVC scheme are compensated.

The review requires companies to identify relevant investors and contact them with an offer to review their individual case. Prudential met an interim deadline set by the FSA of 90% of cases completed by June 30, 2002 and also the deadline for 100% completion by December 31, 2002. As a result of the review, Prudential held a provision of £3 million at December 31, 2002.

Guaranteed Annuities

In common with several other UK insurance companies, Prudential Assurance used to sell guaranteed annuity products in the United Kingdom and held a provision of £46 million at December 31, 2002 within the primary with-profits fund to honor guarantees on these products. Prudential's main exposure to guaranteed annuities in the United Kingdom is through the SAIF Fund and a provision of £744 million was held in SAIF at December 31, 2002 to meet the anticipated cost of the guarantees. As SAIF is a separate ring-fenced sub-fund of the Prudential Assurance long-term fund, this provision has no impact on shareholders. See "   The SAIF Sub-fund and Accounts".

US Business

Prudential conducts its US insurance operations through Jackson National Life Insurance Company and its subsidiaries. The US operations also include PPM America, Prudential's US internal and institutional fund manager, Prudential's US broker-dealer operations (National Planning Corporation, SII Investments, Inc., IFC Holdings, Inc. and Investment Centers of America, Inc.) and Jackson Federal Bank, Prudential's savings and loan institution. At December 31, 2002, Prudential's US operations had approximately 1.5 million policies and contracts in effect and PPM America managed some US$62 billion of assets. In 2002, total new business premiums were £5,757 million and statutory operating profit before amortization of goodwill and tax was £153 million.

US Market Overview

The United States is the world's largest life insurance market in terms of premiums. Many of the factors that have affected the UK life insurance market in recent years, such as an ageing population, have also affected the US market. Uncertainties surrounding the adequacy of public and private pensions benefits are increasing the incentive to fund a secure retirement privately, and the demand for income products is also expected to increase as the baby boomer generation and its parents age.

Despite favorable demographics, the US insurance industry faces a number of challenges, both from within and outside the industry. The life insurance business is projected to grow only slowly, if at all, and competition is fierce. While the growth prospects for the annuity industry are more favorable, there are many players fighting for market share. Likewise, there is competition for retirement savings from other financial services providers, in particular, mutual fund companies and banks.

There has been increasing convergence among US retail financial services providers as regulatory barriers have begun to erode and competition in the US life insurance industry has increased. Overcapacity in the industry generally has also contributed to competitive pricing and fueled consolidation, presenting opportunities to companies with financial strength and below industry-average cost structures.

The US investment markets experienced two years of unusually poor returns in 2001 and 2002, with equity markets suffering significant declines and bond defaults reaching record levels. Like its competitors, Jackson National Life was affected by these market forces. However, long-term demographic trends in the United States are favorable and Jackson National Life has continued to develop and enhance its product range and distribution channels to ensure that it is well placed to benefit from the anticipated growth in the US financial services market.

Products

The demographic factors described above, as well as the increased reliance on defined contribution plans (such as 401(k) plans) have resulted in a shift in the financial services market. This shift has been away from risk protection products, such as traditional life insurance, to tax deferred savings (or asset accumulation) products, such as fixed and variable annuities. These products tend to be spread or fee-based and have accounted for a significant portion of the growth in the US insurance industry in recent years.

When life insurance and annuity products initially became popular in the United States, they were interest-rate based and provided a minimum guaranteed rate of return. However, declining interest rates eroded the after-tax benefits of these products. Meanwhile, during the 1990s there was significant growth in equity markets. As a result, equity-based and equity-linked products, with and without guarantees, became increasingly important product offerings. Reflecting this shift, industry sales of individual variable annuity products grew from $29 billion in 1992 to $128 billion in 2000, a compound

annual growth rate of 20.7%. During the same period, industry individual variable annuity assets grew from $212 billion to $971 billion, a compound annual growth rate of 20.9%.

The mutual fund industry also benefited from the shift to equity-based products. The strong equity markets in the late 1990s fueled growth in assets under management, both through investment returns and increased contributions from the retail sector. In particular, fund managers with strong brands and investment performance provided strong competition for individuals' retirement savings.

The above trends reversed in 2001 when, for the first time in twelve years, industry-wide variable annuity sales did not increase. In 2002, annuity providers continued to face the challenges of the previous year. By year-end, the S&P 500 and NASDAQ Composite Indices had declined from their year 2000 peaks by 40% and 67%, respectively. In these volatile equity markets, annuity sales have been a clear illustration of a flight to safety. In 2002, total industry individual annuity sales increased by 20% to $223 billion, with the bulk of the increase coming from a continuing surge in fixed annuity sales. Nevertheless, variable annuity sales managed some increase in 2002, with significant amounts going to fixed account options.

Distribution

Traditionally, insurance companies distributed their products through career or independent agencies. The career agencies typically received office space, training and administrative support from the sponsoring insurance company in return for directing a significant portion of their business to them. Independent agencies may receive some support from a specific insurance company, but are typically not required to specifically sell their products. The independent agencies have the ability to sell products from any insurance company.

In contrast, broker-dealers are licensed to sell products regulated by the Securities and Exchange Commission, such as variable annuities. Broker-dealers maintain "panels" of preferred providers for each type of product. Broker-dealers are often organized into firms and networks typically depending on size and function. These consist of large broker-dealers specializing in security sales and underwriting, regional broker-dealers who sell securities and perform some underwriting functions, and independent broker-dealers who primarily specialize in financial planning activities. Recently, there has been an industry trend towards insurance companies owning financial planner broker-dealers.

The regional broker-dealer channel focuses on firms with captive agents in a specific region of the United States. Distribution is through branch offices with an average of 10 to 15 brokers per office.

Until recently, regulatory barriers prohibited banks from developing and selling their own insurance products. Banks have therefore generally developed favorable supplier relationships with insurance companies and distributed their products through bank branches. These barriers to entry have begun to diminish, and companies are developing the bancassurance model in the US market.

Direct distribution is relatively mature in the United States. Consumers are accustomed to purchasing less complex retail financial products remotely, both by telephone and via the internet. The mutual fund providers have led this expansion within the retail financial services industry, setting the standard for cost structure and service.

The Registered Investment Advisor (referred to as RIA) market began as a service offered to very high-net worth investment clients, focusing on platforms rather than specific products, and providing institutional-quality management, custom portfolios, and tax services. The industry has evolved to offer personalized investment advice, very high quality money management, good returns, and reasonable costs to a broader range of clients.

Jackson National Life

Jackson National Life is a leading provider of long-term savings and retirement products to retail and institutional customers throughout the United States. Jackson National Life offers variable annuities, equity-indexed annuities, individual fixed annuities, life insurance and stable value products. By developing and offering a wide variety of products, Jackson National Life believes that it has positioned itself to compete effectively in various stock market and interest rate environments. Jackson National Life markets its retail products through various distribution channels, including independent agents, broker-dealer firms (including financial planners), regional broker-dealers and banks.

The interest-sensitive fixed annuities, equity-indexed fixed annuities, immediate annuities and life insurance products are sold through independent agents, broker-dealers and banks. For variable annuity products, which can only be sold through broker-dealers licensed by the US National Association of Securities Dealers, Jackson National Life has selling agreements with such firms and is continuing to focus on its own broker-dealer distribution channel. Its group pension department sells stable value products. In early 2003, Jackson National Life commenced operating in the RIA channel, with the launch of Curian Capital, LLC. See " Curian Capital, LLC".

Products

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

	Year Ended December 31,			Policyholder Reserves At December 31, 2002
	2002	**2001**	**2000**	
		(In £ Millions)		
By Product				
Annuities				
Fixed annuities				
Interest-sensitive	**2,647**	1,812	985	**12,578**
Equity-indexed	**254**	271	409	**1,674**
Immediate	**61**	87	71	**703**
Variable annuities	**1,363**	768	1,709	**4,100**
Total	**4,325**	2,938	3,174	**19,055**
Life insurance	**22**	22	25	**3,106**
Stable value products				
GICs and funding agreements	**292**	170	365	**1,620**
Medium term note funding agreements	**1,118**	1,504	1,291	**3,553**
Total	**1,410**	1,674	1,656	**5,173**
Total	**5,757**	4,634	4,855	**27,334**
By Distribution Channel				
Independent agents	**1,443**	1,139	1,099	
Bank	**1,568**	1,052	631	
Broker-dealer	**1,336**	769	1,469	

	Year Ended December 31,		
Group pension department	**1,410**	1,674	1,656
	5,757	4,634	4,855

Annuities

Fixed Annuities

Interest-sensitive Annuities

In 2002, interest-sensitive fixed annuities accounted for 46% of total new business premiums and 46% of policyholder reserves of the US operations. Interest-sensitive fixed annuities are primarily deferred annuity products that are used for retirement planning and for providing income in retirement. They permit tax-deferred accumulation of funds and flexible payout options.

The policyholder of an interest-sensitive fixed annuity pays Jackson National Life a premium which is credited to the policyholder's account. Periodically, interest is credited to the policyholder's account and in some cases administrative charges are deducted from the policyholder's account. Jackson National Life makes benefit payments at a future date as specified in the policy based on the value of the policyholder's account at that date.

The policy provides that at Jackson National Life's discretion it may reset the interest rate, subject to a guaranteed minimum. The minimum guarantee is not less than 3%, but for some older business it may be higher. In addition, Jackson National Life also offers multi-year guaranteed products.

When the annuity matures, Jackson National Life either pays the amount in the policyholder's account to the policyholder or begins making payments to the policyholder in accordance with the policyholder's instructions. Fixed annuity policies provide for surrender charges to be assessed on surrenders generally for the first seven to nine years of the policy.

Approximately 40% of the interest-sensitive fixed annuities Jackson National Life wrote in 2002 provide for an adjustment, referred to as a market value adjustment, on surrenders in the surrender period of the policy, typically for the first nine years. This adjustment does not depend on the performance of specific assets (as in a variable annuity), but is linked to a formula that helps to match the surrender value to the value of the accumulation account at the time of surrender. The minimum guaranteed rate is not affected by this adjustment.

Jackson National Life bears the investment and surrender risk on interest-sensitive fixed annuities, and its profits come from the spread between the yield on investments and the interest credited to policyholders (net of any surrender charges or market value adjustment) less initial and recurring expenses.

Equity-indexed Annuities

Jackson National Life maintained a top six market position in the sale of equity-indexed annuities in the United States for the year ended December 31, 2002. During 2002, equity-indexed annuities accounted for 4% of total new business premiums and 6% of policyholder reserves of US operations.

Equity-indexed annuities are deferred annuities that enable policyholders to obtain a portion of an equity-linked return but provide a guaranteed minimum return. Jackson National Life guarantees an annual minimum interest rate of 3%, but actual earnings may be higher and are based on a participation (referred to as the index participation rate) in an equity index over its indexed option period. Jackson National Life may reset the index participation rate for each premium deposit. The participation rate set applies for the term selected.

Jackson National Life hedges the equity return risk on equity-indexed products by purchasing futures and options on the relevant index. The cost of these hedges is taken into account in setting index participation rates. Recent volatility in the equity markets combined with lower bond yields has increased the cost of these hedges. In response, Jackson National Life has reduced its index participation rates on new business and developed new products with index participation rates that are less sensitive to changes in these variables.

Jackson National Life bears the investment and surrender risk on equity-indexed fixed annuities. Profit arises from the difference between the premiums received plus the associated investment income, and the combined cost of expenses (general expenses, costs of purchasing fixed interest securities and options) and the policyholder's benefit (subject to the minimum guarantee).

Immediate Annuities

In 2002, immediate annuities accounted for 1% of total new business premiums and 3% of policyholder reserves of US operations. Immediate annuities guarantee a series of payments beginning within a year of purchase and continuing over either a fixed period of years and/or the life of the policyholder. If the term is for the life of the policyholder, then Jackson National Life's primary risk is mortality risk. This product is generally used to provide a guaranteed amount of income for policyholders and is used both in planning for retirement and in retirement itself. The implicit interest rate on these products is based on the market conditions that exist at the time the policy is issued and is guaranteed for the term of the annuity.

Variable Annuities

Jackson National Life began offering variable annuity products in 1995. In 2002, variable annuities accounted for 24% of total new business premiums and 15% of policyholder reserves of US operations. Variable annuities are deferred annuities that have the same tax advantages and payout options as interest-sensitive and equity-indexed fixed annuities. They also are used for retirement planning and to provide income in retirement.

The primary differences between variable annuities and interest-sensitive and equity-indexed fixed annuities are investment risk and return. If a policyholder chooses a variable annuity, the rate of return will depend upon the performance of the underlying fund portfolio. The policyholder bears the investment risk except for fixed account options, where Jackson National Life guarantees a minimum fixed rate of return. In most cases, variable annuities also offer various types of elective enhanced death benefits, guaranteeing that on death the policyholder receives a minimum value regardless of past market performance. These guaranteed death benefits might be expressed as the highest past anniversary value of the policy, or as the original premium accumulated at a fixed rate of interest.

Jackson National Life credits premiums on variable annuities to a separate account or to the fixed account, depending on the policyholders' elections. The policyholders determine how the premiums will be allocated by choosing to allocate all or a portion of their accounts either to a variety of variable sub-accounts, with a choice of investment managers, or to guaranteed fixed-rate options. As expected in volatile equity markets, in 2002 a significant proportion of Jackson National Life's variable annuity investors elected the fixed account option, with 58% of 2002 variable annuity sales going into fixed accounts. The value of the portion of the separate account allocated to variable sub-accounts fluctuates with the underlying investment. Jackson National Asset Management, LLC (a subsidiary of Jackson National Life) earns fee income as the investment adviser for the underlying funds and has retained the services of a number of other investment advisers to act as sub-advisers to Jackson National Asset Management, LLC.

Variable annuity products are backed by specific assets that are held in a separate account. The assets in this separate account are "segregated" pursuant to state insurance law and do not form part of the assets in the US general account, which backs the remainder of the insurance business in the United States. Amounts held in the separate account are not chargeable with liabilities arising out of any other business Jackson National Life may conduct. All of the income, gains or losses from these assets less

specified management charges are credited to or against the policies and not any other policies that Jackson National Life may issue.

Jackson National Life earns fee income on the underlying separate account investment, earns profits from the spread between what it earns on investments backing the fixed rate accounts and the interest credited, and earns fee income for certain additional guarantees in the contract.

Life Insurance

Reflecting the competitive life insurance market place and the overall trend towards asset accumulation products, Jackson National Life's life insurance products accounted for less than 1% of the total new business premiums and 11% of policyholder reserves of US operations in

2002. The products offered include term life insurance and interest-sensitive life insurance. Each of these types of insurance policies can be modified using several options and riders to provide particular benefits, including waiver of premium, accidental death benefit and supplemental term insurance.

Stable Value Products

Stable value products consist of guaranteed investment contracts (GICs), funding agreements and medium term note funding agreements. In 2002, stable value products accounted for 24% of total new business premiums and 19% of policyholder reserves of US operations. Jackson National Life began marketing GICs to institutional investors in December 1995. The GICs are marketed by its group pension department to defined contribution pension and profit-sharing retirement plans. Funding agreements are marketed to institutional investors, including corporate cash accounts and securities lending funds, as well as money market funds. Sales of stable value products decreased in 2002, reflecting Jackson National Life's primary focus on retail sales throughout the year which are expected to continue in 2003. At December 31, 2002, Jackson National Life was a top ten provider of stable value business in terms of sales.

Three types of stable value products are offered:

- traditional GICs,
- funding agreements, and
- medium term note funding agreements.

Traditional Guaranteed Investment Contracts

Under a traditional GIC, the policyholder makes a lump sum deposit. Interest is paid on the deposited funds, usually on a quarterly basis. The interest rate paid is fixed and is established when the contract is issued.

Traditional GICs have a specified term, usually two to three years, and typically provide for phased pay outs. Jackson National Life tailors the scheduled pay outs to meet the liquidity needs of the particular retirement plan. If deposited funds are withdrawn earlier, an adjustment is made that approximates a market value adjustment.

Jackson National Life sells GICs to retirement plans, in particular 401(k) plans. The traditional GIC market is extremely competitive. This is due in part to competition from synthetic GICs.

Funding Agreements

Under a funding agreement, the policyholder either makes a lump-sum deposit or makes specified periodic deposits. Jackson National Life agrees to pay a rate of interest, which may be fixed but which is usually a floating short-term interest rate linked to an external index. Interest is paid quarterly to the

policyholder. The average term for the funding agreements is one to two years. At the end of the specified term, policyholders typically re-deposit the principal in another funding agreement. Jackson National Life makes its profit on the spread between the yield on its investment and the interest rate credited to policyholders.

Typically, brokerage accounts and money market mutual funds are required to invest a portion of their funds in cash or cash equivalents to ensure sufficient liquidity to meet their customers' requirements. The funding agreements permit termination by the policyholder on 7 to 90 days' notice, and thus qualify as cash equivalents for the clients' purposes. Funding agreements terminable by the policyholder with less than 90 days' notice account for less than 2% of Jackson National Life's total policyholder reserves.

Medium Term Note Funding Agreements

Jackson National Life has also established european and global medium-term note programs that access new markets for Prudential. The notes offered may be denominated in any currency. Notes are issued to institutional investors by a special purpose vehicle and are secured by funding agreements issued by Jackson National Life.

Distribution and Marketing

Jackson National Life distributes products in all 50 states of the United States and in the District of Columbia, although not all products are available in all states. Operations in the State of New York are through a New York insurance subsidiary.

Jackson National Life has focused on independent distribution systems and has avoided the fixed costs associated with recruiting, training and maintaining employee agents. It supports its network of independent agents and brokers with education and training programs. A substantial portion of the costs associated with generating new business are not fixed costs but vary directly with the level of business produced. As a result, industry figures show that the costs are low relative to other US insurers.

Jackson National Life offers internet-based support to its broker-dealers. It continues to expand its internet-based services, increasing amounts of information available for both customers and agents.

Independent Agents

The insurance and fixed annuity products are distributed through independent agents located throughout the United States. These 35,000 licensed insurance agents or brokers, who also may represent other companies, are supported by five regional marketing offices. Jackson National Life has continued to review its ranks of licensed agents during 2002, actively identifying non-performing agents and not relicensing them. This initiative is aimed at improving Jackson National Life's ability to service its top agents and assist them in increasing their productivity. Jackson National Life generally deals directly with writing agents and brokers thereby eliminating intermediaries, such as general agents. This distribution channel, called "Deal Direct", has enabled it to generate significant volumes of business on a low, variable cost basis.

Jackson National Life is responsible for providing agents with product information and sales materials.

Broker-Dealers

Jackson National Life Distributors, Inc., a broker-dealer, is the primary wholesale distribution channel for the variable annuity products. Jackson National Life Distributors also sells equity-indexed annuities and fixed annuities. An internal network of wholesalers supports this distribution channel. These wholesalers meet directly with broker-dealers and financial planners and are supported by an extensive

home office sales staff. There are more than 700 active selling agreements with regional and independent broker-dealer organizations throughout the United States. These selling agreements provide Jackson National Life with access to more than 25,000 registered representatives.

In January 2002, Jackson National Life opened a new wholesale distribution channel servicing the regional broker-dealer distribution channel. Jackson National Life is well suited to provide the type of customized sales attention required for this channel, with the emphasis being on providing dedicated, specialized sales support, continuing education and tailored marketing solutions.

Jackson National Life is responsible for training its broker-dealers, providing them with product information and sales materials and monitoring their activities from a regulatory compliance perspective.

Banks, Credit Unions and Other Financial Institutions

Jackson National Life's Institutional Marketing Group distributes its annuity products through banks, credit unions and other financial institutions and through third-party marketing organizations that serve these institutions. Jackson National Life is a leading provider of annuities offered through banks and credit unions and can access over 19,000 financial institution representatives through existing relationships with banks and credit unions. Jackson National Life has established distribution relationships with medium-sized regional banks, which it believes are unlikely to develop their own insurance product capability.

Independent Broker-Dealers

JNL's retail distribution is managed by its independent broker-dealer network, National Planning Holdings ("NPH"), which is made up of four firms. In September 2000, Jackson National Life acquired IFC Holdings, Inc., which included INVEST Financial Corporation and Investment Centers of America, Inc. Together with National Planning Corporation and SII Investments, Inc., Jackson National Life's existing broker-dealer group, it has contracts with more than 2,600 registered representatives.

Curian Capital, LLC

Commencing operation in early 2003, Curian Capital, LLC (Jackson National Life's RIA channel) provides innovative fee-based separately managed accounts and investment products to advisers through a state-of-the-art technology platform.

The RIA industry began as a service offered to very high-net worth investment clients, focusing on platforms rather than specific products, and providing institutional-quality management, custom portfolios, and tax services. The industry has evolved to offer personalized investment advice, very high quality money management, good returns, and reasonable costs to a broader range of clients.

Group Pension Department

Jackson National Life markets its stable value products through its group pension department. It has direct contacts with banks, municipalities, asset management firms and direct plan sponsors. Stable value products are distributed and marketed through intermediaries to these groups.

Factors Affecting Pricing of Products and Asset Liability Management

Jackson National Life prices products based on assumptions about future mortality, investment yields, expenses and persistency. Pricing is influenced by competition and by its objectives for return on capital. Although Jackson National Life includes a profit margin in the price of its products, the variation between the assumptions and actual experience can result in the products being more or less profitable than it was assumed they would be. This variation can be significant.

Jackson National Life designs its interest-sensitive products and conducts its investment operations to match closely the duration of the assets in its investment portfolio with the annuity, whole life, universal life and guaranteed investment contract product obligations. Jackson National Life seeks to achieve a target spread between what it earns on its assets and what it pays on its liabilities by investing principally in fixed-rate securities and in options to match the equity-related returns under its equity-indexed products.

Jackson National Life segregates its investment portfolio for certain investment management purposes and as part of its overall investment strategy into four portfolios: annuities without market value adjustment, fixed annuities with market value adjustment, equity-indexed annuities and stable value liabilities. The portfolios backing fixed annuities with and without market value adjustments have similar characteristics and differ primarily in duration. The portfolio backing the stable value liabilities has its own mix of investments that meet more limited duration tolerances. Consequently, the stable value portfolio is managed to permit less interest rate sensitivity and limited exposure to mortgage-backed securities. At December 31, 2002, 5.3% of the stable value portfolio was invested in residential mortgage-backed securities.

The fixed-rate products may incorporate surrender charges, market value adjustments, two-tiered interest rate structures or other limitations relating to when policies can be surrendered for cash, in order to encourage persistency. At December 31, 2002, approximately 76% of Jackson National Life's fixed annuity reserves had surrender penalties or other withdrawal restrictions, up 3% from 2001 due to high sales levels in 2002. Substantially all of the stable value portfolio had withdrawal restrictions or market value adjustment provisions.

Underwriting

The decision to underwrite a particular life policy depends upon the assessment of the risk to Jackson National Life represented by the proposed policy. The risk selection process is performed by the underwriters who evaluate policy applications on the basis of information provided by the applicant and other sources. Specific medical tests may be used to evaluate policy applications based on the size of the policy, the age of the applicant and other factors.

Jackson National Life's underwriting rules and procedures are designed to produce mortality results consistent with the assumptions used in product pricing while providing for competitive risk selection.

Reserves

Jackson National Life uses reserves established on a US GAAP basis as the basis for consolidation into Prudential's UK GAAP accounts.

For the fixed and variable annuity contracts and stable value products, the reserve is the policyholder's account value. For the immediate annuities, reserves are determined as the present value of future policy benefits. Mortality assumptions are based on the 1983a Individual Annuitant Mortality Table. Interest rate assumptions currently range from 3.0% to 7.5%.

For the traditional term life contracts, reserves for future policy benefits are determined using the net level premium method and assumptions as to mortality, interest, policy persistency and expenses. Mortality assumptions are generally from 50% to 90% of the 1975-1980 Basic Select and Ultimate tables, depending on underwriting classification and policy duration. Interest rate assumptions range from 6.0% to 8.4%. Persistency and expense assumptions are based on Jackson National Life's experience.

For the interest-sensitive life reserves and single premium life reserves, reserves approximate the policyholder's account value.

Reinsurance

Jackson National Life reinsures portions of the coverage provided by its insurance products with other insurance companies under agreements of indemnity reinsurance. Reinsurance assumed from other companies is not material.

Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to obtain a greater diversification of risk for the life insurer. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured. Jackson National Life's reinsured business is ceded to numerous reinsurers and the amount of business ceded to any one reinsurer is not material. Typically, the reinsurers have a rating of A or higher.

Jackson National Life limits the amount of risk it retains on new policies. Currently, the maximum risk that is retained on new policies is $1.0 million ($1.5 million on last survivor life business). Jackson National Life is not a party to any risk reinsurance arrangement with any reinsurer pursuant to which the amount of reserves on reinsurance ceded to such reinsurer equals more than 1% of total policy reserves.

Beginning in late 1995, Jackson National Life entered into reinsurance agreements to cede 80% of its new level premium term life insurance business written in the United States to take advantage of competitive pricing in the reinsurance markets. Beginning January 1, 1999, it began to cede 90% of new writings of level premium term products. Jackson National Life intends to continue to cede a significant proportion of new term life insurance business for as long as pricing in the reinsurance markets remains favorable.

Effective December 31, 2002, Jackson National Life ceded the guaranteed minimum death benefit coverage associated with variable annuities to an affiliate, Prudential Atlantic Reinsurance Company, Dublin, Ireland.

Policy Administration

Jackson National Life provides a high level of administrative support for both new and existing policyholders. Jackson National Life's ability to implement new products quickly and provide customer service is supported by integrated computer systems that propose, issue and administer complex life-insurance and annuity contracts. Jackson National Life continues to develop its life insurance administration and underwriting systems and its fixed and variable annuity administration systems to enhance the service capabilities for both new and existing policies.

Jackson Federal Bank

Prudential further diversified its business in the United States through the purchase in 1998 of a federally chartered savings association, First Federal Savings and Loan Association of San Bernardino, which is now called Jackson Federal Bank. The addition of a federally chartered savings association has resulted in an expanded product range in the United States and gives Jackson National Life the option to roll out a wider range of banking products including loans, checking accounts and credit cards. In 2000, Jackson National Life further expanded its banking operations in the United States. In February 2000, Jackson National Life announced the acquisition of three Fidelity Federal Branches and in September 2000, Jackson National Life acquired Highland Bancorp Incorporated, the holding company for Highland Federal Bank, for $110 million. Highland Federal Bank and the three Fidelity Federal Branches were merged with and renamed as Jackson Federal Bank. At

December 31, 2002, assets totaled $1.6 billion (£1.0 billion).

Jackson Federal Bank, through its 15 retail branch offices located throughout the counties of Los Angeles, Orange and San Bernardino in Southern California, attracts deposits which together with borrowings and other funds provide loans secured by real estate and, to a lesser extent, purchase real

estate related investment securities. Deposit accounts at December 31, 2002 totaled $1.0 billion (£0.6 billion).

Jackson Federal Bank's asset growth is primarily derived from multifamily and commercial real estate loans originated through seven offices, loan purchases and purchases of mortgage-backed securities. At December 31, 2002, loans receivable totaled $1.1 billion (£0.7 billion).

PPM America

PPM America is Prudential's US fund management operation, with offices in Chicago and New York. Its primary focus is to manage funds for Jackson National Life and therefore the majority of funds under management are fixed interest in nature. PPM America has also launched a number of institutional high yield and special investment vehicles to leverage these capabilities into new profitable areas.

Asian Business

Prudential is Europe's leading life insurer operating in Asia in terms of geographic coverage and number of operations, with eight top five new business life market shares in 2002. Starting with a solid base of three established operations in Singapore, Hong Kong and Malaysia, since 1994 Prudential has followed a clear, value creating strategy of entering new markets, building and diversifying distribution and launching innovative products by targeting profitable market segments.

Prudential has operations in 12 countries in Asia offering principally life insurance with some accident and health options, personal lines property and casualty insurance and also mutual funds. The product range is tailored to suit the individual country markets, with insurance products distributed mainly through its 89,000 strong agency sales-forces and 18 complementary bancassurance agreements, while the majority of mutual funds are sold through banks and brokers.

Prudential has over four million customers in Asia and a very strong customer focused culture. While the trading name used depends upon the local market, the businesses are unified under the Prudence icon and a common brand architecture.

The majority of Prudential's operations are wholly owned or, in the case of the Hong Kong life operations, are a branch of Prudential Assurance. However, Prudential does have joint ventures with some of the region's leading financial institutions including CITIC (China International Trust and Investment Corporation), Bank of China International in Hong Kong and India's ICICI Bank.

Prudential's strategy in Asia is to build a material and securely profitable business that is sustainable over the long term through focusing on markets where there is high potential for retail medium to long term savings ("MLTS").

Development of Prudential's Asian Business

Prudential's Asian operations are managed by its Hong Kong-based regional head office. Prudential's operations in Asia date from 1923, when it opened a branch office in India, which served the Indian sub-continent and several Middle Eastern countries with historic ties to the United Kingdom. In 1924, Prudential opened a branch office in Malaysia. Prudential expanded into Singapore in 1931 and opened a branch office in Hong Kong in 1964. In 1956, Prudential's Indian operations were nationalized and, in 1984, the Malaysian government required Prudential to sell a majority interest in its Malaysian operations to a local company. A majority share of the Malaysian operations was then reacquired in 1998. A group strategy review in the early 1990s identified significant opportunities for Prudential in the Asian life sector and Prudential Corporation Asia (referred to as PCA) was established in 1994 to develop a material and profitable Asian business.

During 1995 and 1996, PCA entered Thailand and Indonesia through acquisitions and launched a greenfield operation in the Philippines. These were followed by re-entry into India with a joint venture mutual fund operation in 1998, the acquisition of a Taiwanese life insurance operation and the launch of a greenfield life insurance operation in Vietnam in 1999. In 2000, PCA acquired a mutual fund business in Taiwan, launched greenfield life insurance operations in China and India and established a joint venture in Hong Kong for the Mandatory Provident Fund ("MPF") and mutual funds.

PCA continued its geographic expansion in 2001 with acquisitions of small, but financially and operationally sound life companies in Japan and South Korea. Also in 2001, PCA acquired Allstate's small operations in Indonesia and the Philippines. Most recently, in June 2002, PCA acquired ING's small life operation in the Philippines and in October 2002 acquired Good Morning ITMC, a mid-sized South Korean mutual fund operation.

PCA has also launched greenfield mutual fund operations in Japan, Singapore and Malaysia and has recently had its composite insurance licences in Singapore and Malaysia reactivated.

Prudential believes the key ingredients for the long-term Asian growth model are firmly in place: high population densities, high personal savings rates, improving education levels, increasingly entrepreneurial environment, rapid urbanisation and deregulation. Prudential continues to support the long-term growth prospects of PCA in Asia.

PCA's strategic themes are to:

- build profitable scale in the markets that will make up the largest share of its profitability in the long-term: Taiwan, Japan, Korea, Hong Kong and mainland China,
- continue its core distribution strategy of building agency distribution in all markets, with a strong emphasis on productivity and quality of sales, and with increasing use of segmentation and targeting of the agency force in those more developed markets where doing so is advantageous,
- continue to build upon recent successes in bank and direct distribution to develop a multi-channel distribution model,
- enhance and broaden the customer proposition to support the retail financial service relationship,
- continue to build a profitable and significant mutual fund business, and
- ensure individual country focus is combined with capture of all opportunities to improve efficiency and profit by use of cross-border opportunities for synergy.

Distribution

Throughout Asia, agency continues to be the primary distribution channel. PCA now has 89,000 tied agents, up from 58,000 in 2001. These agents, who are largely self employed, sell insurance products exclusively for PCA. Regional teams ensure that quality training, best practice agency management and high quality customer service are consistently provided.

PCA has also been developing complementary distribution channels, including bancassurance, and today this generates material new business volumes with 18 bancassurance agreements in 10 countries. Alternative distribution, which includes bancassurance and direct distribution, produced 21% of total insurance sales in 2002, up from 17% in 2001.

Products

PCA offers a range of products including life insurance with some accident and health options, personal lines property and casualty insurance and also mutual funds.

Life Insurance

The life insurance products offered by PCA include a range of with-profits and non-participating term, whole life, endowment and unit-linked policies. PCA also offers health, disablement, critical illness and accident covers to supplement its core life products.

PCA has a strong focus on capital-efficient product innovation and packages products to meet specific customer needs. In 1992, PCA was the first company to launch unit-linked products in Singapore and subsequently has leveraged this expertise with great success across the region. In 2002, PCA continued with unit-linked product launches in India, the Philippines and Taiwan. Additionally, PCA LIFE Japan secured regulatory approval in 2002 to offer variable annuity products, drawing on technical expertise developed in Jackson National Life.

Funds Management

In addition to building its life operations, PCA has pursued a long-term strategy of building a regional mutual fund business. Progress to date has been very encouraging with market leading positions in India and Taiwan, growing operations in Japan, Singapore, Malaysia and Hong Kong and the recent acquisition of a mid-sized investment trust management company in the large South Korean market. As at December 31, 2002, total mutual funds under management have increased to £5.1 billion, up 59% compared with 2001, with net inflows of £1.0 billion.

In Hong Kong, PCA has a successful joint venture with Bank of China International (BOCI) for the MPF and also unit trusts. As from December 1, 2000, employees, employers and the self-employed in Hong Kong became obliged to make contributions to the MPF. The plans that comprise the MPF are defined contribution pension plans with immediate vesting, preservation until retirement (or some other event specified by legislation) and full portability. Individuals are required to make mandatory contributions of 5% of salary and employers make contributions equal to 5% of the employee's salary to the individual's accounts in the Fund. Both employee and employer contributions are subject to a maximum amount, currently HK$1,000 per month. Additional voluntary contributions are possible.

Prudential Asset Management (PAM) (formerly PPM Asia) is PCA's fund management division responsible for managing PCA's life and third party institutional funds including the Prudential group's investments in the Asia-Pacific region. PAM has offices in Singapore, Hong Kong and Tokyo.

At December 31, 2002, PCA was managing £15.1 billion of funds, comprising Asian life insurance funds of £5.8 billion, UK life insurance funds of £3.2 billion, PCA retail mutual funds of £5.1 billion, UK retail and third party funds of £0.7 billion and PCA's 36% of Bank of China International-PCA joint venture pension related funds of £0.3 billion.

Products and Profitability

Life Insurance Products

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

Life Product Profitability

The profits from participating policies are shared between the policyholder and insurer (typically in a 90:10 ratio) in the same way as with-profits business in the United Kingdom, see " UK Business UK Products and Profitability". With respect to unit-linked products, the profits reflect the balance by which charges made from managing the policy, its investments and the insurance risk exceed the costs of providing these benefits. These profits accrue entirely to shareholders, with investment gains and losses accruing to the policyholder within the underlying unitized fund. The profits from non-participating products consist of any surplus remaining after paying the defined policy benefits. All the profits from A&H products accrue to shareholders. At the end of 2002, PCA offered unit-linked products in nine of the 12 countries in Asia in which it operates.

Mutual Fund Products

PCA's mutual fund range includes debt, equity and money market funds. PCA makes transaction charges (initial and surrender depending on the type fund and the length of the investment) and also makes a service charge based on assets under management. The charges vary by country and fund with money market style funds generally having the lowest charges and equity funds the highest.

New Business Premiums

In 2002, total sales of insurance products were £944 million, down 7% from 2001. Of this amount, regular premium insurance sales were up 26% to £465 million. Single premium insurance sales declined from £650 million to £479 million. The Central Provident Fund (CPF) in Singapore was further liberalized in 2001 resulting in exceptional levels of single premium insurance sales. Excluding CPF sales, single premium insurance sales were up 35% compared with 2001.

The following table shows Prudential's Asian life insurance new business by territory for the periods indicated. In this table "Other Countries" includes China, India, Thailand, Indonesia, South Korea, the Philippines and Vietnam. Results for 2001 includes the post-acquisition results of Japan and South Korea.

	Year Ended December 31,		
	2002	**2001**	**2000**
		(In £ Millions)	
Singapore	**325**	552	285
Hong Kong	**224**	159	62
Malaysia	**74**	58	47
Taiwan	**159**	140	79
Japan	**48**	40	
Other countries	**114**	70	31
Total	**944**	1,019	504

In addition, for the year ended December 31, 2002, PCA's mutual funds had funds under management of £5.1 billion, up from £3.1 billion in 2001 following net sales of £1.0 billion during the year, down from £1.5 billion in 2001.

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European Business

In early 2002, Prudential re-evaluated its strategy for the Prudential and Scottish Amicable-branded long-term business within continental Europe. The review concluded that an organic strategy based on investment in the German and French markets would be too slow and expensive to create value and would require significant acquisitions to create scale. Further, the analysis indicated that the returns achievable from any available acquisition would be too low to justify the investment of capital.

Sale of German Business to Canada Life

In November 2002, Prudential agreed to sell its German life business to Canada Life for €129 million (£82 million). The sale was completed on January 1, 2003. Irish High Court approval for the transfer of the relevant life assurance policies to Canada Life is expected in the second half of 2003.

The German business consisted of a marketing and distribution operation that specialized in selling unit-linked products through the intermediary channel. Policies were underwritten through Prudential's Dublin based life insurance company (which does not underwrite any business in Ireland). New policies continue to be underwritten by Prudential's Dublin life company, but from the completion date all in force German policies and all new business is reassured to Canada Life. A full portfolio transfer will be implemented following approval from the Irish High Court.

France

In January 2001, Prudential launched Prudential Europe Vie, an equity-backed life insurance product that offers a choice of investment through the Prudential life fund or Réactif, a unit-linked fund provided by Véga Finance. The product was initially sold through independent financial advisors approved by Centre Français du Patrimoine, a subsidiary of Crédit Foncier de France and the largest multi-brokerage network in France.

In 2002, Prudential launched a similar arrangement with Espace Patrimoine Conseil, a subsidiary of Crédit Mutuel de Bretagne.

On June 13, 2003, Prudential announced it was ceasing to write new business in France. As a result, from January 1, 2004 Prudential will no longer be selling the Prudential Europe Vie product in France. It will continue to administer existing policies. This decision does not affect Egg's operation in France.

Investments

General

The overall financial strength of the Prudential group and the results, both current and future, of the insurance business are in part dependent upon the quality and performance of the various investment portfolios in the United Kingdom, the United States, Asia and in Europe.

Prudential's Total Investments

The following table shows Prudential's insurance and non-insurance investments at December 31, 2002. In addition, at December 31, 2002 Prudential had £24 billion of external retail mutual funds under management. The "Other" column includes central funds, a short-term fixed income securities reinvestment program and funds in respect of other non-insurance operations. Assets held to cover linked liabilities relate to unit-linked and variable annuity products. In this table, investments are valued as set out in Note 3 of the notes to Prudential's consolidated financial statements.

At December 31, 2002

	Insurance						Banking	
	United Kingdom	**United States**	**Asia**	**Europe**	**Other**	**Sub-total**	**United Kingdom And United States**	**Total**
	(In £ Millions)							
Debt and other fixed income securities	**37,873**	**21,031**	**3,215**	**61**	**1,020**	**63,200**	**4,499**	**67,699**
Equity securities	**28,901**	**147**	**904**	**39**	**16**	**30,007**	**12**	**30,019**
Loans and other	**3,424**	**6,370**	**569**	**110**	**619**	**11,092**	**6,634**	**17,726**
Total	**70,198**	**27,548**	**4,688**	**210**	**1,655**	**104,299**	**11,145**	**115,444**
Real estate								
Investment	**10,486**	**19**	**62**		**1**	**10,568**		**10,568**
Company-occupied	**102**	**37**	**44**		**15**	**198**	**12**	**210**
Total real estate	**10,588**	**56**	**106**		**16**	**10,766**	**12**	**10,778**
Sub-total	**80,786**	**27,604**	**4,794**	**210**	**1,671**	**115,065**	**11,157**	**126,222**

	At December 31, 2002							
Participating interests	4		36		33	73		73
Total investments	80,790	27,604	4,830	210	1,704	115,138	11,157	126,295
Assets held to cover unit-linked liabilities	11,595	2,724	935	509		15,763		15,763
Total	92,385	30,328	5,765	719	1,704	130,901	11,157	142,058

Prudential's Investment Yields

The following table shows the income from the investments of Prudential's continuing operations by asset category for the periods indicated. This table does not include investment income from unit-linked

and variable annuity products, or from banking investments. Yields have been calculated using the average of opening and closing balances for the appropriate asset.

	Year Ended December 31,					
	2002		2001		2000	
	Yield	Amount	Yield	Amount	Yield	Amount
	(In £ Millions, Except Percentages)					
Debt and other fixed income securities						
Net investment income	**6.7%**	**4,126**	7.0%	3,772	7.4%	3,264
Net realized investment (losses) gains	**(0.9)%**	**(531)**	0.7%	369	1.2%	533
Net unrealized investment gains (losses)	**1.1%**	**653**	(1.1)%	(588)	(1.6)%	(717)
Ending assets		**63,200**		59,181		48,594
Equity investments						
Net investment income	**3.0%**	**1,053**	2.5%	1,132	2.3%	1,268
Net realized investment gains	**1.5%**	**520**	4.6%	2,122	11.1%	6,022
Net unrealized investment (losses)	**(27.9)%**	**(9,907)**	(18.4)%	(8,475)	(13.1)%	(7,146)
Ending assets		**30,007**		40,948		51,232
Loans and other						
Net investment income	**9.7%**	**984**	8.7%	758	8.7%	721
Net realized investment (losses) gains	**(0.0)%**	**(3)**	(0.0)%	(3)	0.0%	4
Net unrealized investment gains (losses)	**0.8%**	**80**	(0.8)%	(74)	1.0%	87
Ending assets		**11,092**		9,199		8,299
Real estate						
Net investment income	**7.4%**	**789**	7.3%	764	7.5%	716
Net realized investment gains	**1.9%**	**200**	2.8%	288	1.5%	143
Net unrealized investment gains (losses)	**0.2%**	**21**	(2.0)%	(206)	3.9%	369
Ending assets		**10,766**		10,487		10,303
Total (excluding unit-linked and cash)						
Net investment income	**5.9%**	**6,952**	5.4%	6,426	5.1%	5,969

	Year Ended December 31,					
Net realized investment gains	**0.2%**	**186**	2.3%	2,776	5.8%	6,702
Net unrealized investment (losses)	**(7.8)%**	**(9,153)**	(7.8)%	(9,343)	(6.4)%	(7,407)
Ending assets		**115,065**		119,815		118,428

Prudential's Insurance Investment Strategy and Objectives

Prudential's insurance investments support a range of businesses operating in many geographic areas. Each of the operations formulates a strategy, based on the nature of its underlying liabilities, its level of capital and its local regulatory requirements. Where the nature of underlying liabilities, level of capital and local regulatory requirements permit, Prudential tends to invest its assets predominantly in equities and real estate that have, over longer periods, provided superior returns to fixed interest assets.

Management of Insurance Funds

Except for a small amount of unit-linked business and variable annuity business, amounting to approximately 4% of Prudential's own funds under management at December 31, 2002, Prudential manages its insurance funds principally through its fund management businesses, M&G in the United Kingdom, together with PPM America in the United States and Prudential Asset Management (formerly PPM Asia) in Singapore, Hong Kong and Japan.

In each of the operations, local management analyzes the liabilities and determines asset allocation, benchmarks and permitted deviations from these benchmarks appropriate for its operation. These benchmarks and permitted deviations are agreed with internal fund managers, who are responsible for implementing the specific investment strategy through their local fund management operations.

Investments Relating to UK Insurance Business

Strategy

In the United Kingdom, Prudential tailors its investment strategy for long-term business, other than unit-linked business, to match the type of product a portfolio supports. The primary distinction is between with-profits portfolios and non-participating portfolios, which include the majority of annuity portfolios. Generally, the objective is to maximize returns while maintaining investment quality and asset security and adhering to the appropriate government regulations.

With-profits contracts are long-term contracts with minimal guaranteed amounts, the nature of which permits Prudential to invest primarily in equities and real estate. Accordingly, the with-profits fund investment strategy emphasizes a well-diversified equity portfolio (containing some international equities), real estate (predominantly in the United Kingdom), UK and international fixed income securities and cash.

For Prudential's UK pensions annuities business and other non-participating business the objective is to maximize profits while ensuring stability by closely matching the cashflows of assets and liabilities. To achieve this matching, the strategy is to invest in fixed income securities of appropriate maturity dates.

For Prudential's unit-linked business, the primary objective is to maximize investment returns subject to following an investment policy consistent with the representations Prudential has made to its unit-linked product policyholders.

Investments

The following table shows the investments relating to Prudential's UK insurance business, other than its unit-linked business, at December 31, 2002. In this table, investments are shown at market value. The with-profits fund also includes two other businesses, SAIF and Prudential Annuities Limited. The investments in respect of SAIF are shown separately. The investments in respect of Prudential Annuities Limited are included within the Annuities column. The "Other" column includes investments relating to solvency capital of unit-linked funds and investments relating to non-life long-term business.

	At December 31, 2002					
	With-Profits	Annuities	SAIF	Other	Total	Total %
	(In £ Millions, Except Percentages)					
Equity securities						
United Kingdom						
Listed	17,040		3,303		20,343	
Unlisted	92		38		130	
Total United Kingdom	17,132		3,341		20,473	25.3
International						
United States	1,662		345		2,007	
Europe (excluding the United Kingdom)	2,034		391		2,425	
Japan	787		155		942	
Pacific (excluding Japan)	1,840		323		2,163	
Other	780		111		891	
Total international	7,103		1,325		8,428	10.5
Total equity securities	24,235		4,666		28,901	35.8
Debt and other fixed income securities						
UK government	620	1,497	174	118	2,409	
US government	4	8	0	58	70	
Other	18,130	11,201	5,540	523	35,394	
Total fixed income securities	18,754	12,706	5,714	699	37,873	46.9
Real estate						
Investment property	8,624	340	1,522		10,486	
Company-occupied property	102				102	
Total real estate	8,726	340	1,522		10,588	13.1
Loans and other						
Loans	79	286	161	2	528	
Deposits	2,170	14	241	471	2,896	
Total loans and other	2,249	300	402	473	3,424	4.2
Total	53,964	13,346	12,304	1,172	80,786	100.0

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Equity Securities

Prudential's UK insurance operations, excluding unit-linked business, had £28,901 million invested in equities at December 31, 2002. Most of these equities support Prudential Assurance's with-profits fund and the SAIF fund, both of which are managed using the same general investment strategy. The following table shows the geographic spread of this equity portfolio by market value.

	At December 31, 2002	
	Market Value	%
	(In £ Millions, Except Percentages)	
United Kingdom	20,473	70.8
United States	2,007	6.9
Europe (excluding United Kingdom)	2,425	8.4
Japan	942	3.3
Pacific (excluding Japan)	2,163	7.5
Other	891	3.1
Total	28,901	100.0

The UK equity holdings are well diversified and broadly mirror the FTSE All-Share share index. Prudential holds equities in more than 600 UK companies. At December 31, 2002, the ten largest holdings in UK equities amounted to £9,757 million, accounting for 47.7% of the total UK equity holdings of £20,473 million supporting the UK insurance operations. The following table shows the market value of the ten largest holdings in UK equities at December 31, 2002.

	At December 31, 2002	
	Market Value	%
	(In £ Millions, Except Percentages)	
B.P.	1,841	9.0
GlaxoSmithKline	1,451	7.1
Vodafone Group	1,418	6.9
HSBC Holdings	1,176	5.8
The Royal Bank of Scotland Group	784	3.8
Shell Transport and Trading	760	3.7
Astra Zeneca	723	3.5
Barclays	625	3.1
Diageo	496	2.4
Lloyds TSB Group	483	2.4
Total	9,757	47.7

All industry sectors are represented in Prudential's equity portfolio. At December 31, 2002, within the £20,473 million in UK equities supporting the UK insurance operations, Prudential had £15,112 million, or 73.8% of the holdings invested in ten industries. The following table shows the

primary industry concentrations based on market value of the portfolio of UK equities relating to the UK insurance business at December 31, 2002.

	At December 31, 2002	
	Market Value	%
	(In £ Millions, Except Percentages)	
Banks	4,037	19.7
Oil and Gas	2,854	14.0
Pharmaceuticals	2,245	11.0
Telecommunication Services	1,892	9.2
Media and Photography	806	3.9
Electricity	734	3.6
General Retailers	695	3.4
Beverages	654	3.2
Mining	638	3.1
Support services	557	2.7
Total	15,112	73.8

Debt and Other Fixed Income Securities

At December 31, 2002, 85.9% of Prudential's fixed income securities supporting the UK insurance operations were issued by corporations, 6.4% were issued or guaranteed by the UK government, 0.2% were issued or guaranteed by the US government and 4.8% were issued or guaranteed by other overseas governments. These guarantees relate only to payment and, accordingly, do not provide protection against fluctuations in market price that may occur during the term of the fixed income securities. The remaining 2.7% of Prudential's fixed income securities supporting the UK insurance operations consists mainly of local UK government issues.

The following table shows the market value of the fixed income securities portfolio by maturity at December 31, 2002.

	At December 31, 2002	
	Market Value	%
	(In £ Millions, Except Percentages)	
Securities maturing:		
Within one year	617	1.6
Over one year and up to five years	5,299	14.0
Over five years and up to ten years	9,596	25.3
Over ten years and up to fifteen years	4,162	11.0
Over fifteen years	18,199	48.1
Total	37,873	100.0

Approximately 69.8% of the fixed income securities portfolio was rated by Standard & Poor's at December 31, 2002, of which 19.5% was rated AAA, 7.2% was rated between AA- and AA+, 23.5% was rated between A- and A+, 15.5% was rated between BBB- and BBB+ and 4.1% was rated below BBB-. A further 9.1% of this portfolio was rated by Moody's at December 31, 2002, of which approximately 2.4% was rated Aaa, 1.7% was rated between Aa1 and Aa3, 2.5% was rated between A1 and A3, 1.8% was rated between Baa1 and Baa3 and 0.7% was rated below Baa3.

Real Estate

At December 31, 2002, Prudential's UK insurance operations had £10,588 million of investments in real estate in the United Kingdom. The following table shows the real estate portfolio by type of investment. The real estate investments are shown at market value in accordance with the policies described in Note 3 of the notes to the consolidated financial statements.

	At December 31, 2002	
	Market Value	%
	(In £ Millions, Except Percentages)	
Office buildings	**4,002**	**37.8**
Shopping centers/commercial	**4,568**	**43.1**
Retail warehouses/industrial	**1,908**	**18.0**
Development	**51**	**0.5**
Other	**59**	**0.6**
Total	**10,588**	**100.0**

57.2% of the UK real estate investments are located in London and Southeast England (Buckinghamshire, Berkshire, East and West Sussex, Hampshire, Isle of Wight, Kent, Oxfordshire and Surrey) with the remaining 42.8% located throughout the rest of the United Kingdom.

Loans and Other

At December 31, 2002, the loans and other portfolio of the UK insurance operations amounted to £3,424 million. The following table shows the loans and other portfolio by value at December 31, 2002.

	At December 31, 2002
	(In £ Millions)
Loans collateralized by mortgages	**363**
Loans to policyholders collateralized by insurance policies	**77**
Other loans	**89**
Deposits with credit institutions	**2,281**
Other	**614**
Total	**3,424**

Investments Relating to US Insurance Business

Strategy

Jackson National Life's investment strategy, for business other than its variable annuity business, is to maintain a diversified and largely investment grade debt and fixed income securities portfolio that maintains a desired investment spread between the yield on the portfolio assets and the rate credited on policyholder liabilities. Interest rate scenario testing is continually used to monitor the effect of changes in interest yields on cash flows, the present value of future profits and interest rate spreads.

Jackson National Life's investment portfolio consists primarily of fixed income securities, although the portfolio also contains investments in mortgage loans, policy loans, common and preferred stocks, cash and short-term investments and miscellaneous other investments.

Investments

The following table summarizes Jackson National Life's total insurance investments, other than the investments supporting its variable annuity business, at December 31, 2002.

	December 31, 2002			
	Non-Stable Value	Stable Value	Total	Total %
	(In £ Millions, Except Percentages)			
Debt and other fixed income securities				
Corporate securities and commercial loans	11,775	3,880	15,655	56.7
Residential mortgage-backed securities	2,098	315	2,413	8.7
Commercial mortgage-backed securities	870	365	1,235	4.5
Other	1,157	571	1,728	6.3
Total debt and other fixed income securities	15,900	5,131	21,031	76.2
Loans and other	5,589	781	6,370	23.1
Equity securities	146	1	147	0.5
Total	21,635	5,913	27,548	99.8
Real estate	46	10	56	0.2
Total	21,681	5,923	27,604	100.0

Debt and other fixed income securities are shown at amortized cost, with the exception of certain securities held by the US fund management operation, which are shown at market value. Loans and other and equity securities are shown at market value, with the exception of interests in associate undertakings (included in equity securities) and mortgage loans. Real estate is shown at depreciated cost. Interests in associate undertakings are carried at Jackson National Life's proportionate share of net assets. The market value of unlisted securities is estimated by Jackson National Life, using independent pricing services or analytically determined values. Mortgage loans are shown at outstanding loan amount.

Debt and Other Fixed Income Securities

Corporate Securities and Commercial Loans

At December 31, 2002, Jackson National Life had £15,655 million of corporate securities and commercial loans, representing 56.7% of US insurance total investments. Of the £15,655 million, £12,980 million consisted of fixed income securities that are publicly traded or trade under Rule 144A of the Securities Act of 1933 ("Rule 144A") and £2,675 million consisted of investments in non-Rule 144A privately placed fixed income securities.

For statutory reporting in the United States, debt securities are classified into six quality categories specified by the Securities Valuation Office of the National Association of Insurance Commissioners ("NAIC"). The categories range from Class 1 (the highest) to Class 6 (the lowest). Performing securities are rated Classes 1-5. Securities in or near default are rated Class 6. Securities designated as Class 3, 4, 5 and 6 are non-investment grade securities. Generally, securities rated AAA to A by nationally recognized statistical ratings organizations are Class 1, BBB in Class 2, BB in Class 3 and B and below in Classes 4 through 6. If a rating is not currently available from the NAIC, Jackson National Life's investment advisor provided the rating for the purposes of the disclosure contained herein.

The following table shows the credit quality of the portfolio of publicly traded and Rule 144A fixed income securities at December 31, 2002.

	At December 31, 2002	
	Book Value	% of Total
	(In £ Millions, Except Percentages)	
NAIC Designation		
1	4,237	32.6
2	7,228	55.7
3	987	7.6
4	342	2.6
5	86	0.7
6	100	0.8
Total	12,980	100.0

The following table shows the credit quality of the non-Rule 144A private placement portfolio at December 31, 2002.

	At December 31, 2002	
	Book Value	% of Total
	(In £ Millions, Except Percentages)	
NAIC Designation		
1	894	33.4
2	1,160	43.4
3	201	7.5
4	257	9.6
5	118	4.4
6	45	1.7
Total	2,675	100.0

Residential Mortgage-Backed Securities

At December 31, 2002, Jackson National Life had £2,413 million of residential mortgage-backed securities, including commercial mortgage obligations, representing 8.7% of US insurance total investments. Although this percentage is higher than the average US insurance company, Jackson National Life believes these securities provide additional yield and liquidity. At December 31, 2002, 82.2% of Jackson National Life's residential mortgage-backed securities were rated AAA or the equivalent by a nationally recognized statistical ratings organization, and 97.8% were rated NAIC 1.

The primary investment risk associated with residential mortgage-backed securities is that a change in the interest rate environment could cause payment of the underlying obligations to be made more slowly or quickly than was anticipated at the time of their purchase. If interest rates decline, then this risk is called "pre-payment risk" and the underlying obligations will generally be repaid more quickly when the yields on reinvestment alternatives are lower. Alternatively, if interest rates rise, the risk is called "extension risk" and the underlying obligations will generally be repaid more slowly when reinvestment alternatives are higher. Residential mortgage-backed securities offer additional yield to compensate for these risks. Jackson National Life manages pre-payment risk, in part, by reducing crediting rates on its products.

Commercial Mortgage-Backed Securities

At December 31, 2002, Jackson National Life had £1,235 million, representing 4.5% of US insurance total investments, invested in commercial mortgage-backed securities. 99.9% of this total was rated by a nationally recognized statistical ratings organization and 98.6% was rated investment grade. Due to the structures of the underlying commercial mortgages, these securities do not present the same pre-payment or extension risk as residential mortgage-backed securities.

Other Fixed Income Securities

At December 31, 2002, Jackson National Life had £1,728 million of other fixed income securities, representing 6.3% of US insurance total investments.

Loans and Other

Loans and other totaled £6,370 million, representing 23.1% of US insurance total investments at December 31, 2002. Of the £6,370 million, £2,504 million consisted of loans and £3,866 million consisted of other financial investments.

Loans

Loans represented 9.1% of US insurance total investments at December 31, 2002. £2,060 million related to commercial mortgage loans and £444 million to policy loans.

Commercial Mortgage Loans

Commercial mortgage loans represented 7.5% of US insurance total investments at December 31, 2002. This total included 434 first mortgage loans with an average loan balance of approximately £4.8 million, collateralized by properties located in Canada and the United States. The vast majority of Jackson National Life's investments has been directly originated in the last seven years.

Jackson National Life has addressed the risk of these investments by building a portfolio that is diverse both in geographic distribution and property type, emphasizing four main institutional property types: multi-family residential, retail, suburban office and warehouse/distribution facilities. These investments are often structured to minimize pre-payment risk through make-whole or lock-out pre-payment provisions.

As of December 31, 2002, approximately 21.6% of the portfolio was industrial, 25.2% multi-family residential, 21.9% retail, 21.3% suburban office, 8.5% hotel and 1.5% other. Approximately 17.3% of the portfolio is secured by properties in Texas and 8.9% of the portfolio is secured by properties in California, with no other state representing more than 6% of the total origination.

Commercial mortgages generally involve more credit risk than residential mortgages due to several factors, including larger loan size, general and local economic conditions, local real estate conditions and the credit quality of the underlying tenants for the properties. Jackson National Life's investment policy and strict underwriting standards are designed to reduce these risks while maintaining attractive yields. In contrast to residential mortgage loans, commercial mortgage loans have minimal or no pre-payment and extension risk.

Policy Loans

Policy loans represented 1.6% of US insurance total investments at December 31, 2002. Policy loans are fully secured by individual life insurance policies or annuity policies and are contractual arrangements made under the policy.

Other

Other financial investments, representing 14.0% of US insurance total investments at December 31, 2002, were made up of £3,112 million of cash and short-term investments, £484 million of investments in limited partnerships and £270 million of other miscellaneous investments.

The largest investment in the limited partnerships category is a £140 million interest in the PPM America Private Equity Fund. The remainder of this category consists of diversified investments in 145 other partnerships managed by independent money managers that generally invest in various equity and fixed income loans and securities.

Equity Securities

Equity securities supporting US insurance operations totaled £147 million at December 31, 2002 representing 0.5% of US insurance total investments, and consisted of £85 million of common stocks and £62 million of preferred stocks.

Common Stocks

The £85 million of investments in common stocks included £50 million of investments in mutual funds and £35 million of other investments in common stocks at December 31, 2002.

Preferred Stocks

The £62 million of investments in preferred stocks included £42 million of private equity preferred stocks at December 31, 2002.

Real Estate

At December 31, 2002, Jackson National Life had £56 million of investments in real estate, £37 million of which is real estate Jackson National Life occupies.

Investments Relating to Asian Insurance Business

Prudential's Asian operations' investments, other than investments in respect of unit-linked business, largely support the business of its Singapore, Hong Kong, Malaysia, Japan and Taiwan operations.

The following table shows Prudential Asia's investments, other than investments from unit-linked business, at December 31, 2002. In this table, investments are valued on the same basis as in the consolidated financial statements.

	At December 31, 2002	
	Market Value	% of Total
	(In £ Millions, Except Percentages)	
Debt and other fixed income securities	3,215	66.6
Equity securities	904	18.7
Loans and other	569	11.8
Real estate	106	2.2
Participating interests	36	0.7
Total	4,830	100.0

Prudential manages interest rate risk in Asia by matching liabilities with fixed interest assets of the same duration to the extent possible. Asian fixed interest markets however generally have a relatively short bond issue term, which makes complete matching challenging. A large proportion of the Hong

Kong liabilities are denominated in US dollars and Prudential holds US fixed interest securities to back these liabilities.

Debt and Other Fixed Income Securities

The following table shows consolidated investment categorization of the debt and fixed income security investments of Prudential Asia's long-term insurance fund, other than investments from unit-linked business, at December 31, 2002.

	At December 31, 2002	
	Market Value	**% of Total**
	(In £ Millions, Except Percentages)	
Debt and other fixed income securities:		
Government Bonds	**1,587**	**49.4**
Quasi Government Bonds	**263**	**8.2**
Investment grade Corporate Bonds	**832**	**25.9**
Non-investment grade Corporate Bonds	**70**	**2.2**
Unrated Bonds	**276**	**8.6**
Cash	**187**	**5.7**
Total	**3,215**	**100.0**

Equity Securities

The following table shows a geographic analysis of equity security investments of Prudential Asia's long-term insurance fund, other than investments from unit-linked business, at December 31, 2002.

	At December 31, 2002	
	Market Value	**% of Total**
	(In £ Millions, Except Percentages)	
Singapore	**473**	**52.3**
Hong Kong	**272**	**30.1**
Malaysia	**80**	**8.9**
Taiwan	**43**	**4.7**
Japan	**33**	**3.7**
Other	**3**	**0.3**
Total	**904**	**100.0**

Loans and Other

Loans and other include policy loans, mortgage loans, deposits with credit institutions, unit trust investments and derivatives, including forwards, futures, options and swaps.

Investments Relating to Banking Business

At December 31, 2002, Prudential had total banking investments of £11,157 million. The following table summarizes the investment portfolios relating to the UK and US banking businesses. In this table, investments are valued on the same basis as in the consolidated financial statements.

	At December 31, 2002			
	UK	US	Total	Total %
	(In £ Millions, Except Percentages)			
Debt and other fixed income securities	4,268	231	4,499	40.3
Loans and other	5,935	699	6,634	59.5
Equity securities		12	12	0.1
Real estate	10	2	12	0.1
Total	10,213	944	11,157	100.0

Of the £10,213 million of investments relating to the UK banking business, which includes £145 million relating to Egg France, £1,230 million was in respect of certificates of deposit maturing in less than three months.

The following table shows UK banking business loans by type and repayment period at December 31, 2002.

	At December 31, 2002				
	Due in One Year or Less	Due in Over One Year and Up to Five Years	Due in Over Five Years	Provision for bad and doubtful debts	Total
	(In £ Millions)				
Overdrafts	4			(3)	1
Unsecured personal loans	22	708	243	(45)	928
Credit card receivables	2,338			(78)	2,260
Residential mortgages	2	73	2,285	(3)	2,357
Loans to banks	236	3			239
Other	150				150
Total	2,752	784	2,528	(129)	5,935

The following table shows UK banking business loans by type and interest rate at December 31, 2002.

	At December 31, 2002			
	Fixed Rate	Variable Rate	Provision for bad and doubtful debts	Total
	(In £ Millions)			
Overdrafts		4	(3)	1

	At December 31, 2002			
Unsecured personal loans	**973**		**(45)**	**928**
Credit card receivables		**2,338**	**(78)**	**2,260**
Residential mortgages	**201**	**2,159**	**(3)**	**2,357**
Loans to banks	**38**	**201**		**239**
Other	**150**			**150**
Total	**1,362**	**4,702**	**(129)**	**5,935**

Description of Property

Prudential occupies 35 properties in the United Kingdom. These properties are primarily offices with some ancillary storage/warehouse facilities. Its headquarters are located in London. Of the remainder the most significant are offices in London, Reading, Chelmsford, Dudley and Derby in England, Stirling in Scotland and Belfast in Northern Ireland. The properties in Stirling and Derby are held on a freehold basis with the rest as long-term leaseholds. The leasehold properties range in size from 3,000 to 146,000 square feet. Overall, the occupied property portfolio totals approximately 1,300,000 square feet.

In addition to these properties, the Prudential group owns the freehold of a sports facility in Reading for the benefit of staff.

The Prudential group also holds approximately 145 other leasehold properties in the United Kingdom. This surplus accommodation consists primarily of small offices spread geographically across the United Kingdom and totals approximately 510,000 square feet.

Prudential is one year into a three-year program aimed at reducing its occupied property portfolio, and its associated costs in line with the restructuring of the UK business. The estimated cost of the program is £12 million, financed through internal funding.

Within France, Germany, Ireland and Italy Prudential currently leases approximately 65,000 square feet of office space.

In the United States, Prudential owns Jackson National Life's executive and principal administrative office located in Michigan. Prudential also leases premises in Michigan, Colorado, California, Illinois, New York, New Jersey, Georgia, Florida, Wisconsin and North Dakota for certain of its operations. Prudential leases regional marketing sales offices in five locations, and holds 50 operating leases with respect to office space, throughout the United States. In the United States, Prudential owns and leases a total of approximately 740,000 square feet of property.

In Asia, Prudential owns or leases properties principally in Hong Kong, Singapore, Malaysia, Indonesia, Thailand, the Philippines, China, Taiwan, Japan, Vietnam, India and Korea. Within these countries, Prudential holds 36 offices on a freehold basis, 8 offices on a leasehold basis and 348 operating leases in respect of office space, totaling approximately 3,151,000 square feet of property. In addition, Prudential holds 11 freeholds in Taiwan and 3 operating leases in Vietnam relating to storage/warehousing facilities, totaling approximately 29,500 square feet of property. Prudential is looking to acquire additional square footage in Asia of approximately 403,500 square feet.

Prudential believes that its facilities are adequate for its present needs in all material respects.

Prudential had tangible assets, principally computer equipment, furniture and fixtures of £196 million, £241 million and £288 million at December 31, 2002, 2001 and 2000 respectively.

Competition

General

There are significant participants in each of the financial service markets in which Prudential operates. Its competitors include both mutual and stock financial companies. In addition, regulatory and other developments in many of Prudential's markets have obscured traditional financial service industry lines and opened the market to new competitors and increased competition. Some new entrants are taking advantage of the low barriers to entry afforded by internet distribution, especially in the area of retail banking. In some of Prudential's markets, other companies may have greater financial resources, allowing them to benefit from economies of scale, and may have stronger brands than Prudential does in that market.

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

- price and yields offered,
- financial strength and ratings,
- commission levels, charges and other expenses,
- range of product lines and product quality,
- brand strength, including reputation and quality of service,
- distribution channels,
- investment management performance, and
- historical bonus levels.

An important competitive factor is the ratings Prudential receives in some of its target markets, most notably in the United States, from recognized rating organizations. The intermediaries with whom Prudential works, including IFAs, agents, brokers, wholesalers and financial institutions consider ratings as one factor in determining from which provider to purchase financial products. Prudential Assurance's long-term fund is currently rated AA+ "very strong" (stable outlook) and Jackson National Life is rated AA (negative outlook) by Standard & Poor's. Jackson National Life is currently rated AA (stable outlook) by Fitch Ratings, A+ (stable outlook) by A.M. Best Co and A1 (stable outlook) by Moody's. On December 20, 2002, Moody's downgraded the financial strength of Prudential Assurance's long-term fund from Aaa (review for possible downgrade) to Aa1 (stable outlook). On January 29, 2003, Standard and Poor's downgraded the financial strength of Prudential Assurance's long-term fund from AAA (negative outlook) to AA+ (stable outlook). Prudential believes the recent downgrades that it, and the rest of the UK insurance industry, recently experienced have not to date had a discernible impact on its trading performance.

Prudential offers different products in its different markets of the United Kingdom, the United States and Asia and, accordingly, faces different competitors and different types of competition in these markets. In all of the markets in which Prudential operates its products are not unique and, accordingly, it faces competition from market participants who manufacture a varying range of similar and identical products.

The United Kingdom

Prudential's principal competitors include many of the major stock and mutual retail financial services and fund management companies operating in the United Kingdom. These companies include Aviva, Legal & General, Standard Life, Friends Provident, Lloyds TSB, HBOS, Aegon, AXA, Zurich Financial Services, Fidelity, Invesco, Threadneedle and Schroders. Prudential competes with other providers of financial products to be included on IFA panels of preferred providers.

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

The United States

Jackson National Life's competitors in the United States include major stock and mutual insurance companies, mutual fund organizations, banks and other financial services companies. National banks, in particular, may become more significant competitors in the future for insurers who sell annuities, as a result of recent legislation, court decisions and regulatory actions. Jackson National Life's principal life insurance company competitors in the United States include AXA, Lincoln National Corporation, Transamerica Corporation, Nationwide Financial Services, Inc., SunAmerica, Inc. and Hartford Life, Inc.

Jackson National Life does not have a career agency salesforce in the United States and, consequently, competes for distributors such as banks, broker-dealers and wholesalers. Jackson National Life also competes with other providers of financial products to be placed at the top of independent agents' lists of sources.

Asia

Competition in the Asian markets in which Prudential operates is mainly focused on distribution, with particular emphasis on the size and competency of the agency salesforce. Within Asia, Prudential is second to AIG in terms of penetration and overall life market share across the region. While there are large local participants in individual markets for example Great Eastern Life in Singapore and Malaysia, Nippon Life in Japan, Cathay Life in Taiwan, and LIC in India, none of these has pan-regional businesses. Regional players are typically of North American or European origin.

In the regional mutual fund market in terms of market presence and position, Prudential ranks alongside leading international participants such as Schroders and Fidelity.

Intellectual Property

Prudential does not operate in the United States under the Prudential name and there have been long-standing arrangements between it and Prudential Financial, Inc. and its subsidiary, The Prudential Insurance Company of America, relating to their respective uses of the Prudential name. Prudential and Prudential Financial, Inc. and its subsidiary, The Prudential Insurance Company of America, have now made competing trademark claims in various jurisdictions around the world and legal proceedings in connection with these matters have commenced.

Legal Proceedings

Jackson National Life

Jackson National Life has been named in civil proceedings, which appear to be substantially similar to other class actions brought against many life insurers alleging misconduct in the sale of insurance products. At this time it is not possible to make a meaningful estimate or range of loss, if any, that could result from any unfavorable outcome. In addition, Jackson National Life is a defendant in individual actions that involve similar issues. Several cases including one which was on appeal to the Supreme Court in the State of Mississippi, were settled in January 2002 for a sum of £7 million.

Prudential Group

Prudential and its subsidiaries are involved in other litigation arising in the normal course of business. Although the outcome of such matters cannot be predicted with certainty, management believes that the ultimate outcome of such litigation will not have a material adverse effect on the group's financial condition, results of operations or cash flows.

Sources

Throughout this annual report, Prudential describes the position and ranking of its overall business and individual business units in various industry and geographic markets. The sources for such descriptions come from a variety of conventional sources generally accepted as relevant business indicators by members of the financial services industry. These sources include information available from the Association of British Insurers, the UK Department of Trade and Industry, Association of Unit Trusts and Investment Funds, Neilsen Net Ratings, A.M. Best, Moody's, Standard and Poor's, UBS Warburg, Life Insurance Marketing and Research Association, the Variable Annuity Research Data Service, referred to as VARDS, Townsend and Schupp, The Advantage Group, the Life Insurance Association of Singapore, the Hong Kong Federation of Insurers, Life Insurance Association of Malaysia, Life Insurance Association of Taiwan and the Taiwanese Securities Investment Trust Consulting Association.

SUPERVISION AND REGULATION OF PRUDENTIAL

Prudential's principal insurance, investment and banking operations are in the United Kingdom, the United States and Asia. Accordingly, it is subject to applicable United Kingdom, United States and Asian insurance, banking and other financial services regulation which is discussed below.

UK Supervision and Regulation

The Financial Services and Markets Act 2000

Prudential's insurance, investment and banking businesses in the United Kingdom are regulated by the Financial Services Authority (the "FSA"), the statutory regulator granted powers under the Financial Services and Markets Act 2000 (the "2000 Act").

Risk-Based Regulation

The 2000 Act regime employs a risk-based regulatory approach pursuant to which each regulated firm's risk is assessed on a common FSA-wide model. This covers the firm's control environment and business and customer risk profiles, together with an assessment of the potential impact on consumer protection and market stability of financial or compliance failure of that firm. The FSA aims to create a single set of prudential requirements organized according to risk category with sections containing rules and guidance on credit, market, operational and insurance risks, as well as capital adequacy and consolidated supervision.

A key feature of the risk- based regime is the anticipated introduction of a single integrated prudential rulebook to replace current multiple "Interim Prudential Sourcebooks" that apply to regulated businesses. While the FSA initially envisaged that the integrated prudential rulebook would be fully implemented on January 1, 2004, the Basel Committee's announcements in 2001 and 2002 regarding delays in the introduction of the new Basel Capital Accord, which is now expected to occur in 2006, led the FSA to postpone its full implementation. Nevertheless, because insurance regulation is not dependent on the Basel Capital Accord, the FSA is proceeding with the early introduction of a fully revised prudential regime for insurance firms in its original target year of 2004.

Overview of 2000 Act Regulatory Regime

Single Regulator

The FSA is the single regulator for all authorized persons with respect to every regulated activity in the investment business sector. In this regard, the FSA is authorized to make rules and issue guidance and codes in relation to a wide sphere of activity encompassing the governance of the conduct of business by, and the prudential supervision of, authorized persons.

Permission to carry on "Regulated Activities"

Under the 2000 Act no person may carry on or purport to carry on a regulated activity in the United Kingdom unless he has received FSA permission to carry on one or more regulated activities and, as a result, is an authorized person. "Regulated activities" are prescribed in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and comprise banking activities, insurance activities and certain other principal activities, including dealing in investments as principal or agent, and the establishment, operation and winding up of a stakeholder pension scheme, as described below.

Single Authorization Procedure

A firm becomes an authorized person by virtue of being granted permission by the FSA to carry out specific regulated activities. The FSA may grant permission to carry out any regulated activity and may

delineate the scope of, and include such restrictions to, its permission as it deems appropriate. In granting or varying the terms of its permission the FSA must ensure that the firm meets certain threshold conditions, which among other things require it to have adequate resources for the carrying on of its business, and to be a fit and proper person, having regard to all the circumstances.

In addition to the threshold conditions to authorization, firms are obliged to comply with the FSA Principles for Business, which are high level principles for conducting financial services business in the United Kingdom.

In parallel, the 2000 Act includes the "approved persons" regime, whereby firms are obliged to secure the approval of the FSA to the appointment of individuals performing certain important functions within a firm or on its behalf with respect to the carrying on of regulated activities.

Market Abuse

The FSA is empowered to instigate proceedings in connection with offences concerning the financial markets. Most significantly, the FSA has the power to apply sanctions upon the occurrence of market abuse, which is broadly defined as the failure to observe certain standards of behavior in relation to investments traded on prescribed markets. Market abuse may be committed both by authorized and unauthorized persons. The person upon whom sanction is imposed may refer the matter for hearing by the Financial Services Tribunal.

Application of 2000 Act Regulatory Regime to Prudential

By carrying on regulated activities, each of Prudential's principal UK insurance, investment and banking businesses is subject to regulation and supervision by the FSA. The following discussion considers, in turn, the main features of the 2000 Act regime applicable to Prudential's insurance, investment and banking businesses in the United Kingdom.

Regulation Applicable to Prudential's Insurance, Investment and Banking Businesses

Supervision of Management and Change of Control

The FSA closely supervises the management of firms through the approved persons regime, under which any appointment of persons to a position of significant influence within an authorized person must be approved by the FSA.

The FSA must approve any proposed acquisition of 10% or more of the shares or voting rights in an authorized person or its parent and any increase in control over 20%, 33% and 50% of the shares or voting power of an authorized person or its parent. FSA approval is also required in circumstances where a person, taken together with any associates, becomes able to exercise significant influence over an authorized person or its parent by virtue of his shareholding or voting power in either. In considering whether to grant or withhold its approval, the FSA must be satisfied both that the acquirer is a fit and proper person to have control over the authorized person that he either has or would have if he acquired the control in question, and that the interests of consumers would not be threatened by the acquirer's control or by his acquiring control.

Intervention and Enforcement

The FSA has extensive powers to investigate and intervene in the affairs of an authorized person. The 2000 Act imposes on the FSA statutory obligations to monitor compliance with the requirements imposed by, and to enforce the provisions of, the 2000 Act, related secondary legislation and the rules made thereunder.

The FSA's enforcement powers, which may be exercised against both authorized and approved persons, include public censure, imposing unlimited fines and, in serious cases, the revocation or variation of permission to carry on regulated activities or of an approved person's approval. In addition, the FSA may revoke an authorized person's permission if it is necessary to protect the interests of consumers or potential consumers. The FSA has further powers to obtain injunctions against authorized persons and to impose or seek restitution orders where persons have suffered loss. Once the FSA has made a decision to take enforcement action against an authorized or approved person (other than in the case of an application to the court for an injunction or restitution order), the person affected may refer the matter to the Financial Services Tribunal.

In addition to its ability to apply sanctions for market abuse (described above), the FSA has the power to prosecute criminal offences arising under the 2000 Act and insider dealing under Part V of the Criminal Justice Act 1993 and breaches of money laundering regulations. The FSA's stated policy is to pursue criminal prosecution in all appropriate cases.

The FSA, although not a creditor, may seek administration orders under the Insolvency Act 1986 (as amended), present a petition for the winding-up of an authorized person or have standing to be heard in the voluntary winding-up of an authorized person (other than insurers carrying on long-term insurance business, which cannot voluntarily be wound up, as set out in " Winding-Up Rules" below).

FSA Conduct of Business Rules

The FSA Conduct of Business Rules apply to every authorized person carrying on regulated activities and regulate the day-to-day conduct of business standards to be observed by authorized persons in carrying on regulated activities.

Financial Promotion

The Conduct of Business Rules prescribe stringent rules relating to the circumstances and manner in which authorized persons may communicate and approve "financial promotions", which are communications in the course of business or invitations or inducements to engage in investment activity.

Polarization and Financial Promotion

Polarization rules require employed and self-employed staff or tied agents to advise on and sell the packaged products of only one company or group. Independent financial advisers are required to advise on the whole range of packaged products offered by companies in the relevant sector. The FSA relaxed the polarization rules in March 2001 with respect to stakeholder pension schemes and direct offer financial promotions for packaged products (which include life policies other than pure protection policies, pensions, regulated collective investment schemes and investment trust savings schemes). As a result of these changes, tied salesforces and appointed representatives of product provider firms are now free to market stakeholder pensions manufactured by any other company, and authorized persons may directly offer the packaged products of other authorized persons to the public (although if advice is provided, the advising authorized person remains responsible for that advice, regardless of which company's product is recommended).

In November 2002, the FSA announced that it had decided to abolish polarization restrictions, and in January 2003 published Consultation Paper 166 setting out details of how it proposes to do this. The proposed changes will mean that:

- firms currently restricted to selling just one company's products will be able to offer customers more choice, with no limit on the number of companies whose products can be sold,

- firms can continue to hold themselves out as "independent" provided they both advise from across the market and offer a fee-paying option, and firms advising customers will be obliged to recommend the most suitable product from the range on which advice is being given and clearly explain the scope of advice or service they are offering through a new initial disclosure document.

The FSA also indicated in January 2003 that the removal of the polarization restrictions would not be carried out until it has concluded separate consultations introducing more transparency for customers into the cost of advice. This cost of advice consultation is expected in the first half of 2003, meaning the removal of polarization restrictions is unlikely until late 2003 or early 2004.

The FSA has also proposed eliminating the current restrictions on the ability of product manufacturers to hold significant interests in independent financial advisers. If the proposal were adopted, independent advisers would be required to disclose to customers the extent of their ownership by product manufacturers so as to prevent the use of equity ownership *de facto* to tie independent advisers.

The Financial Services Ombudsman Scheme

The Financial Services Ombudsman Scheme is intended to provide speedy, informal and cost effective dispute resolution of a firm's individual and small-business customers' complaints, and the Ombudsman is empowered to order firms to pay fair compensation for loss and damage, and may order a firm to take such steps as it determines to be just and appropriate to remedy a complaint.

The Financial Services Compensation Scheme

The 2000 Act provides for the establishment of a compensation scheme intended to compensate individuals and small businesses for loss occasioned in respect of business carried on by an authorized person in violation of the rules of the 2000 Act regulatory regime in circumstances where such an authorized person is unable or unlikely to be able to satisfy claims against him. The scheme is divided into three sub-schemes of banking, insurance and investment business, reflecting the different kinds of business undertaken by authorized persons. The scheme is funded by contributions from industry participants referable to the particular sub-schemes so as to minimize cross-subsidy between authorized persons whose businesses are not similar. Prudential estimates its reserve for future fund assessments for its UK business to be insignificant, and, believes the reserves in place are adequate for all payments for known insolvencies. The scheme rules for calculating contributions for the type of business carried out by the group are not clear.

Regulation of Insurance Business

Effecting and carrying out a contract of insurance as principal are both regulated activities for which FSA permission is required under the 2000 Act, and the carrying on of such regulated activities is referred to as insurance business. Some of Prudential's subsidiaries, including The Prudential Assurance Company Limited, Scottish Amicable Life plc, Prudential Annuities Limited, Prudential Retirement Income Limited, Prudential Pensions Limited and Prudential (AN) Limited, carry on insurance business in the United Kingdom with the permission of the FSA and are supervised by the FSA under the 2000 Act.

Current Regime

The FSA regulates insurance business principally through the issuance of rules with which authorized persons are required to comply. In particular, the FSA Interim Prudential Sourcebook for Insurers (referred to below as the Insurer's Sourcebook, which applies to all UK insurers) prescribes rules and guidance specifically for authorized persons carrying on insurance business. Under the Insurer's Sourcebook, an insurance company is restricted from carrying on any activities other than in connection with or for the purposes of its insurance business.

Proposed Regime

The FSA is proceeding with the introduction of a fully revised prudential regime to apply to insurance firms beginning in 2004. The revised prudential regime will require much more explicit, and documented, management of risk by regulated firms. The FSA has proposed that the regime will include two key elements: a self-assessment undertaken by firms within a framework of rules and guidance set out within the integrated prudential rulebook and a supervisory assessment by which a firm may be required by the FSA to hold additional capital in response to specific systems and controls related concerns. Also key to the proposed new prudential regime are proposals to radically reform regulatory reporting by insurance companies to convey a clearer picture of the real nature and underlying risks of their businesses. The FSA believes that the current reporting regime for both life and non-life insurers is over-complex and voluminous and that there is too much focus on historic financial information which is difficult even for expert users to understand. The reporting regime which the FSA intends to introduce aims to be more proactive and less retrospective, with reporting more streamlined and occurring more frequently than once a year. The FSA expects the new reporting regime to capture less raw data but more and better quality information on a wide range of relevant areas. Core elements of the new regulatory system are likely to require insurance firms to:

- provide more information on the operational risks facing the firm,
- provide more analysis of the asset side of the balance sheet,
- disclose more information about holdings in, or transactions with, affiliates,
- give more information on key performance indicators relating to a firm's dealings with its customers, and
- provide enhanced disclosure on reinsurance and financial reinsurance arrangements.

Long-term Assets and Liabilities

Long-term business assets and liabilities those assets and liabilities relating to, broadly, life and health insurance policies must be segregated from the assets and liabilities attributable to non-life insurance business or to shareholders. Separate accounting and other records must be maintained and a separate fund must be established to hold all receipts of long-term business.

The extent to which long-term fund assets may be used for purposes other than long-term business is restricted by the Insurer's Sourcebook. Only the "established surplus" the excess of assets over liabilities in the long-term fund, as determined by an investigation by the appointed actuary may be transferred so as to be available for other purposes. Restrictions also apply to the payment of dividends by the insurance company or its parent, as described below. In practice, the level of assets held in the long-term fund will need to remain well in excess of the insurer's long-term liabilities.

Solvency Requirements

The Insurer's Sourcebook also requires that insurance companies maintain a margin of solvency at all times in respect of both any long-term insurance and general insurance undertaken by the insurance company, the calculation of which in any particular case depends on the type and amount of insurance business a company writes. The method of calculation of the solvency margin is set out in the Insurer's Sourcebook, and for these purposes, an insurer's assets and its liabilities are subject to specific valuation rules set out in the Insurer's Sourcebook. Failure to maintain the required solvency margin is one of the grounds on which wide powers of intervention conferred upon FSA may be exercised.

Appointed Actuary

Under the Insurer's Sourcebook, every insurance company that carries on long-term business must appoint an actuary. The appointed actuary must prepare an annual report for the company's directors quantifying the company's long-term liabilities attributable to the insurance company's long-term insurance business, determining the value of any excess over those liabilities of the assets representing the long-term insurance fund and where any rights of long-term policyholders to participate in profits relate to particular parts of such a fund, a valuation of any excess of assets over liabilities in respect of each of those parts.

The appointed actuary must be an "approved person" and must comply with the regulatory provisions applicable to approved persons. Furthermore, the appointed actuary has a professional duty to be satisfied at all times as to the solvency of the company and that policyholders' reasonable expectations are safeguarded. The UK Institute of Actuaries and the UK Faculty of Actuaries require all members, including appointed actuaries, to comply with their Professional Conduct Standards.

In connection with an extensive review of the UK with-profits business, the FSA has asked whether the requirement that an insurance company have an appointed actuary should be retained in light of the responsibilities already imposed upon the board of an insurance company under the 2000 Act regime and, if the requirement to have an appointed actuary is to be retained, whether the current regulatory regime could be improved. In January 2003, the FSA made the following proposals in this regard:

discontinuing the existing appointed actuary regime,

introducing two new actuarial functions: the actuarial function and that of the with-profits actuary, both of which would be "controlled functions" (meaning that the persons undertaking these functions would need to be approved by the FSA), and

introducing new requirements dealing with potential conflicts of interest where the with-profits actuary is also a board member.

Distribution of Profits and With-profits Business

The Insurer's Sourcebook provides that, once an allocation of surplus in a with-profits fund has been made to policyholders, no transfer of assets representing any part of a subsequent surplus can be made, to shareholders or otherwise, unless either the "relevant minimum" (as defined in the Insurer's Sourcebook) of the surplus has been allocated to policyholders or a statutory notification procedure has been followed. Calculation of the relevant minimum is based upon the percentage of the relevant surplus previously allocated to eligible policyholders.

Under the Insurer's Sourcebook, the parent of an insurance company is not prohibited from declaring dividends in circumstances where the value of the long-term insurance business assets is less than the amount of the long-term insurance business liabilities. HM Treasury however is given power under the 2000 Act to make regulations preventing an insurance company's parent from doing anything to lessen the effectiveness of any "asset identification rules" made by the FSA, which will include in this context rules requiring insurers to maintain the solvency of the long-term fund.

There has been considerable public debate regarding the rights and legitimate expectations of with-profits policyholders to assets forming part of an insurance company's surplus, particularly where such assets do not derive from the payment of current policyholders premiums but are rather "inherited" from previous generations of policyholders or from other entities.

In addition to its proposed changes with respect to the appointed actuary regime, the FSA also proposed in January 2003 that firms carrying on with-profits business must:

define and make publicly available the Principles and Practices of Financial Management (the "PPFM") applied in their management of with-profits funds,

ensure their governance arrangements offer assurance that they have managed their funds in line with the PPFM they have established and published,

produce annual reports for with-profits policyholders on how they have complied with this obligation, including how they have addressed any competing or conflicting rights, interests or expectations of policyholders and, if applicable, shareholders,

comply with (i) modified regulatory reporting requirements designed to achieve the FSA's objective of making directors and senior management more explicitly responsible for setting up technical provisions and other decisions taken on actuarial advice and (ii) new audit requirements for liabilities, and

comply with consequential changes to certification in the insurance returns.

HM Treasury contemporaneously conducted its own review (termed the "Sandler Review") of the UK with-profits business, and expressed the following concerns about with-profits products from the perspective of competition and efficiency:

- the opacity of with-profits products hides the factors that contribute to the return under the policies, allied to which is a lack of clarity of charges, which inhibits effective competition,
- the manner in which funds derived from with-profits policyholders are held within the corporate structure can give rise to conflicts of interest, particularly in relation to investments and expense charging,
- the participation structure in proprietary firms further increases opacity, reduces incentives for efficiency and has no direct relationship to the risk to which shareholder capital is exposed, and
- the existence of inherited estates distorts competition, further increasing opacity.

To address these concerns, the Sandler Review included detailed recommendations for consideration and possible implementation by the FSA for a "new model" of with-profits products covering, among other things:

- the structure of the funds in which with-profits business is written,
- with-profits fund investments and the operation of with-profits policies,
- disclosure of information,
- options for existing business,
- treatment of inherited estates, and
- specific requirements for a proposed simplified with-profits product.

The FSA has issued Discussion Paper 20 (termed "DP20") in which it indicates that it is considering the Sandler Review recommendations and, while indicating that it considers that some of these recommendations may be unnecessarily prescriptive, has commenced consultation on the recommendations.

Reporting Requirements

Under the Insurer's Sourcebook, insurance companies must file with the FSA their audited annual accounts and balance sheets and appointed actuaries' reports.

In July 2002, the FSA began consultation on a proposed new regulatory approach to implicit items (an umbrella term used by the FSA to cover arrangements that improve or smooth reported profits, or improve the reported balance sheet position, of an insurer in its financial and/or regulatory reporting). The FSA is concerned that implicit items may obscure the underlying financial condition of a firm, or be designed to mislead consumers or regulators, or otherwise cause a lack of transparency. Accordingly, the FSA has proposed rules requiring clearer presentation of the effects of implicit items on the financial condition of life insurers, directive friendly societies and individual with-profits funds therein. In December 2002 the FSA adopted some new rules following feedback to this consultation to encourage clearer and more directly comparable presentations of information on implicit items in regulatory returns of life insurers in their returns for the year ending December 31, 2002. The FSA has indicated that it will state in early 2003 its conclusions from the remaining consultations in these proposals. See " Business of Prudential UK Business Financial Strength of Prudential Assurance's Long-term Fund" for more information on implicit items.

Equalization Reserves

The Insurer's Sourcebook requires every insurance company to maintain certain equalization reserves in respect of both general and credit insurance business, and to comply with the equalization reserve rules of the Insurer's Sourcebook.

Transfer of Insurance Business

Before any transfer of insurance business may take place, the 2000 Act requires a scheme of transfer to be prepared and approved by the High Court.

Winding-Up Rules

The general insolvency laws applicable to UK companies are modified in certain respects in relation to insurance companies. Since the introduction of the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 (the "2002 Order"), which came into force on May 31, 2002, insurance companies in the UK have become subject to the administration procedures contained in Part II of the Insolvency Act 1986 (which previously did not apply). These administration procedures have, however, also been slightly modified by the 2002 Order in relation to, for example, the power of an administrator to make any payments due to a creditor.

Additionally, in the United Kingdom, all FSA authorized insurance companies, except for pure reinsurers, are subject to the Insurers (Reorganization and Winding-up) Regulations 2003, which came into force on April 20, 2003. These Regulations provide, among other things, that direct insurance claims will have priority over the claims of other unsecured creditors, including reinsurance creditors, on a winding-up or on certain "reorganizations" of the insurance company. Furthermore, instead of making a winding-up order when an insurance company has been proved unable to pay its debts, a UK court may, under Section 377 of the 2000 Act, reduce the amount of one or more of the insurance company's contracts on terms and subject to conditions (if any) which the court considers fit. Where an insurance company is in financial difficulties but not in liquidation, the Financial Services Compensation Scheme has certain powers, including the power to take measures for securing the transfer of all or part of the business to another insurance company.

Section 376 of the 2000 Act provides further insolvency protection to insurance companies effecting or carrying out contracts of long-term insurance. Unless the court orders otherwise, a liquidator

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must carry on the insurer's business so far as it consists of carrying out the insurer's contracts of long-term insurance with a view to it being transferred as a going concern to a person who may lawfully carry out those contracts. In carrying on the business, the liquidator may agree to the variation of any contracts of insurance in existence when the winding-up order is made, but must not effect any new contracts of insurance.

EU Directive on Group Supervision

The European Union formally adopted directive 98/78/EC on the supplementary supervision of insurance undertakings within a group (the "Insurance Groups Directive") in October 1998. Currently, under European law, insurance regulation, including in respect of solvency, is directed at individual insurance companies, (so-called "solo supervision") and makes no specific provision for particular issues which arise in the context of a member of a group. The directive does not change this basic approach, but requires member states to introduce the following measures to strengthen supervision of insurance companies which are part of a group:

- an adjustment to the solo supervision solvency calculation in relation to participating interests in other insurance undertakings in order to eliminate "double-gearing" (the use of the same capital to cover different risks within a group),

- an additional parent undertaking solvency margin calculation analogous to the adjusted solo solvency margin test referred to above, to be applied at the level of the parent undertaking, the introduction of new solo-supervision requirements, including rules as to internal control within the insurance undertaking regarding the production of information relevant to supplementary supervision, the exchange of information within the group and the supervision of intra-group transactions, and

further provisions aimed at ensuring co-operation between competent regulatory authorities of member states.

The United Kingdom implemented those requirements of the Insurance Groups Directive which are new to the United Kingdom through the Insurer's Sourcebook.

The parent undertaking solvency margin under the legislation that implements the Directive is filed privately with the FSA and differs from the adjusted solo solvency margin test in that it is a calculation rather than a formal test. The Insurance Groups Directive requires that the calculation be performed and that if, on the basis of the calculation, the competent regulatory authorities conclude that the solvency of the regulated direct insurers are, or may be jeopardized, they take appropriate measures at the level of those insurers.

EU Directive on Financial Conglomerates

In November 2002, the European Union formally adopted directive 2002/87/EC on financial conglomerates (groups that include regulated entities which are active in both the banking/investment services sectors on the one hand, and the insurance sector on the other hand, and which meet certain criteria). The aim of the directive is to impose, from 2005, additional prudential requirements in respect of regulated entities within financial conglomerates including, to a certain extent, any mixed financial holding company. The additional supervision will be organized at the level of the financial conglomerate and will cover capital adequacy, risk concentration and intra-group transactions.

The manner of the implementation of this directive, together with the Insurance Groups Directive and new EU rules on solvency margins (see below) may lead to Prudential being required to maintain higher level of capital than currently necessary to support some of its businesses or, alternatively, to constrain the growth of those businesses. In addition, an inconsistent application of these directives by

regulators in different EU member states may place Prudential at a competitive disadvantage to other European financial services groups.

New EU Rules on Solvency Margins

Under new rules amending the solvency margin requirements for life and non-life insurance undertakings, which will be implemented in EU member states in 2004, each insurance company in an EU member state must maintain a solvency margin (shareholders' equity and quasi-equity) at a level that depends on the nature of the insurer's activity and that is calculated with reference to certain balance sheet and income statement items, subject to an absolute minimum (so-called minimum guaranteed fund) of €3 million (€2 million for some classes of non-life insurance). The rules are part of the European Commission's efforts to achieve a single European market for financial services by 2005. The rules will also give regulators greater powers to intervene in the event of concerns regarding an insurance company's financial position.

Regulation of Investment Business

Certain of Prudential's subsidiaries are authorized by the FSA to carry on investment business. These entities are subject to regulation and supervision by the FSA and must comply with the FSA Conduct of Business Rules and all other applicable rules prescribed by the 2000 Act regime.

The establishment, operation and winding-up of a stakeholder pension scheme is a regulated activity, and rights under a stakeholder pension scheme are defined as "investments" for the purposes of the 2000 Act regime, so that dealing, arranging, managing, advising and providing custody activities in respect of rights relating to a stakeholder pension also constitute regulated activities.

Entering into and administering mortgage contracts relating to land used as a dwelling by the borrower or his relatives are both a regulated activity under the 2000 Act regime, so that, following the expiry of a transitional provision, appropriate permission from the FSA must be obtained before such regulated activities may be carried on. In addition, HM Treasury has announced that the provision of mortgage advice and mortgage arranging will also become regulated activities once the FSA has completed its consultation process.

The designation of effecting, administering, arranging and advising on mortgages as regulated activities will, when it comes into effect (expected to be October 2004), constitute a significant extension of the scope of regulation. Grandfathering will not be an appropriate means of obtaining permission for these activities, so lenders will have to obtain FSA permission and devise new compliance procedures.

Regulation of Banking Business

The FSA has sole responsibility for banking supervision and regulation in the United Kingdom and has wide discretionary powers in relation to those banks it regulates. The FSA has wide investigatory and enforcement powers, including the power to require information and documents from banks, appoint investigators, apply to the court for injunctions in cases of breaches or likely breaches of rules, impose financial penalties, issue a public statement or censure and vary, cancel or withdraw authorization to carry on banking business.

Supervision

In its role as supervisor of banks, the primary objective of the FSA is to fulfil its responsibilities under the 2000 Act regime relating to the safety and soundness of banks with the aim of strengthening, but not guaranteeing, the protection of depositors. The FSA has adopted a risk-based approach to bank supervision.

The FSA requires Prudential to maintain a certain minimum capital adequacy ratio of total capital to risk-weighted assets and to report large exposures. The Interim Prudential Sourcebook for Banks, on a general level, requires banks operating in the United Kingdom to maintain adequate liquidity, taking into account the nature and scale of their business so that they are able to conduct business in a prudent manner and meet their obligations as they fall due. As part of its supervision, the FSA requires the banks subject to its supervision to provide it with information that the FSA may reasonably require to perform its functions under the 2000 Act regime.

Transfer of Banking Business

Before any transfer of business wholly or partly involving deposit taking may take place, the 2000 Act requires a scheme of transfer to be prepared and approved by the High Court.

Solvency Requirements

The requirement to have adequate capital is one of the criteria for permission to accept deposits under the 2000 Act. A bank should have sufficient capital to provide a stable resource to absorb any losses arising from the risks in its business. In assessing a bank's capital adequacy, the FSA takes into account not only the level of a bank's own funds but also other matters such as concentration of the loan book (large exposures) and liquidity.

The FSA applies capital adequacy guidelines that accord with relevant EC directives and the Basel Accord of 1988, which established a framework for measuring the capital adequacy of international banking organizations. These guidelines implement a number of EC directives, including the Own Funds Directive, concerning capital requirements, the Solvency Ratio Directive, concerning solvency ratios that credit institutions must maintain, and the Capital Adequacy Directive, as amended, referred to as CAD, requiring credit institutions to provide capital for market risk. The FSA's guidelines impose on banks a requirement that they maintain a minimum level of capital to support on and off-balance sheet exposures, weighted according to broad categories of risk. Each bank subject to the FSA's guidelines must maintain a required capital adequacy ratio of total capital to risk-weighted assets. This ratio is set by the FSA individually for each such bank, but the ratio is in no case less than 8%.

The FSA introduced a new market risk regime as from October 1, 1998 for implementation of its policy based on the Basel Accord and the parallel EC Market Risk Directive, known as the "CAD Amending Directive". Both the 1996 Basel Amendment to the Basel Accord and the CAD Amending Directive enable banks to use internal value-at-risk models to calculate capital charges for market risks.

Banks that have a trading book over a certain size are obliged to meet the trading book capital requirements of the CAD and the CAD Amending Directive in respect of the market-related and credit-related risks arising from their trading activities. This involves splitting their business between trading and banking books. UK banks are required to maintain, in non-interest-bearing accounts at the Bank of England, a cash balance, known as the cash ratio deposit, which is based on eligible liabilities, primarily pound sterling deposits less amounts on loan to other monetary institutions. Although these balances count towards the liquidity requirements for the real time gross settlement system introduced in the United Kingdom during 1996, they are generally regarded as non-operational and, accordingly, do not count towards overall liquidity requirements. The liquidity standard for sterling, which the UK government introduced in January 1996, requires the maintenance of sufficient holdings of liquid assets to cover potential cash outflows over the next five business days. This policy applies to UK-incorporated retail banks and group UK-based sterling operations.

In June 1999, the Basel Committee on Banking Supervision issued a proposal for a new capital adequacy framework to replace the Basel Accord of 1988. The new capital framework consists of three "pillars": minimum capital requirements that will expand and develop the standardized rules set out in the 1988 Accord, a supervisory review of an institution's capital adequacy and internal assessment

process and effective use of market discipline to strengthen disclosure and encourage safe banking practices. In furtherance of its objective to replace the Basel Accord of 1988, on January 16, 2001 the Basel Committee published its consultation paper entitled "The New Basel Capital Accord" and is currently conducting an extended consultation process in connection with the paper with banking industry participants. The Basel Committee hopes to implement the new accord in 2006.

On November 23, 1999 the European Commission published a consultation document on its proposals to review the existing capital adequacy framework for EU credit institutions and investment firms. The Commission's paper complements the Basel Committee's paper and similarly contains proposals on minimum capital requirements, supervisory review, and disclosure as an aid to market discipline.

The European Commission also launched on February 5, 2001 a second round of consultations on a new capital adequacy framework for banks and investment firms. The European Commission will publish a third and final consultative document in mid-2003 shortly after the Basel Committee publishes its final consultative document on the proposed new Basel Capital Accord. The European Commission aims for the new EU capital adequacy regime to be implemented into EU member states' domestic legislation at the same time as the new Basel Capital Accord is implemented globally in 2006. The broad aim of the European Commission is for the new EU regime to:

- reflect market change by taking into account the different needs of global players and locally acting institutions, with the one-size fits all approach likely to be abandoned,
- align capital charges and underlying economic risk more closely,
- provide incentives for enhanced risk mitigation standards, and
- provide a framework to support a comprehensive assessment of the risks to which firms are exposed.

US Supervision and Regulation

General

Prudential conducts its US insurance activities through Jackson National Life, which is a stock life insurance company licensed to transact its insurance business in, and subject to regulation and supervision by, the District of Columbia and 49 of the 50 states; Jackson National Life operates a subsidiary, Jackson National Life Insurance Company of New York, in the state of New York. The extent of such regulation varies, but most jurisdictions have laws and regulations governing the financial aspects of insurance companies, including standards of solvency, reserves, reinsurance and capital adequacy and the business conduct of insurance companies. In addition, statutes and regulations usually require the licensing of insurers and their agents and the approval of policy forms and related materials. These statutes and regulations in Jackson National Life's state of domicile, which is Michigan, also set out the permitted types and concentration of investments.

Insurance regulatory authorities in each of the jurisdictions in which Jackson National Life does business require it to file detailed quarterly and annual financial statements, and these authorities have the right to examine its operations and accounts. In addition, Jackson National Life is generally subject to federal and state laws and regulations that affect the conduct of its business. New York and Michigan require their state insurance authorities to conduct an examination of an insurer under their jurisdiction at least once every five years. The New York Insurance authorities conducted an examination of Jackson National Life of New York in 2000 and the report included no material findings. Michigan insurance authorities completed a routine examination of Jackson National Life during the year 2001 and the report included no material findings. The New York insurance authorities are in the process of

conducting an examination of Jackson National Life of New York for the year ending December 31, 2002.

Jackson National Life's ability to pay shareholder dividends is limited under Michigan insurance law. The Michigan insurance commissioner ("the commissioner") may limit, or not permit the payment of, shareholder dividends if the commissioner determines that an insurer's surplus, as regards policyholders, is not reasonable in relation to its outstanding liabilities and is not adequate to meet its financial needs as required by Michigan insurance law. Jackson National Life must report any shareholder dividends to the commissioner before they can be paid. In the case of an extraordinary shareholder dividend or distribution, an insurer must give 30 days' advance notice to the commissioner and may not pay the dividend or distribution if the commissioner disapproves within such 30-day period. For this purpose, an extraordinary dividend or distribution means any dividend or distribution of cash or other property whose fair market value together with that of other dividends or distributions that an insurer made within the preceding twelve months exceeds the greater of 10% of the insurer's surplus as regards policyholders as of December 31 of the immediately preceding year, or the net gain from operations of the insurer, not including realized capital gains, for the prior year. In 2000, 2001 and 2002 Jackson National Life paid shareholder dividends of $176.3 million, $131.1 million and $142.0 million, respectively.

State regulators also require prior notice or regulatory approval of changes in control of an insurer or its holding company and of certain material transactions with affiliates. Under New York and Michigan insurance laws and regulations, no person, corporation or other entity may acquire control of an insurance company or a controlling interest in any parent company of an insurance company, unless that person, corporation or entity has obtained the prior approval of the regulator for the acquisition. For the purpose of New York and Michigan law, any person acquiring, directly or indirectly, 10% or more of the voting securities of an insurance company is presumed to have acquired "control" of the company. To obtain approval of any change in control, the proposed acquiror must file an application with the New York superintendent of insurance or the Michigan insurance commissioner, as appropriate. This application requires the proposed acquiror to disclose, among other information, its background, financial condition, the financial condition of its affiliates, the source and amount of funds by which it will effect the acquisition, the criteria used in determining the nature and amount of consideration to be paid for the acquisition, proposed changes in the management and operations of the insurance company and other related matters.

Guaranty Associations and Similar Arrangements

Each of the 50 states of the United States, the District of Columbia and the Commonwealth of Puerto Rico have laws requiring insurance companies doing business within their jurisdictions to participate in various types of guaranty associations or other similar arrangements. These associations and arrangements provide certain levels of protection to policyholders from losses under insurance policies issued by insurance companies that became impaired or insolvent. Typically, these associations levy assessments, up to prescribed limits, on member insurers on a basis that is related to the member insurer's proportionate share of the business in the relevant jurisdiction of all member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Some jurisdictions permit member insurers to recover assessments that they paid through full or partial premium tax offsets, usually over a period of years. Prudential estimated its reserve for future guarantee fund assessments for Jackson National Life to be £25 million at December 31, 2002. Prudential believes this reserve to be adequate for all anticipated payments for known insolvencies.

Asset Valuation Reserve

State regulators generally require that insurers establish an asset valuation reserve that consists of two components: a default component to provide for future credit-related losses on fixed income

investments and an equity component to provide for losses on all types of equity investments. The asset valuation reserve establishes statutory reserves for fixed maturity securities, equity securities, mortgage loans, equity real estate and other invested assets. The reserve is designed to provide for all realized and unrealized gains and losses on such assets, other than those resulting from changes in interest rates. The level of reserves is based on both the type of investment and its rating. Contributions to the reserve may result in a slower growth in surplus or a reduction of Jackson National Life's unassigned surplus, which, in turn, may reduce funds available for shareholder dividends or shareholder distributions. The extent of the impact of its asset valuation reserve on Jackson National Life's surplus depends in part on the future composition of the investment portfolio.

Interest Maintenance Reserve

State regulators generally require that insurers establish an interest maintenance reserve to defer non-credit-related realized capital gains and losses, net of taxes, on fixed income investments, primarily bonds and mortgage loans, which are amortized into net income over the estimated remaining periods to maturity of the investments sold. The extent of the impact of the interest maintenance reserve depends on the amount of future interest-rate related realized capital gains and losses on fixed maturity investments.

The National Association of Insurance Commissioners Ratios

On the basis of statutory financial statements that insurers file with state insurance regulators, the National Association of Insurance Commissioners annually calculates twelve financial ratios to assist state regulators in monitoring the financial condition of insurance companies. A usual range of results for each ratio is used as a benchmark and departure from the usual range on four or more of the ratios can lead to inquiries from individual state insurance departments.

One Jackson National Life ratio fell outside the usual range in 2002. This was the net income to total income ratio which fell outside the usual range because of the net loss reported for 2002. The net loss resulted from realized capital losses. Although the statutory gain from operations was $128 million, it was more than offset by $386 million of realized investment losses. Any net loss is considered unusual for this ratio.

Policy and Contract Reserve Sufficiency Analysis

Michigan insurance law requires Jackson National Life to conduct annually an analysis of the sufficiency of its life and annuity reserves. A qualified actuary must submit to the insurance department an opinion that states that the reserves, when considered in the light of the assets that an insurance company holds with respect to such reserves, make good and sufficient provision for the associated contractual obligations and related expenses of the insurance company. If a qualified actuary cannot provide such an opinion, then the insurance company must set up additional reserves by moving funds from unassigned surplus. The 2002 opinion has been submitted to the insurance department without any qualifications.

Jackson National Life's Capital and Surplus

Michigan insurance law requires Jackson National Life, as a domestic stock life insurance company, to maintain at least US$7,500,000 in unimpaired capital and surplus. In addition, insurance companies are required to have sufficient capital and surplus to be safe, reliable and entitled to public confidence.

As a licensed insurer in the District of Columbia and every state but New York, where it operates through a subsidiary, Jackson National Life is subject to the supervision of the regulators of each such jurisdiction. In connection with the continual licensing of Jackson National Life, regulators have discretionary authority to limit or prohibit the new issuance of business to policyholders when, in their

judgment, the regulators determine that such insurer is not maintaining minimum surplus or capital or if the further transaction of business will be hazardous to policyholders.

Risk-based Capital

In 1992, the National Association of Insurance Commissioners approved risk-based capital standards for life insurance companies as well as a model act for state legislatures to enact. The model act requires that life insurance companies report on a formula-based, risk-based capital standard that they calculate by applying factors to various asset, premium and reserve items. The formula takes into account the risk characteristics of a company, including asset risk, insurance risk, interest rate risk and business risk. The National Association of Insurance Commissioners designed the formula as an early warning tool to identify potentially inadequately capitalized companies for purposes of initiating regulatory action. The National Association of Insurance Commissioners intended the formula as a regulatory tool only and did not intend it as a means to rank insurers generally. The model act imposes broad confidentiality requirements on those engaged in the insurance business (including insurers, agents, brokers and others) and on state insurance departments as to the use and publication of risk-based capital data.

Any state adopting the model act gives the state insurance commissioner explicit regulatory authority to require various actions by, or take various actions against, insurance companies whose adjusted capital does not meet minimum risk-based capital standards. The Michigan insurance commissioner takes into account the National Association of Insurance Commissioners' risk-based capital standards to determine adequate compliance with Michigan insurance law. At December 31, 2002, Jackson National Life's total adjusted capital under the National Association of Insurance Commissioners' definition substantially exceeded Michigan standards.

Regulation of Investments

Jackson National Life is subject to state laws and regulations that require diversification of its investment portfolio, limit the amount of investments in certain investment categories such as below investment grade fixed income securities, equity real estate, foreign securities and common stocks and forbid certain other types of investments altogether. Jackson National Life's failure to comply with these laws and regulations would cause investments exceeding regulatory limitations to be treated by the Michigan Insurance Division as non-admitted assets for purposes of measuring surplus, and, in some instances, the Michigan Insurance Division could require divestiture of non-qualifying investments.

Federal Financial Services Regulation

Thrift Regulation

Jackson National Life, through JNL Thrift Holdings, Inc. ("Thrift Holdings"), owns Jackson Federal Bank, a federally chartered savings association, or "thrift". Jackson Federal Bank is subject to extensive regulation and examination by the Office of Thrift Supervision of the U.S. Department of the Treasury (the "OTS"). Jackson Federal Bank's deposits are insured to applicable limits by the Federal Deposit Insurance Corporation (the "FDIC"), and Jackson Federal Bank is therefore subject to a certain amount of regulation by the FDIC.

In addition, the parent companies of Jackson Federal Bank, including Thrift Holdings, Jackson National Life and Prudential plc, are subject to regulation by the OTS as thrift holding companies. Because the parent companies of Jackson Federal Bank control only a single thrift, they are regulated as so-called "unitary" thrift holding companies a status that confers certain benefits that are described below.

Holding Company Regulation

One of the principal advantages of unitary thrift holding company status relates to the ability of a unitary thrift holding company to acquire other types of financial and non-financial companies in the United States without regard to restrictions on such affiliations that apply to banking organizations and to "multiple" thrift holding companies (*i.e*., thrift holding companies that control more than one thrift). Under U.S. federal banking laws, including the Gramm-Leach-Bliley Act of 1999, bank holding companies and foreign banking organizations that meet certain criteria, as well as multiple thrift holding companies, are permitted to engage in a broad range of financial activities through their affiliates. These types of organizations are not, however, permitted to engage in commercial activities either directly or through affiliates.

In contrast, unitary thrift holding companies that existed before the Gramm-Leach-Bliley Act and entities that had submitted applications to become unitary thrift holding companies as of May 4, 1999, are "grandfathered" or exempted from these restrictions, and the Gramm-Leach-Bliley Act does not impose affiliation restrictions on grandfathered unitary thrift holding companies. Jackson Federal Bank's parent companies, including Prudential plc, meet the criteria to be grandfathered unitary holding companies under the Gramm-Leach-Bliley Act. However, this privilege exists only so long as the parent companies preserve their status as a grandfathered unitary thrift holding companies. The primary restrictions in this regard are that the parent companies cannot undergo a change in control or acquire a separate US bank or thrift (unless the acquired institution is merged with the existing thrift subsidiary, Jackson Federal Bank).

In addition, Jackson Federal Bank's parent companies, including Prudential plc, could become subject to restrictions on their activities and investments if Jackson Federal Bank were to fail to be a "qualified thrift lender" ("QTL") under the Home Owners' Loan Act ("HOLA"). In general, in order for Jackson Federal Bank to remain a QTL, a certain percentage of its assets must consist of residential real estate mortgage loans, consumer loans, small business loans and other similar and related assets. Jackson Federal Bank is currently in compliance with QTL standards. In addition to triggering restrictions on activities of affiliates, failure to remain a QTL would also trigger restrictions on the ability of Jackson Federal Bank to obtain funding from the Federal Home Loan Bank System, establish new branches and pay dividends.

Under HOLA and applicable OTS regulations, thrift holding companies must file periodic reports with the OTS and must comply with OTS recordkeeping requirements. Thrift holding companies are subject to holding company examination by the OTS, and the OTS may take enforcement action against a thrift holding company if the activities of the thrift holding company constitute a serious risk to the financial safety, soundness or stability of a subsidiary thrift. Thrift holding companies are not subject to OTS capital adequacy requirements.

Regulation of Jackson Federal Bank

Jackson Federal Bank is subject to extensive regulation and examination by the OTS under HOLA and other federal laws and regulations. These laws and regulations govern Jackson Federal Bank's lending, deposit-taking and other activities, establishment of branches, transactions with affiliates, payment of dividends, capital adequacy and "community reinvestment" activities.

Capital Adequacy

Jackson Federal Bank is subject to OTS capital requirements. An institution's capital category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure, a tangible equity ratio measure, and certain other factors. Federal law and regulations establish minimum capital standards and also establish five

capital categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

Undercapitalized depository institutions are subject to growth limitations, the requirement to submit a capital restoration plan, and a variety of other restrictions the severity of which are keyed to the capital tier and other factors. Ultimately, critically undercapitalized institutions are subject to the appointment of a receiver or conservator. If an insured institution fails, the FDIC is appointed as receiver for the institution. Claims for administrative expenses of the receiver and for deposits in U.S. branches (including claims of the FDIC as subrogee of the failed institution) have priority over the claims of general unsecured creditors.

As of December 31, 2002, Jackson Federal Bank met all capital requirements to which it is subject and satisfied the requirements to be treated as well-capitalized.

Deposit Insurance

The FDIC insures the deposits of Jackson Federal Bank to the applicable maximum limits. The FDIC administers two separate deposit insurance funds, the Bank Insurance Fund and the Savings Association Investment Fund (the "SAIF"). The SAIF is a deposit insurance fund for most savings associations. Jackson Federal Bank is a member of the SAIF.

The FDIC has established a risk-based system for setting deposit insurance assessments. Under the risk-based assessment system, an institution's insurance assessments vary according to the level of capital the institution holds and the degree to which it is the subject of supervisory concern. In addition, regardless of the potential risk to the insurance fund, federal law requires the FDIC to establish assessment rates that will maintain each insurance fund's ratio of reserves to insured deposits at $1.25 per $100. Both funds met this reserve ratio as of December 31, 2002. During 2002, the assessment rate for SAIF deposits ranged from zero to 0.27% of assessable deposits. Jackson Federal Bank qualified for the lowest rate on its deposits in 2002.

Affiliate Transaction Restrictions

Jackson Federal Bank is subject to certain restrictions under federal law and OTS regulations on extensions of credit to, and other transactions with, affiliates and insiders (*e.g.*, directors, executive officers and controlling shareholders) of Jackson Federal Bank. For these purposes, "affiliate" generally includes parent companies such as Jackson National Life and Prudential plc, and any company under common control with Jackson Federal Bank. Depending on the type of transaction, Jackson Federal Bank's transactions with insiders and affiliates may be subject to prohibitions, quantitative restrictions (such as limitations based on a percentage of Jackson Federal Bank's capital), collateralization requirements and/or qualitative standards (such as requirements that transactions be on arm's length terms).

Community Reinvestment Act

The Community Reinvestment Act ("CRA") requires that Jackson Federal Bank ascertain and help meet the credit needs of the communities it serves, including low- to moderate-income neighborhoods, while maintaining safe and sound banking practices. The OTS assigns one of four possible ratings to Jackson Federal Bank's CRA performance and is required to make public Jackson Federal Bank's rating and written evaluation. The four possible ratings of meeting community credit needs are "outstanding", "satisfactory", "needs to improve", and "substantial noncompliance". In 2002, Jackson Federal Bank received a "satisfactory" CRA rating from the OTS.

USA PATRIOT Act

On October 26, 2001, President George W. Bush signed into law the USA PATRIOT Act ("Patriot Act"). The Patriot Act includes numerous provisions designed to fight international money laundering and to block terrorist access to the U.S. financial system. The U.S. Treasury Department has issued a number of regulations implementing the Patriot Act that apply certain of its requirements to financial institutions such as Prudential's banking and broker-dealer subsidiaries. Among other things, the regulations impose new obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. Jackson National Life does not expect the impact of the Patriot Act on its operations to be material, and has established policies and procedures to ensure compliance with the Patriot Act's provisions. The Treasury Department is expected to issue a number of additional regulations which will further clarify the Patriot Act's requirements, including with respect to insurance companies.

Changes in Regulations

Proposals to change the laws and regulations governing the banking industry are frequently introduced in U.S. Congress, in the state legislatures and before the various bank regulatory agencies. The likelihood and timing of any proposals or legislation and the impact they might have on Jackson National Life and its subsidiaries cannot be determined at this time.

Securities Laws

Jackson National Life, certain of its affiliates and certain policies and contracts that Jackson National Life offers are subject to various levels of regulation under the federal securities laws that the Securities and Exchange Commission administers.

The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations. Jackson National Life may also be subject to similar laws and regulations in the states in which it provides investment advisory services, offers the products described above or conducts other securities-related activities.

Jackson National Asset Management, LLC is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940 and a transfer agent under the Securities Exchange Act of 1934 (the "Securities Exchange Act"). Curian Capital, LLC is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940. The mutual funds for which Jackson National Asset Management LLC serves as investment adviser are subject to regulation under the Securities Act of 1933 (the "Securities Act") and the Investment Company Act of 1940 (the "Investment Company Act"). In addition, variable annuities and the related separate accounts of Jackson National Life are subject to regulation by the Securities and Exchange Commission under the Securities Act and the Investment Company Act as well as applicable insurance laws.

Each of Jackson National Life Distributors, Inc., National Planning Corporation, SII Investments, Inc., INVEST and ICA is registered as a broker-dealer under the Securities Exchange Act. National Planning Corporation was formerly known as Jackson National Financial Services, Inc. Jackson National Life Distributors, National Planning Corporation, SII Investments Inc., INVEST and ICA are subject to regulation and supervision by the Securities and Exchange Commission, each of the state securities authorities (to the extent that they transact business in that state), and the National Association of Securities Dealers, Inc., each of which has broad administrative and supervisory powers relative to all aspects of the broker-dealer business and may examine a broker-dealer's business and accounts at any time.

Prudential also conducts US investment management activities through PPM America, Inc., which is registered with the Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940. PPM America, Inc. serves as the investment adviser to Jackson National Life, certain mutual funds, several private investment funds and structured finance vehicles, and the US equity and fixed income portions of portfolios of certain UK affiliates of PPM America, Inc. The mutual funds for which PPM America, Inc. serves as investment adviser or sub-adviser are subject to regulation under the Securities Act and the Investment Company Act.

PPM America, Inc. and certain of its subsidiaries are subject to various levels of regulation under the federal securities laws that the Securities and Exchange Commission administers. The primary intent of these laws and regulations is to protect investors in the securities markets and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations.

To the extent that PPM America, Inc. manages assets for certain types of employee benefit plans subject to ERISA, the Employee Retirement Income Security Act of 1974, certain activities of PPM America, Inc. are potentially subject to the same types of regulatory restrictions that ERISA and the Internal Revenue Code impose. Such restrictions are the same as those described with respect to Jackson National Life concerning Employee Benefit Plan Compliance. See " Employee Benefit Plan Compliance" in this section below. The Department of Labor and the Internal Revenue Service have interpretive and enforcement authority over these provisions of ERISA and the Internal Revenue Code.

Employee Benefit Plan Compliance

Jackson National Life issues certain types of general account stable value products, such as GICs and funding agreements, to employee benefit plans and to investment vehicles that pool the investments of such plans. To a large extent, these plans are retirement plans that are subject to the fiduciary standards of ERISA, and that are tax qualified under the Internal Revenue Code. As such, certain activities of Jackson National are potentially subject to certain regulatory restrictions that ERISA and the Internal Revenue Code impose. These restrictions include:

- the requirement under ERISA that fiduciaries must perform their duties solely in the interests of ERISA plan participants and beneficiaries,

- the requirements under ERISA and the Internal Revenue Code that fiduciaries may not engage in conflict of interest transactions, and

- the requirements under ERISA and the Internal Revenue Code that a fiduciary may not cause a covered plan to engage in certain prohibited transactions with certain persons who provide services to the plan or are affiliated with the plan sponsor or a plan service provider.

The Department of Labor and the Internal Revenue Service have interpretive and enforcement authority over these provisions of ERISA and the Internal Revenue Code.

In the instance where an insurer issues a guaranteed benefit policy to a plan, ERISA provides that the insurer need not become a fiduciary with respect to the plan solely as a result of the issuance of the policy. Under Section 401 of ERISA, a guaranteed benefit policy means an insurance policy to the extent such policy provides for benefits the amount of which the insurer guarantees.

In 1993, in *John Hancock Mutual Life Insurance Company v. Harris Trust & Savings Bank*, the US Supreme Court held that, with respect to a portion of the funds held under a general account group annuity contract, an insurer could be subject to the fiduciary requirements of ERISA and the prohibited transaction provisions of ERISA and the Code. This decision was in contradiction to interpretations that the Department of Labor had previously issued.

As part of the Small Business Job Protection Act of 1996, Congress offered some relief from the impact of the *Harris Trust* decision for certain policies issued on or before December 31, 1998. This Act also required the Department of Labor to issue regulations for the purpose of determining, in cases where an issuer issues general account policies to or on behalf of employee benefit plans, which assets of the insurer will be subject to the fiduciary responsibility and prohibited transaction provisions of ERISA. In addition, the Act provided some protection from lawsuits claiming breaches of fiduciary duties under ERISA for actions arising prior to the finalization of such regulations for policies.

Nonetheless, the relief provided by the Small Business Job Protection Act is only transitional and the Department of Labor has not to date provided detailed guidance on the application of the *Harris Trust* decision to a determination of whether one or more policies will qualify as a guaranteed benefit policy. Accordingly, although Prudential does not believe that the *Harris Trust* decision will have a material adverse effect on Jackson National Life's business, financial condition or operations results, and Jackson National Life is proceeding with its general account products with the understanding that their issuance will not alone make Jackson National Life subject to ERISA's fiduciary standards and prohibited transaction provisions, the full impact of the *Harris Trust* decision is not entirely clear.

In addition, for plans that are not subject to ERISA or the prohibited transaction provisions of the Internal Revenue Code, such as pension plans maintained by state or local governments, state and local laws may apply in lieu of these fiduciary standards. Although Prudential does not believe that such laws will have a material adverse effect on Jackson National Life's business, financial condition or operations results, the application of these laws is generally less developed than the federal pension laws.

Financial Services Regulatory and Legislative Issues

The US President has in the past proposed to increase the taxes levied against the insurance industry to increase the federal budget revenues. The industry has been very successful in resisting these proposals on the grounds that an increase in taxes on insurance companies or insurance policies would have a negative affect on US citizens saving for their retirement. The insurance industry is very vigilant in monitoring these proposals and taking action to oppose them.

States regulate the business of insurance and each state regularly enacts or promulgates legislation and regulations that affect the way insurers do business within the state's boundaries. A major issue at the state level involves genetic information and whether insurers should be able to use such information when underwriting insurance policies. Many states have passed legislation restricting a health insurer's ability to use this information, but, at present, life insurance companies have not been made subject to similar restrictions. Prudential expects that similar legislative initiatives will continue to be passed into law.

Asian Supervision and Regulation

At the country level, Prudential's businesses in Asia are subject to comprehensive regulatory and supervisory schemes in the jurisdictions in which they operate. The laws and regulations vary from country to country, but the regulators generally have sufficient powers to grant or revoke licenses and registrations and therefore the ability to transact business.

Regulations are generally widely drawn and often include provisions governing both financial matters and the way in which PCA conducts and governs its business. Specific regulations exist to control many aspects of insurance and asset management businesses. This includes the registration of agents, the approval of products, the diversification and protection of company's assets, the provision of minimum capital, the calculation of the company's solvency and reserves and the valuation of policy liabilities. In some markets, the regulators also have powers over affiliations with other financial institutions, change of control of operating entities and the movement of capital and dividends. The regulators undertake regular examinations of financial statements and other returns as well as carrying out inspections of business operations.

A number of Asian countries require insurance companies to participate in policyholder protection schemes under which companies contribute to a fund to support policyholders of failed insurers.

In keeping with international developments, some Asian jurisdictions have updated or are expected to update their corporate governance frameworks, further laws and regulations in this area are expected during 2003.

For PCA's more material operations the details of the regulatory regimes are as follows:

Hong Kong

The Office of the Commissioner of Insurance is the regulatory body set up for the administration of the Insurance Companies Ordinance (referred to as the ICO). The Office is headed by the Commissioner of Insurance who has been appointed as the Insurance Authority for administering the ICO.

Authorization pursuant to the provisions of the ICO must be obtained for a company to carry on any class of insurance business in or from Hong Kong. The Hong Kong branch of Prudential Assurance is authorized to carry on both long-term business and general business under a composite license.

Japan

The Financial Services Agency of Japan (referred to as the JFSA) regulates Japanese insurance companies and other financial institutions. The supervision of insurance companies is specifically undertaken by the Insurance Business Division of the JFSA. The fundamental principles of insurance regulation are set out in the Insurance Business Law (referred to as the IBL).

PCA Life is licensed by and registered with the JFSA as a life insurance company. Apart from operating in accordance with the IBL and applicable formal regulations, the company also needs to comply with the Inspection Manual and other guidance issued by the JFSA.

Singapore

Insurance company regulation and supervision in Singapore is undertaken by the Monetary Authority of Singapore (referred to as the MAS). In order to sell insurance in Singapore, companies need to be licensed by the MAS.

Until August 2002 Prudential Assurance Company Singapore only held a life insurance license after which date, on application, it became registered and licensed to sell both life and general insurance business. This licensing applies to product manufacturing.

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Taiwan

The Taiwanese Ministry of Finance (referred to as the MOF) is responsible for approving a company's participation in insurance activities and for regulating and supervising authorized insurers. The MOF regulates all aspects of life insurance business including financial matters, capital adequacy, agency contracts, the training of agents and selling practices including the standards for issuing policies. PCA's Taiwanese operation is licensed for life insurance business.

Malaysia

The insurance industry in Malaysia is highly regulated and Bank Negara is the regulatory body responsible for supervising and regulating the conduct of financial services including insurance business. The law that governs the insurance industry is the Insurance Act 1996 which came into force on January 1, 1997 and is supplemented by regulations.

All insurance companies must be licensed with the Ministry of Finance. In addition, they are required to be a member of the Life Insurance Association of Malaysia and/or General Insurance Association of Malaysia. PCA's Malaysian operation currently holds a license for both life and general insurance business.

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Item 5. Operating and Financial Review and Prospects

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with Prudential's consolidated financial statements and the related notes to Prudential's consolidated financial statements included elsewhere in this document. Prudential's consolidated financial statements have been prepared in accordance with UK GAAP, which differs in certain material respects from US GAAP. For a summary of the material differences between UK GAAP and US GAAP relevant to Prudential's financial statements, see Notes 35 of the notes to Prudential's consolidated financial statements. A summary of the critical accounting policies which have been applied to these statements is set forth in the section below entitled " UK GAAP Critical Accounting Policies".

The results discussed below are not necessarily indicative of the results to be expected in any future periods. This discussion contains forward-looking statements based on current expectations, which involve risks and uncertainties. Actual results and the timing of certain events may differ significantly from those projected in these forward-looking statements due to a number of factors, including those set forth in the section below entitled " Factors Affecting Results of Operations", in Item 3, "Key Information Risk Factors" and elsewhere in this document.

Introduction

Prudential provides a broad range of financial products and services, primarily to the retail market. The period since 2000 has been one of significant change as Prudential has positioned itself to compete internationally in an increasingly challenging global marketplace.

In 2000, Prudential completed its listing on the New York Stock Exchange and completed an initial public offering of Egg plc on the London Stock Exchange.

In 2001, Prudential restructured its UK Insurance Operations to improve operational effectiveness and customer focus, while reducing operating costs. In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance business to Winterthur Insurance and the Churchill Group, its UK subsidiary. The transfer was completed on January 4, 2002 and resulted in a profit on disposal of £355 million after allowing for the costs of sale and other related items.

In 2002, Prudential's UK Insurance Operations announced plans to establish an offshore service center in India to improve customer contact service for the UK business and achieve additional cost savings. This initiative is expected to incur a restructuring charge of approximately £20 million with an estimated total impact on shareholders of £5 million by 2004, with the remaining £15 million borne by the PAC long-term fund. However, the charge is expected to be offset by gross cost savings from 2006 of approximately £16 million, of which approximately £4 million per annum is expected to be attributable to shareholders. See "Item 4 Information on the Company Business of Prudential UK Business Units UK Restructurings". In November 2002, Prudential agreed to sell its German life business (the policies for which are underwritten through a Dublin-based life insurance company) to Canada Life for €129 million (£82 million). The sale was completed on January 1, 2003. See "Item 4 Information on the Company Business of Prudential European Business Sale of German Business to Canada Life".

Factors Affecting Results of Operations

Prudential's results of operations are affected, to a greater or lesser degree, by a variety of factors, including demographics, general economic and market conditions, government policy and legislation and regulation, as discussed in greater detail below. See Item 3, "Key Information Risk Factors" for more information on risks associated with these and other factors. In addition, changes to the composition of

its businesses and the execution of its growth strategy may result in increased variation in profits from year to year.

General Economic and Market Conditions

In the 1990s, retail financial services and fund management markets in the United Kingdom and the United States benefited from generally favorable economic and market conditions. During that period, both the United Kingdom and the United States experienced strong economic growth, stable interest rates, low inflation rates and very strong growth in stock market prices. However over the last few years, stock market prices have fallen significantly as have interest rates. Despite these recent fluctuations, Prudential believes that the historical strength of the UK and US equity markets, combined with demographic factors and governmental efforts to increase individual savings and self-provision for retirement, have resulted in increased consumer focus on savings and investment products.

In Asia, any further global economic slowdown is likely to depress short-term growth. However, over the long-term, Prudential believes the potential in Asia remains and that it is in a strong position to benefit from the long-term growth potential throughout the region.

Changes in interest rates and returns from equity, real estate and other investments as well as volatility in these items may affect Prudential's profitability. In the United Kingdom, where Prudential invests in debt and other fixed income securities, equity securities and real estate, shareholders' profits under UK GAAP are largely a function of the bonuses it declares on with-profits products. The most important influences on the bonus rates are the overall rate of return earned on investments and Prudential's expectation of future investment returns. See "Analysis by Geographic Region United Kingdom Basis of Profits", " With-profits Products" and " Bonus Rates" below. In recent years, Prudential's long-term expectations of lower investment returns have had a negative impact on annual bonus rates and, as a result, shareholders' profit. A sustained fall in equity markets would have a negative impact on final bonus rates and, consequently, shareholders' profit. Prudential's bonus policy and its impact on profitability is addressed in more detail in "UK GAAP Critical Accounting Policies" below.

In the United States, fluctuations in prevailing interest rates, including changes in the difference between the levels of prevailing short-term and long-term rates, can affect results from Jackson National Life, which is predominantly a spread-based business with the majority of its assets invested in fixed income securities. Changes in interest rates, either upward or downward, can expose Jackson National Life to the risk of not earning anticipated spreads between the rate earned on investments and the rate credited on its policies. For example, if interest rates go up and/or competitors offer higher crediting rates, withdrawals on annuity contracts may increase as policyholders seek higher investment returns elsewhere. In response, Jackson National Life could (1) raise its crediting rates to stem withdrawals, decreasing its spread; (2) sell assets which may have depressed values in a high interest rate environment, creating realized investment losses; or (3) pay out existing cash which would otherwise have earned interest at the higher interest rates. Moreover, to the extent that Jackson National Life holds illiquid private placements and commercial mortgages, there is a risk that it will incur losses if it needs to sell those assets. Conversely, if interest rates decrease, withdrawals from annuity contracts may decrease relative to original expectations, creating more than expected cash to be invested at lower rates. Jackson National Life may have the ability to lower the rates it credits to policyholders as a result, but may be forced to maintain crediting rates for competitive reasons or because there exist minimum interest rate guarantees in certain contracts. In either case, the spread earned by Jackson National Life would be lowered.

The profitability of Jackson National Life's spread-based businesses depends in large part on its ability to manage interest rate spreads, as well as the credit and other risks inherent in its investment portfolio. There can be no guarantee that these risks will be managed successfully. Prudential designs its

US products and manages the investments supporting this business to reduce interest rate sensitivity. This has the effect of moderating the impact on Prudential's results of changes in prevailing interest rates. See Item 11, "Quantitative and Qualitative Disclosures about Market Risk" for a discussion of the management of Prudential's exposure to such market risk.

Government Policy and Legislation

Changes in government policy or legislation applying to companies in the financial services and insurance industries in any of the jurisdictions in which Prudential operates, particularly in the United Kingdom and the United States, may adversely affect the result of its operations. These include possible changes in the tax treatment of financial products and services, government pension arrangements and policies, the regulation of selling practices and solvency standards. These changes may affect Prudential's existing and future business by, for example, causing customers to cancel existing policies, requiring Prudential to change its range of products and services, redesign its technology or other systems, retrain staff, pay increased tax or incur other costs.

Regulation

In recent years, the insurance sectors in the markets in which Prudential operates have faced increased scrutiny. In 1997, Prudential was publicly criticized by its UK regulators for its treatment of pension mis-selling during the period from 1988 to 1994 and for failures to adequately monitor and train its salesforce. In 2001, a fine of £650,000 was levied by the Personal Investment Authority on Prudential, following an inspection in 1999 of Prudential's Phase 1 procedures, which revealed instances of delay in making payments of redress and of deficiencies in its record keeping. Pension mis-selling is discussed in more detail under Item 4, "Information on the Company Business of Prudential UK Business Compliance Pension Mis-selling". In March 2003, the FSA levied a fine of £750,000 on Prudential for the mis-selling of mortgage endowment policies by Scottish Amicable during the period from January 1999 to February 2001. Mortgage endowment mis-selling and regulatory actions taken by the FSA to address the issue are discussed in more detail under under Item 4, "Information on the Company Business of Prudential UK Business Compliance Mortgage Endowment Products Review".

Additional regulation, scrutiny and related costs have put pressure on the margins on new business. In the United States, Prudential has been the subject of regulatory sanctions and class actions. These class actions are discussed in more detail under Item 4, "Information on the Company Business of Prudential Legal Proceedings". Changes in pensions financial services and tax regulation could have an impact on Prudential's results. See Item 4, "Information on the Company Supervision and Regulation of Prudential" for a summary of the current regulatory environment in which Prudential conducts its business.

Exchange Rates

Due to the geographical diversity of Prudential's businesses, it is subject to the risk of exchange rate fluctuations. Prudential's international operations in the United States, Asia and Europe, which represent a significant proportion of total group income and expenses, generally write policies and invest in the same local currency, which although limiting the effect of exchange rate fluctuations on local operating results, can lead to fluctuations in Prudential's consolidated financial statements upon translation of results into pounds sterling.

UK GAAP Critical Accounting Policies

Prudential's discussion and analysis of its financial condition and results of operations are based upon Prudential's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United Kingdom. Prudential's financial statements are prepared in accordance with the modified statutory basis ("MSB") of reporting of long-term business. This is in accordance with the Statement of Recommended Practice issued by the Association of British Insurers ("ABI") in December 1998. In broad terms, MSB profits for long-term business reflect the aggregate of statutory transfers from with-profits funds and profits on a traditional deferred and matching approach for other long-term business.

The preparation of these financial statements requires Prudential to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, Prudential evaluates its estimates, including those related to long-term business provisioning, the fair value of assets and the declaration of bonus rates. Prudential bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. Prudential believes that its critical accounting policies are limited to those described below. For a detailed discussion on the application of these and other accounting policies, see Note 3 of the notes to the consolidated financial statements and "US GAAP Analysis US GAAP Critical Accounting Policies" below.

The critical accounting policies in respect of the items discussed below are critical for the group's results in so far as they relate to the group's shareholder financed business, in particular for Jackson National Life.

Long-term Business Provision

At December 31, 2002, the long-term business provision represented 65% of Prudential's total liabilities. These liabilities predominantly relate to with-profits and other protection type policies. These liabilities are estimated using actuarial methods based on assumptions relating to premiums, interest rates, investment returns, expenses, mortality and surrenders.

The future policyholder benefit provisions for Jackson National Life's conventional protection-type policies are determined using the net level premium method, with an allowance for surrenders and claims expenses. Rates of interest used in establishing the policyholder benefit provisions range from 6.0% to 8.4%. Mortality assumptions range from 50% to 90% of the 1975-1980 Basic Select and Ultimate tables, depending on underwriting classification and policy duration. For investment-type products sold by Jackson National Life, the policyholder benefit provision included within technical provisions in the consolidated balance sheets is the policyholder account balance.

The future policyholder benefit provisions for Asian businesses are determined in accordance with methods prescribed by local GAAP. In regions where local GAAP is not well established, US GAAP is used as the most appropriate proxy to local GAAP. The valuation of policyholder benefit provisions may differ from that determined on a UK modified statutory basis.

Fair Value of Assets

Equity securities, debt and other fixed income securities, except for those held by Jackson National Life (which are carried at amortized cost), are carried at fair value with unrealized gains and losses reflected in the profit and loss account. Fair value is based on market prices for listed securities and on quotations provided by external fund managers, brokers, independent pricing services or values determined by management for unlisted securities. Where third party information is not available, the

group performs alternative valuation techniques, including discounted cash flow analysis, option-adjusted spread models, and enterprise valuation.

Except to the extent of other than temporary impairments, movements in the fair value of Jackson National Life's bond portfolio do not impact shareholders' profits or funds. Impairments in the carrying value of the individual bonds and other fixed income securities that are considered other than temporary are reflected as losses in profit or loss before tax. Among the factors considered is whether the decline in fair value results from a change in the quality of the security itself, or from a downward movement in the market as a whole, and the likelihood of recovering the carrying value based on the current and short term prospects of the issuer. Unrealised losses that are considered to be primarily the result of market conditions, such as increasing interest rates, unusual market volatility or industry-related events, and where the group also believes there exists a reasonable expectation for recovery and, furthermore, has the intent and ability to hold the investment until maturity or the market recovers, are usually determined to be temporary.

Investment Returns

Investment returns comprise investment income, realized gains and losses and changes in unrealized gains and losses, except for changes in unrealized gains and losses on debt securities held by Jackson National Life. These securities are carried in the balance sheet at amortized cost. For debt and other fixed interest securities held by Jackson National Life, purchase premiums and discounts are amortized based on the underlying investments' call or maturity dates and this amortization is included in investment returns. Realized gains and losses, including writedowns on permanent dimunitions, are recognized in income on the date of sale as determined on a specific identification basis for Jackson National Life and on an average cost basis elsewhere.

Deferred Acquisition Costs

In common with other insurers, Prudential incurs significant costs in connection with acquiring new insurance business. These costs, which vary with and are primarily related to the production of new business, are capitalized and amortized against margins in future revenues on the related insurance policies. The recoverability of the asset is measured and the asset is deemed impaired if the projected future margins are less than the carrying value of the asset. Management makes assumptions as to whether certain costs should be deferred or not and whether they will be offset by future margins on the policies. To the extent that the actual future margins differ from those anticipated then an adjustment to the carrying value of the deferred acquisition cost asset will be necessary.

The deferral and amortization of deferred acquisition costs is of most relevance to the group's reported profits for shareholder financed long-term business operations, principally Jackson National Life in the United States. In 2002, for Jackson National Life, poor equity market performance has lowered future expected profits on the variable annuity line through lower fee income and an increased provision for future guaranteed minimum death benefit claims. As a result, the deferred acquisition cost asset associated with the variable annuities has become impaired. During 2002, the asset has been reduced through increased amortization compared to 2001 of approximately £85 million primarily due to the poor market performance. Further impairments or accelerated amortization of this deferred acquisition cost asset are likely to result if future market returns are below assumed levels.

Deferred Tax

Deferred tax assets and liabilities generally are recognized in accordance with the provisions of FRS 19 "Deferred Tax" ("FRS 19"). Prudential has chosen not to apply the option available under FRS 19 of recognizing such assets and liabilities on a discounted basis to reflect the time value of money. Except as set out in FRS 19, deferred tax is recognized in respect of timing differences that have

originated but not reversed by the balance sheet date. Deferred tax assets are recognized 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 timing differences can be deducted. The UK taxation regime applies separate rules to trading and capital profits and losses. The distinction between timing differences that arise from items of either a capital or trading nature may affect the recognition of deferred tax assets under FRS 19. Accordingly, for the 2002 results and balance sheet position at December 31, 2002, the possible tax benefit, which may arise from capital losses valued at approximately £1.7 billion, is sufficiently uncertain that it has not been recognized.

Derivative Financial Instruments

Jackson National Life uses derivatives (primarily interest rate swaps) to hedge certain risks in conjunction with its asset/liability management program. As permitted by UK GAAP, earnings for Jackson National Life exclude the fair value of fluctuations on these derivative instruments including, in particular, those that are regularly used to manage risks associated with movements in interest rates. Under UK GAAP such derivatives are not required to be accounted for at fair value.

Other Features of UK GAAP Accounting That Are of Particular Significance to an Understanding of Prudential's UK GAAP Results

The other features that are of significance relate to the method of accounting for the assets and liabilities of the group's with-profit funds. A summary of this basis of accounting is included in Item 5, "Operating and Financial Review and Prospects Analysis by Geographic

Region United Kingdom Basis of Profits". Further details are described below.

The future policyholder benefit provisions on conventional with-profits and other protection-type policies are calculated using the net premium method. The net premium is calculated such that it would be sufficient at the outset of the policy to provide only for the discounted value of the original guaranteed death and maturity benefits. The provision is then calculated by subtracting the present value of future net premiums from the present value of future benefits (including vested bonuses) using a prudent discount rate. The assumptions to which the estimation of the long-term business provision is particularly sensitive are the interest rate used to discount the provision and the assumed future mortality experience of policyholders. The net premium reserves are calculated using assumptions for interest, mortality, morbidity and expense, but without assumptions for withdrawals. These assumptions are determined as prudent best estimates at the date of valuation. Interest rates used in establishing policyholder benefit provisions for conventional with-profits policies in the consolidated financial statements range from 3.0% to 5.0%. The interest rates used in establishing policyholder benefit provisions for pension annuities in the course of payment are adjusted each year and ranged from 2.4% to 5.4% for 2002, and 5.0% to 6.0% for 2001 and 2000. Mortality rates used in establishing policyholder benefit provisions are based on published mortality tables adjusted to reflect actual experience. For PAC's accumulating with-profits business, the provision is taken as the lower of:

- the accumulated fund or the value at the bid price of the notional number of units allocated to policyholders, in both cases excluding final bonuses, and

- the surrender or transfer of value which, having regard to policyholders' reasonable expectations, would be payable at the valuation date,

or, if greater, the value of the guaranteed liabilities excluding final bonuses calculated on a gross premium bonus reserve method.

For the purpose of calculating the liability using the bonus reserve method, the assumed interest rates range from 3.2% to 5.0%, while future reversionary bonuses are assumed to fall from current levels

to zero at 1.5% per year. For unitized with-profits policies, the policyholder benefit provisions are based on the policyholder account balance.

If actual experience differs from these assumptions, or the basis of preparation is altered (for example, as for UK unitized with-profits business in 2002), then the value of the liabilities would need to be adjusted. See Item 4, "Business of Prudential UK Business Units UK Insurance operations Life Insurance Products Savings Products Investment Bonds" for a discussion of Prudential's unitized with-profits business.

For with-profits business (including non-participating business of Prudential Annuities Limited which is owned by the PAC with-profits fund), adjustments to liabilities and any related tax effects are recognized in the profit and loss account. However, except for any impact on the annual declaration of bonuses, shareholder profits for with-profits business and shareholders' funds would not be affected by adjustments to liabilities. This is because UK GAAP profits for with-profits business solely reflect one-ninth of the cost of bonuses declared for the year. Adjustments to the UK GAAP basis long-term business provision for the PAC with-profits fund would normally reflect changes that have also been reflected in the annual regulatory returns submitted to the FSA. Except to the extent of any second order effects on other elements of the regulatory returns, such changes can be expected to have a consequent effect on the excess of assets over liabilities of the fund for purposes of solvency calculations, and the related free asset ratio which is an indicator of the overall financial strength of the fund. Similar principles apply to the group's Asian with-profits business.

Fund for Future Appropriations

The excess of assets over liabilities (including long-term business provision) of the group's long-term with-profits funds are retained within the fund for future appropriations and excluded from equity. Similarly excesses and deficits of net income over the UK basis surplus for distribution to policyholders and shareholders are transferred to, or from, the fund for future appropriations.

Changes to the level of the fund for future appropriations do not directly impact shareholders' results or funds. After allowing for differences in the basis of preparation of UK GAAP and UK regulatory returns, movements in the level of the fund for future appropriations are broadly indicative of movements in the excess of regulatory basis assets over liabilities of the fund. In turn, movements in this excess as a proportion of liabilities are indicative of changes in the financial strength of the fund. Differences in the basis of preparation of UK GAAP and UK regulatory returns arise principally from the treatment of certain regulatory basis liabilities, such as mismatching reserves (that are accounted for as reserves within the fund for future appropriations), recognition of deferred acquisition costs for UK GAAP, and asset valuation differences and admissibility deductions reflected in the regulatory returns.

Profits Recognition

As outlined in " Basis of Profits" below, Prudential's results include an annual profit distribution to shareholders from long-term with-profits funds that represents an amount of up to one-ninth of the value of that year's bonus declarations to policyholders. The distribution corresponds directly to the post-tax modified statutory basis profit for with-profits business. The boards of directors of the subsidiary companies that have with-profits operations, using the advice of their appointed actuary, determine the amount of annual and final bonuses to be declared each year on each group of contracts. More detail on Prudential's bonus policy is set out in " Analysis by Geographic Operations UK Operations Basis of Profits".

Fair Value of Assets

Changes in the fair value of assets of Prudential's long-term with-profits funds will primarily be reflected in the excess of assets over liabilities recorded under UK GAAP as the fund for future

appropriations. Shareholders' profits from with-profits business and shareholders' funds are not directly impacted by movements in the fair values of the assets. However, current investment performance is a factor that is taken into account in the setting of the annual declaration of bonuses which, in turn, affects UK shareholder profits to the extent of one-ninth of the cost of bonus.

Changes in the fair value of assets of unit-linked (separate account) funds are normally accompanied by a matching change in unit-linked business liabilities that is also recognized in the profit and loss account.

Investment Returns

For with-profits business, investment returns together with other income and expenditure are recorded within the profit and loss account. However, the difference between net income of the fund and the cost of bonuses and related statutory transfers is reflected in an amount transferred to or from the fund for future appropriations within the profit and loss account. Except to the extent of current investment returns being taken into account in the setting of bonus policy, the investment returns of with-profits fund in a particular year do not affect shareholder profits or with-profits funds.

Overview of Consolidated Results

The following table shows Prudential's UK GAAP consolidated total profit on ordinary activities on the modified statutory basis for the periods indicated.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Operating profit before amortization of goodwill and tax[1]			
Continuing operations:			
UK operations	**419**	422	438
US operations	**153**	298	466
Asian operations	**62**	25	36

	Year Ended December 31,		
European operations	**1**	(24)	(10)
Other income and expenditure	**(189)**	(130)	(123)
UK restructuring costs	**(14)**	(41)	
Total continuing operations	**432**	550	807
Discontinued operations			
UK personal lines property and casualty operations		79	33
UK restructuring costs		(7)	
Total discontinued operations		72	33
Operating profit before amortization of goodwill and tax	**432**	622	840
Amortization of goodwill	**(98)**	(95)	(84)
Short-term fluctuations in investment returns	**(205)**	(480)	(48)
Profit on business disposals	**355**		120
Merger break fee net of expenses		338	
Profit on Egg flotation			119
Total profit on ordinary activities before tax	**484**	385	947
Tax on profit on ordinary activities			
Tax on operating profit before amortization of goodwill	**(122)**	(174)	(260)
Tax on items excluded from operating profit before amortization of goodwill	**78**	153	(54)
Total tax on profit on ordinary activities	**(44)**	(21)	(314)
Profit on ordinary activities after tax before minority interests	**440**	364	633
Minority interests	**9**	25	24
Profit on ordinary activities after tax and minority interests	**449**	389	657

(1) Due to the long-term nature of Prudential's business, the basis of presentation of operating profit may not be comparable with other UK companies. See Note 4 of the notes to Prudential's consolidated financial statements for a description of the basis.

Profit Before Tax

Total profit on ordinary activities before tax in 2002 was £484 million compared with £385 million in 2001. The increase in 2002 primarily reflects a £355 million profit on the disposal of the UK personal lines property and casualty operations, and a £275 million decrease in negative short-term fluctuations in investment returns primarily due to a reduced charge for defaults and impairments on bonds in the United States. However, these results were partially offset by a £145 million reduction in operating profits from Jackson National Life, principally reflecting increases in both the amortization of deferred acquisition costs, costs in respect of the provision of guaranteed minimum death benefits and a £121 million charge in relation to averaged realized gains and losses on bonds and the non-recurrence of the merger break fee of £338 million in 2001.

Total profit on ordinary activities before tax in 2001 was £385 million compared with £947 million in 2000. The decrease in 2001 reflects a £168 million reduction in profits from Jackson National Life in the United States, a £432 million increase in negative short-term fluctuations in investment returns primarily due to defaults and impairments on bonds in the United States and the non-recurrence of profits on business disposals and on the Egg flotation of £239 million in 2000. These losses were partially offset by £338 million net of related expenses representing the American General merger termination break fee. Goodwill amortization of £95 million in 2001 was £11 million higher than 2000 primarily due to a full year charge in relation to acquisitions in Taiwan and of US broker dealer operations.

Profit After Tax

Profit after tax before minority interests in 2002 was £440 million compared with £364 million in 2001 and £633 million in 2000. These movements reflect the movements in profit before tax in those years and effective tax rates of 9.1% in 2002, 5.5% in 2001 and 33.2% in 2000. The low rate of tax in both 2002 and 2001 reflects tax payable on business disposals and on the merger break fee being relieved against capital losses available to the group which were acquired during 2001.

Analysis by Geographic Region

Prudential focuses on operating profit before amortization of goodwill and tax by geographic region as the primary measure of current year performance. This excludes exceptional items, such as profits on business disposals, and includes the investment return for (i) the UK shareholders' funds, (ii) Jackson National Life and (iii) for those periods prior to its disposal, the UK personal lines property and casualty insurance operations, using a longer term rate of return, rather than the actual return for the year, in accordance with UK GAAP and The Association of British Insurers' guidelines. The analysis and discussion below is based upon operating profit before amortization of goodwill and tax. Due to the long-term nature of Prudential's business, its basis of presentation of operating profit may not be comparable with other UK companies. See Note 4 of the notes to Prudential's consolidated financial statements for a description of this basis.

For all of Prudential's long-term insurance businesses (United Kingdom, United States, Asia and Europe), operating profit is generated principally from its in force book of business. Prudential's in force book is business written in earlier years and on which it continues to declare bonuses or credit interest to policyholders and generate profit for shareholders. These books of in force business have been built up over many years with the result that, for Prudential's long-term insurance business, sales in any one year do not have a significant impact on shareholders' profit in that year, but may have an impact in subsequent years.

United Kingdom

Basis of Profits

In order to understand how Prudential's results are derived it is necessary to understand how profit emerges from its with-profits business.

Prudential's results comprise an annual profit distribution to shareholders from its UK long-term with-profits fund, hereafter referred to as the with-profits fund, as well as profits from its other businesses. Prudential's primary UK GAAP financial statements are prepared under the modified statutory basis of reporting as required by UK law. For most of its operations, other than its UK long-term insurance businesses, the modified statutory basis matches items of income and related expenditure within the same accounting period. This is achieved through the deferral of acquisition costs and application of the accruals concept.

With-profits Products

For Prudential's UK long-term insurance business, the primary annual contribution to shareholders' profit comes from its with-profits products. With-profits products are designed to provide policyholders with smoothed investment returns through a mix of annual and final bonuses. Shareholders' profit in respect of bonuses from with-profits products represents an amount of up to one-ninth of the value of that year's bonus declaration to policyholders. The smoothing inherent in the bonus declarations provides for relatively stable annual shareholders' profit from this business.

Bonus Rates

The main factors that influence the determination of bonus rates are the return on the investments of the with-profits fund, the effect of inflation, taxation, the expenses of the fund chargeable to policyholders and the degree to which investment returns are smoothed. The overall rate of return earned on investments and the expectation of future investment returns are the most important influences on bonus rates. The assets backing the with-profits business are predominantly invested in equities and real estate. If the financial strength of the with-profits fund were adversely affected, then a higher proportion of fixed interest or similar assets might be held by the fund.

Fund For Future Appropriations

The annual excesses of premiums and investment returns over claim payments, operating expenses and the change in benefit provisions within Prudential's with-profits fund that are not distributed in that year as bonuses and related shareholders' profit are transferred to the fund for future appropriations by a charge to the profit and loss account of the with-profits fund. Any shortfall in such amounts would result in a transfer from the fund for future appropriations by a credit to the profit and loss account of the long-term fund. Current year amounts in respect of premiums, investment returns, operating expenses and unusual charges or credits do not directly affect the distribution of profit to shareholders from the with-profits business in that year. Current year claims, which include final bonus payments, do have an effect on shareholders' profit through the shareholders' proportion of the value of those final bonuses.

Surplus Assets and Their Use

The fund for future appropriations comprises amounts Prudential expects to pay to policyholders in the future, the related shareholder transfers and surplus assets. These surplus assets, which are described in more detail under Item 4, "Information on the Company Business of Prudential UK Business Shareholders' Interests in Prudential's Long-term Insurance Business Surplus Assets in Prudential Assurance's Long-term With-profits Fund", have accumulated over many years from a variety of sources and provide the with-profits fund with working capital. This working capital permits Prudential to invest a substantial portion of the assets of the with-profits fund in equity securities and real estate, smooth investment returns to with-profits policyholders, keep its products competitive, write new business without being constrained as to cash flows in the early policy years and demonstrate solvency.

In addition, Prudential can use surplus assets to absorb the costs of significant events, such as fundamental strategic change in its long-term business and, with the consent of the UK regulator, the cost of its pension mis-selling, without affecting the level of distributions to policyholders and shareholders. The costs of fundamental strategic change may include investment in new technology, redundancy and restructuring costs, cost overruns on new business and the funding of other appropriate long-term insurance related activities, including acquisitions.

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The "SAIF" and "PAL" Funds

Prudential's with-profits fund also includes the Scottish Amicable Insurance Fund ("SAIF") and the wholly-owned Prudential Annuities Limited ("PAL"). All assets of the SAIF business are solely attributable to former policyholders of Scottish Amicable Life Assurance Society (predating the acquisition of Scottish Amicable by Prudential in October 1997). The SAIF with-profits fund is discussed in more detail under Item 4, "Information on the Company Business of Prudential UK Business Shareholders' Interests in Prudential's Long-term Insurance Business The SAIF Sub-fund and Accounts". PAL is a wholly owned subsidiary of the with-profits fund and, accordingly, profits from this business affect shareholders' profits only to the extent that they affect the annual with-profits bonus declaration and resultant transfer to shareholders.

UK Operating Results

The following table shows operating profit before amortization of goodwill, tax and restructuring, for the periods indicated.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		

	Year Ended December 31,		
Continuing operations			
UK Insurance Operations long-term business	**368**	435	468
Egg	**(20)**	(88)	(155)
M&G			
Long-term business			35
Other activities	**71**	75	90
M&G total	**71**	75	125
Total continuing operations	**419**	422	438
Discontinued operations:			
Personal lines property and casualty insurance operations		79	33
Total operating profit before amortization of goodwill, tax and restructuring	**419**	501	471

UK Insurance Operations

Operating profit from continuing operations before amortization of goodwill, tax and restructuring from UK Insurance Operations in 2002 totaled £368 million, compared with £435 million in 2001 and £468 million in 2000. The reduction in 2002 primarily reflected lower with-profits bonuses leading to a reduction in the shareholder transfer from the Prudential Assurance long-term with-profits fund, partially offset by the impact of higher surrenders, which have a positive impact on final bonuses. See Item 4, "Business of Prudential UK Business UK Business Units UK Insurance Operations Life Insurance Products Savings Products Investment Bonds" for information on the bonus structure of Prudential's with-profits products.

In any single period, operating profit is primarily the shareholders' annual distribution, also known as the shareholder transfer, from the Prudential Assurance long-term with-profits fund which represents up to one-ninth of the value of bonuses declared in that year to policyholders, and consequently is not directly impacted by current year gross premiums, investment return or expenses.

In 2002, Prudential declared total post-tax bonuses of £2,720 million from the Prudential Assurance long-term with-profits fund, of which £2,447 million was credited to the with-profits policies and £273 million was distributed to shareholders. In 2001, Prudential declared total post-tax bonuses of £3,100 million from the fund, of which £2,790 million was credited to with-profits policies and £

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310 million was distributed to shareholders. In 2000, Prudential declared total post-tax bonuses of £3,103 million from the fund, of which £2,796 million was added to with-profits policies and £307 million was distributed to shareholders. Along with the rest of the UK insurance industry, Prudential has reduced its bonuses over the last three years, reflecting the lower investment return expected in the future and the actual returns earned by the Prudential Assurance long-term with-profits fund. As a result of these actions Prudential expects UK operating profit to be adversely affected by approximately £100 million in 2003.

All unit-linked business written by Prudential or Scottish Amicable in the United Kingdom is written within the shareholder-backed portion of the Prudential Assurance long-term fund using capital provided by shareholders. All profit from this business goes to shareholders. In 2002 £95 million was distributed to shareholders compared to £125 million in 2001 and £161 million in 2000.

Egg

The following table shows operating profit (loss) before tax, for the periods indicated.

Year Ended December 31,

	Year Ended December 31,		
	2002	2001	2000
	(In £ Millions)		
UK banking operations			
Operating income	**326**	189	93
Expenses	**(291)**	(265)	(247)
UK banking operating profit (loss)	**35**	(76)	(154)
International banking operations	**(50)**	(5)	
Share of operating losses from joint ventures and associated undertakings	**(5)**	(4)	(1)
Restructuring costs		(3)	
Total loss on ordinary activities before tax	**(20)**	(88)	(155)

Egg's operating loss before tax amounted to £20 million in 2002 compared to £88 million in 2001 and £155 million in 2000.

Egg's UK banking operations, having become profitable during the fourth quarter of 2001, generated a profit before tax in 2002 of £35 million compared to a loss in 2001 of £76 million. Losses on joint ventures were £5 million in 2002, excluding the exceptional profit arising from the sale of 15% of Fundsdirect to Prudential. Egg International recorded a £50 million loss in 2002, including £47 million relating to the investment in the development of Egg's French business. In Egg's first quarter new business results in 2003, it announced that in France it intends to increase the investment over the next three years by approximately €140 million (£97 million based on March 31, 2003 exchange rate) and expects the operation to break even in 2005.

The profit from the UK banking operations reflects operating income of £326 million, compared to £189 million in 2001, offset by expenses of £291 million, compared to expenses of £265 million in 2001. The increase in expenses is largely due to a £17 million increase in the bad debt provision that reflects the 32% growth in the credit book.

The UK banking operations' increase in operating income also reflects net interest income of £223 million, 53% higher than in 2001, due largely to increased customer numbers and an improved net interest margin. In addition, other operating income of £103 million increased by £60 million in 2002, principally reflecting fees and commissions earned from a larger credit card book and a reduction in cash rebates on credit cards. Unsecured lending (credit card and personal loans) in 2002 grew by

£945 million, leading to a balance of £3.3 billion, of which credit card balances accounted for £2.3 billion (£1.8 billion in 2001).

Egg's loss of £88 million in 2001 reflects operating income of £189 million, compared to £93 million in 2000, offset by total expenses of £277 million, compared to £248 million in 2000. The increase in operating income reflects both an increase in net interest income of £66 million to £146 million, resulting from an increase in the net interest margin, and a £30 million increase in other operating income, to £43 million, primarily reflecting fees and commissions earned from unsecured lending products. Higher expenses in 2001 were largely due to a £31 million increase in the bad debt provision to £68 million, reflecting the significant growth in credit card balances.

M&G

In 2002, M&G's total operating profit before amortization of goodwill and tax was £71 million, compared to £75 million in 2001. Operating profit of £52 million, excluding investment income and which thereby reflects M&G's trading performance was £2 million higher than 2001, a significant achievement in the context of depressed equity markets, where average market levels as represented by the FTSE All-Share share index were 17% lower in 2002 compared with 2001. This increase reflects the benefits of M&G's diversified revenues, with earnings from fixed income and property offsetting the effect of lower equity markets, together with disciplined cost management. The result has also been negatively affected by a £3 million increase in losses from M&G International, which were £15 million in 2002. A performance fee of £20 million was recognized in the 2002 result (£19 million in 2001) due to PAC's long-term fund beating its strategic benchmark by an average of 2.3% per annum over the last three years.

In 2001, M&G's total operating profit before amortization of goodwill and tax decreased by £50 million, from £125 million in 2000 to £75 million. This was mainly as a result of the transfer of M&G's life and pensions business to UK Insurance Operations, which contributed £35 million to M&G's total operating profit in 2000.

Discontinued Operations

In November 2001, Prudential agreed to transfer its personal lines property and casualty insurance operations to Winterthur Insurance and the Churchill Group, its UK subsidiary. On December 31, 2001 the insurance liabilities were almost wholly reassured to Winterthur Insurance. The related cash transfer for this reinsurance was offset in January 2002 against the sales proceeds of this business. The sale was completed on January 4, 2002 for a consideration of £353 million. After allowing for the costs of sale and other related items, the profit on sale recorded in the 2002 results was £355 million before tax.

United States

Prudential's US operations comprise its US insurance company, Jackson National Life, which includes Jackson National Life Insurance Company of New York and Jackson Federal Bank, PPM America, its US internal and institutional investment manager, and its US broker-dealer group, National Planning Holdings.

Basis of Profits

The profit on Jackson National Life's business predominantly arises from spread income from interest-sensitive products, such as fixed annuities and stable value products. For the purposes of UK reporting, deposits into these products are recorded as premiums, withdrawals and surrenders are included in benefits and claims and the resulting net movement is recorded under other reserve movements within benefits and claims. Benefits and claims also includes interest credited to policyholders in respect of deposit products and fees charged on these policies. While the presentation of these items differs between UK GAAP and US GAAP, there is no net impact on operating profit. The

UK GAAP result for Jackson National Life is based on Jackson National Life's US GAAP results with an adjustment to exclude the requirements of FAS 133 "Accounting for Derivative Instruments and Hedging Activities" as amended by FAS 137 and 138 ("FAS 133"), and for a different treatment of investment gains and losses.

United States Operating Results

The following table shows operating profit before amortization of goodwill and tax for the periods indicated.

	Year Ended December 31,		
	2002	2001	2000
	(In £ Millions)		
Jackson National Life	**139**	282	459
National Planning Holdings		(4)	
PPM America	**14**	20	7
Total operating profit before amortization of goodwill and tax	**153**	298	466

Operating profit before amortization of goodwill and tax of £153 million in 2002 was £145 million lower than in 2001. The decline principally reflects increases in both the amortization of deferred acquisition costs (referred to as DAC amortization), costs in respect of the provision of guaranteed minimum death benefits (referred to as GMDB) and a £121 million charge in relation to averaged realized gains and losses on bonds. In 2002, spread income (the difference between the rate of return that Jackson National Life is able to earn on its investments and the amount it is required to pay on its deposit liabilities and reserves) was higher than in 2001 by £29 million, reflecting the increase in policies in force and the benefits from reductions in crediting rates with respect to the in force fixed annuity and life insurance contracts. GMDB provisions were reviewed at the year end resulting in a total charge, including payments during the year, of £43 million.

The increase in DAC amortization of £106 million includes an increase of £85 million in respect of variable annuity products and £16 million in respect of equity-indexed annuities. A consequence of the review of GMDB provisions and the resultant strengthening has been a reduction in the expected future gross profits from variable annuity products, which has itself resulted in a higher level of variable annuity DAC amortization. When calculating the DAC amortization, the long-term return on variable annuity business is assumed to be 8.4%, gross of investment management and mortality and expense charges. The assumption is implemented through the use of a mean reversionary methodology. If the mean reversion was eliminated as at December 31, 2002 so that the long-term return on separate account business was assumed to be 8.4% per annum in all future years, DAC values would be reduced by approximately £32 million. Should these assumptions not be met in future periods, a further increase in variable annuity DAC amortization may be required.

Operating profit before amortization of goodwill and tax of £298 million in 2001 was £168 million lower than in 2000. The decline principally reflected reduced spread income combined with a £67 million charge in the current year in relation to average realized gains and losses on bonds (as realized gains and losses on bonds are taken through operating profit on a five year averaging basis). Lower spread income reflected lower investment returns and the fact that Prudential did not, in the increasingly competitive market, fully reset policyholder crediting rates to compensate. Fee income was lower due to lower sales and lower account values for variable annuities.

The movement in the average exchange rates from $1.44/£1.00 to $1.50/£1.00 during 2002 had an adverse impact on Jackson National Life's total operating profit before amortization of goodwill and tax of £7 million.

Asian Operations

The relatively recent growth of Prudential's Asian operations and the deferred emergence of profits from its long-term insurance business means that these businesses currently make only a relatively small contribution to group operating profit before amortization of goodwill and tax. PCA head office costs are included in Other Income and Expenditure below.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Long-term business and investment products	**88**	44	39
Development expenses	**(26)**	(19)	(3)
Asia total	**62**	25	36

Prudential Asia's operating profit before amortization of goodwill and tax was £62 million in 2002, an increase of £37 million over the £25 million achieved in 2001. This reflects an increase in underlying profits of £44 million partially offset by an increase in development expenses of £7 million.

Prudential Asia's operating profit before development expenses, amortization of goodwill and tax was £88 million in 2002, an increase of £44 million over the £44 million achieved in 2001. Profits from the more established operations in Singapore, Hong Kong and Malaysia were £79 million, an increase from the £56 million recorded in 2001, as these operations continue to build scale.

Operating profit in 2002 includes an £8 million gain arising from the reorganization of long-term funds approved by the regulators allowing the value of the shareholders' interest in certain non-participating policies to be recognized for the first time. This result is after significant investment in 2002, as Prudential builds high quality customer-focused distribution channels in Japan and Korea. Further significant investment is planned for 2003.

Development expenses (excluding Asia regional head office expenses) increased from £19 million in 2001 to £26 million in 2002, and include £20 million in relation to the development of the Japanese business.

Prudential Asia's operating profit before amortization of goodwill and tax was £25 million in 2001, a decrease of £9 million over the £36 million achieved in 2000. This reflects an increase in underlying profits of £5 million offset by an increase in development costs of £16 million.

Operating profit before development expenses, amortization of goodwill and tax from Prudential's Asian operations in 2001 was £44 million, an increase of £5 million over 2000. This reflects strong performances from the established markets and regional fund management, offset by increased losses in developing markets including significant start up losses in Japan. Development expenses (excluding Asia regional head office expenses) increased £16 million, from £3 million in 2000 to £19 million in 2001. The development expenses of £19 million reflects increased project-related expenses and merger and acquisition activity in the region, combined with a brand launch and start-up costs associated with PCA Life in Japan.

European Operations

Operating profit before amortization of goodwill and tax from Prudential's European operations represents profits from Scottish Amicable Life International, an Irish company, which mainly markets

long-term insurance products into Germany, France and the United Kingdom, although German operations were disposed of on January 1, 2002.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Long-term business	**9**	5	8
Development expenses	**(8)**	(29)	(18)
Europe total	**1**	(24)	(10)

Operating profit before amortization of goodwill and tax from Prudential's European operations was £1 million in 2002, compared to operating loss before tax of £24 million and £10 million in 2001 and 2000, respectively. The increase in 2002 reflects reduced development expenses of £8 million incurred in the period, compared to £29 million in 2001 and £18 million in 2000 as a result of the decision to manage European operations for value. Underlying European performance (operating profit before development costs, amortization of goodwill and tax) of £9 million in 2002 was £4 million higher than 2001.

In November 2002, Prudential agreed to sell its German long-term business to Canada Life for €129 million (£82 million). The sale was completed on January 1, 2003. Irish High Court approval for the transfer of the relevant life assurance policies to Canada Life is expected early in the second half of 2003. See Item 4, "Business of Prudential European Operations Sale of German Business to Canada Life". In June 2003, Prudential announced it was ceasing to write new business in France. See Item 4, "Business of Prudential European Operations France".

Other Income and Expenditure

Other income and expenditure represents the longer-term investment return on centrally retained shareholder capital and funds, interest expense on group borrowings and central corporate expenditure.

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Investment return and other income	**3**	51	64
Interest payable on core structural borrowings of shareholder financed operations	**(130)**	(118)	(131)
Corporate expenditure			
Group Head Office	**(36)**	(39)	(42)
Asia Head Office	**(26)**	(24)	(14)

	Year Ended December 31,		
Total other income and expenditure	**(189)**	(130)	(123)

Losses from other income and expenditure before amortization of goodwill and tax for group activities increased to £189 million in 2002 from £130 million in 2001. This was mainly due to a reduction in investment return and other income from £51 million in 2001 to £3 million in 2002, primarily as a result of a £24 million write down of the group's 15% holding in Life Assurance Holding Corporation Limited in 2002, compared with a positive revaluation of £12 million in 2001. In addition, funding costs increased by £12 million, from £118 million in 2001 to £130 million in 2002.

Losses from other income and expenditure before amortization of goodwill and tax for group activities increased to £130 million in 2001 from £123 million in 2000 due to lower investment return and other income and due to an increase in Asian regional head office expenses of £10 million to £24 million in 2001, reflecting the increased size of this business, partially offset by lower interest payable.

UK Restructuring

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Continuing operations	**(14)**	(41)	
Discontinued operations		(7)	
Total	**(14)**	(48)	

In 2002, Prudential incurred a total restructuring charge for its UK Insurance Operations of £38 million, of which £10 million related to the establishment of an offshore customer contact center in Mumbai, India and £28 million related to additional costs for the simplification of its organizational structure (each as described in greater detail below). Of the £38 million, £24 million was borne by Prudential Assurance's long-term fund and £14 million by shareholders' funds. The allocation between Prudential Assurance's long-term fund and shareholders' funds reflects the basis of the activity to which these costs relate.

In September 2002, Prudential announced plans to establish an offshore service center in India to improve customer contact service levels for its UK Insurance Operations customers and to achieve further cost savings to those announced in November 2001. The new processing center will be established in Mumbai and is expected to be operational in 2003. The initiative is expected to incur a restructuring charge of approximately £20 million, with £10 million charged to net operating expenses in the long-term business technical section of the profit and loss account in 2002, of which £7 million was borne by Prudential Assurance's long-term fund and £3 million by shareholders' funds. Of the total expected charge of £20 million, £15 million is expected to be borne by Prudential Assurance's long-term fund and £5 million by shareholders' funds. As of December 31, 2002, there were no charges paid against the £10 million provision. The £10 million outstanding related to termination and redundancy costs and property related charges. As part of these restructurings, Prudential planned to make 850 customer services jobs redundant, all notifications with respect to which had been completed by December 31, 2002. Termination did not commence until 2003.

In February 2001, Prudential announced the restructuring of the direct salesforce and customer service channels of its UK Insurance Operations. In November 2001, Prudential announced further details of changes to the future structure of those operations, in particular the intention to pursue a single brand strategy for life and pensions business including the integration of its Scottish Amicable operations under the Prudential brand. The changes also included a simplification of the organizational structure and plans for a significant reduction in operating costs. The total cost in 2001 of this restructuring was £200 million which was charged to net operating expenses in the long-term technical section of the profit and loss account, with £152 million borne by Prudential Assurance's long-term fund and £48 million by shareholders' funds, of which £41 million was allocated to continuing operations and the remainder to discontinued operations. The total additional cost of the above restructuring in 2002 was £28 million, which was also charged to net operating expenses in the long-term business technical section of the profit and loss account, with £17 million borne by Prudential Assurance's long-term fund and £11 million by shareholders' funds. The components of the total £228 million provision included termination and redundancy costs of £107 million, branch closures and other property related charges of £51 million, and other transition and system-related costs of £70 million. As of December 31, 2002, £143 million was paid and charged against this provision. Of the remaining £85 million, £31 million was for termination and redundancy costs, £46 million was for branch closures and property-related charges and £8 million was for other transition and systems-related costs. As part of these restructurings Prudential planned to make 4,100 jobs redundant, of which approximately 3,200 were completed by December 31, 2002.

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Geographic Analysis by Nature of Income and Expense

The following table shows Prudential's consolidated total profit on ordinary activities before amortization of goodwill and tax for the periods indicated, following which is a discussion of significant line items by geography.

	Year Ended December 31,		
	2002	**2001**	**2000**
		(In £ Millions)	
Long-term business:			
Gross premiums	**16,669**	15,196	14,173
Reinsurance	**(216)**	(180)	(109)
Earned premiums	**16,453**	15,016	14,064
Investment returns	**(3,693)**	(1,070)	4,821
Expenses	**(2,079)**	(2,098)	(1,980)
Restructuring costs attributable to with-profits policyholders	**(24)**	(152)	
Taxation within long-term business funds	**659**	241	(166)
Benefits and claims	**(16,406)**	(19,160)	(19,528)
Transfers from the fund for future appropriations	**5,520**	7,754	3,480
Shareholders' profits after tax	**430**	531	691
Shareholders' tax attributable to long-term business	**174**	235	318
Shareholders' profits from long-term business before tax, restructuring costs attributable to shareholders and development costs	**604**	766	1,009
Development expenses	**(34)**	(48)	(21)
Long-term business restructuring costs attributable to shareholders	**(14)**	(41)	
Shareholders' profit from long-term business	**556**	677	988
Other operations:			
Continuing operations			
Broker dealer and fund management	**85**	91	97
UK banking	**(20)**	(88)	(155)
Other income and expenditure	**(189)**	(130)	(123)
Total other continuing operations	**(124)**	(127)	(181)
Discontinued operations			
UK personal lines property and casualty insurance operations		79	33
Restructuring costs		(7)	

	Year Ended December 31,		
Total other discontinued operations		72	33
Shareholders' result from other operations	**(124)**	(55)	(148)
Total operating profit before amortization of goodwill and tax	**432**	622	840

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Gross Premiums

	Year Ended December 31,		
	2002	**2001**	**2000**
		(In £ Millions)	
Long-term business:			
United Kingdom	**8,435**	8,198	7,708
United States	**6,098**	5,008	5,223
Asia	**1,896**	1,793	1,076
Europe	**240**	197	166
Total	**16,669**	15,196	14,173

Gross premiums totaled £16,669 million in 2002, an increase of 10% over 2001. Gross premiums in 2002 include £8,435 million from Prudential's UK operations, an increase of 3% primarily due to increased sales of bulk and individual annuities, and £6,098 million from its US operations, an increase of 22% due to higher sales of fixed and variable annuities, partially offset by lower stable value product sales. Meanwhile, in Asia gross premiums grew 6% to £1,896 million, reflecting increased sales across the region, while gross premiums of European operations grew 22% to £240 million.

Gross premiums totaled £15,196 million in 2001, an increase of 7% over 2000. Gross premiums in 2001 include £8,198 million from Prudential's UK operations, an increase of 6% primarily due to strong sales by Prudential's IFA business, and £1,793 million from its Asian operations, an increase of 67% due to strong contributions from all Asian countries. Meanwhile, in the United States gross premiums fell 4% to £5,008 million reflecting poor market conditions during the year while gross premiums of European operations grew 19% to £197 million reflecting a strong first year contribution from Prudential's French operations.

United Kingdom

Gross premiums increased 3% in 2002, to £8,435 million compared to £8,198 million in 2001. The increase is mainly a result of increased sales of single premium individual and bulk annuities, principally distributed through IFAs, and increased sales of single premium corporate pensions distributed through pension advisors and consulting actuaries. These increases have been offset by lower sales of Prudential's single premium with-profits bond, the Prudence Bond, after the high sales experienced in the previous year.

Gross premiums increased 6% in 2001, to £8,198 million compared to £7,708 million in 2000. The increase was mainly a result of higher sales of Prudential's single premium with-profits bond, the Prudence Bond, sold through the IFA network, and increased sales of directly marketed bulk annuities. These increases were partially offset by the effect on sales of the closure of Prudential's direct sales force, announced in February 2001.

United States

Gross premiums in 2002 were £6,098 million, or 22% above 2001 levels of £5,008 million, due to higher sales of fixed and variable annuities, partially offset by lower stable value product sales.

Record fixed annuity sales of £2.7 billion were 43% higher than in 2001, reflecting strong consumer preference for guaranteed returns in the current volatile equity markets.

Despite the continued challenging market conditions, Jackson National Life also recorded a strong increase in variable annuity sales in 2002. Total sales of almost £1.4 billion were 77% higher than in 2001, and increased quarter-on-quarter throughout the year. This upward trend reflected the successful

launch in the first quarter of Perspective II, a new variable annuity product which was highly competitive in the market and can be individually tailored to customers' needs. As expected in volatile equity markets, in 2002 a significant proportion of Jackson National Life's variable annuity investors elected the fixed account option, with 58% of 2002 variable sales going into fixed accounts. Sales of equity-indexed annuities of £254 million were 6% lower than in 2001. Sales of stable value products of £1.4 billion in 2002 decreased by 16% compared with 2001, reflecting Jackson National Life's primary focus on retail sales throughout the year, which it expects to continue in 2003.

Gross premiums in 2001 were £5,008 million, or 4% below 2000 levels of £5,223 million, due to lower sales volumes of variable annuities and equity-indexed annuities. This was partially offset by strong growth in fixed annuity products.

Volatile equity markets which affected consumer appetite for equity based products in 2001 negatively impacted sales of variable annuities and equity-indexed annuities. In addition, sales of equity based products were affected by a fiercely competitive environment characterized by revenue growth over profitability. In 2001, variable annuity premiums fell 55% to £768 million, while sales of equity-indexed annuities fell 34% to £271 million.

The strong growth in fixed annuities to £1,899 million represented an 80% increase on 2000 sales and a record level of sales for a single year. Stock market volatility and a declining interest rate environment made fixed annuities more attractive to investors seeking a low risk product with more competitive crediting rates than bank deposits. Sales of stable value products of £1,674 million in 2001 were in line with 2000 levels, and included approximately £1.5 billion of funding agreements sourced from overseas markets.

Asia

Gross premiums increased by 6% to £1,896 million in 2002 compared to £1,793 million in 2001 and £1,076 million in 2000, due to strong new business growth in all countries. This growth reflects Prudential's successful strategy of entering new markets, strengthening and diversifying distribution channels and launching customer-focused products.

The increase in gross premiums in 2002 reflects a 26% increase in new regular (continuing) premium insurance sales from £369 million in 2001 to £465 million in 2002 and a 23% increase in renewal premiums from £774 million to £952 million over the same period. These were offset by a 26% decrease in single premium insurance sales from £650 million to £479 million. Single premium insurance sales in Singapore totaled £515 million in 2001 following the further liberalization of the Central Provident Fund. In 2002, sales returned to more normalized levels, totaling £279 million. New regular premium insurance sales in 2002 were up 24% in Singapore, 18% in Hong Kong, 31% in Malaysia, 7% in Taiwan and 39% in Japan. These five territories accounted for 80% of total regular premium insurance sales in 2002, down from 86% in 2001, reflecting the growth in Prudential's other operations.

Gross premiums increased by 67% to £1,793 million in 2001 compared to £1,076 million in 2000, due to strong new business growth in all countries. The increase in gross premiums includes the growth in single premium business from £275 million in 2000 to £650 million in 2001, which was mainly generated from Singapore following further liberalization of the Central Provident Fund and from Hong Kong, following the successful development of Prudential's bancassurance channel there. Prudential also had first time contributions from new life operations in Japan and Korea in 2001.

Investment Returns

	Year Ended December 31,

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Long-term business:			
United Kingdom	**(5,207)**	(2,663)	3,277
United States	**1,460**	1,540	1,673
Asia	**143**	85	(136)
Europe	**(89)**	(32)	7
Total	**(3,693)**	(1,070)	4,821

The investment return for shareholder financed businesses, principally the operations in the United States, shown above represents longer-term investment returns. For other businesses, investment returns represent income and realized and unrealized investment appreciation.

In 2002, investment returns fell to negative £3,693 million, compared to negative £1,070 million in 2001. This was due to a fall in the UK investment returns from a loss of £2,663 million in 2001 to a loss of £5,207 million in 2002, reflecting a negative return on PAC's long-term fund of 8.1% in 2002 compared to a negative return of 3.5% in the previous year. Meanwhile, US investment returns fell from £1,540 million in 2001 to £1,460 million in 2002, Asian investment returns grew from £85 million in 2001 to £143 million in 2002 and European investment returns fell from negative £32 million in 2001 to negative £89 million in 2002.

In 2001, investment returns fell to negative £1,070 million compared to a positive £4,821 million in 2000. This was principally due to investment returns from UK Insurance Operations falling from a positive £3,277 million in 2000 to negative £2,663 million in 2001. Meanwhile, US investment returns fell 8% from £1,673 million in 2000 to £1,540 million in 2001, Asian investment return grew from negative £136 million in 2000 to a positive £85 million in 2001 and European investment returns fell from a positive £7 million in 2000 to negative £32 million in 2001.

The overall decline over the three year period is primarily as a result of lower equity returns achieved across the major global equity markets.

United Kingdom

Total investment returns decreased from negative £2,663 million in 2001 to negative £5,207 million in 2002. Investment income primarily represents the return on the assets supporting the Prudential Assurance long-term fund. At December 31, 2002, 32% of these assets were invested in UK equities, 13% in overseas equities, 33% in fixed maturities, 18% in real estate, and 4% in cash and other assets. The negative return on the Prudential Assurance long-term fund of 8.1% compares favorably to a decline of 24.5% for the UK FTSE 100 Share Index and a decline of 25% for the UK FTSE All-Share index (22.2% including reinvestment and income.)

Total investment returns decreased from £3,277 million in 2000 to negative £2,663 million in 2001. At December 31, 2001, 38% of invested assets were in UK equities, 14% in overseas equities, 28% in fixed maturities, 15% in real estate, 3% in loans and deposits and 2% in other investments. The loss of £2,663 million reflected a negative return on the Prudential Assurance long-term fund in 2001 of 3.5% compared to positive return of 3% in 2000. The investment return of negative 3.5% compared favorably to a decline of 16.2% for the UK FTSE 100 Index and a decline of 15.4% for the UK FTSE All-Share index.

United States

Investment return for US operations represents longer-term investment returns and is analyzed as below:

	Year Ended December 31,		
	2002	**2001**	**2000**

	Year Ended December 31,		
	(In £ Millions)		
Investment income and realized gains and losses	**1,202**	1,172	1,621
Adjustment from actual to longer-term investment returns	**258**	368	52
Total	**1,460**	1,540	1,673

Investment returns of £1,460 million in 2002 represented a 5% decrease over 2001. Investment returns in 2002 continued to be adversely affected by defaults and impairments on bonds, resulting in realized losses of £264 million (net of related amortization of deferred acquisition costs) in the year. This resulted in a £121 million charge to the current year operating result as realized gains and losses on bonds are recognized on a five-year averaging basis.

Investment income (before realized gains and losses and net of certain investment expenses) was £1,533 million in 2002 compared with £1,601 million in 2001. This reflects investment yields of 5.78% on average invested assets of £26,957 million in 2002, versus investment yields of 6.41% on average invested assets of £25,439 million in 2001. The 6% increase in average invested assets is due to growth in fixed annuity products, partially offset by adverse exchange rate movements. The fall in investment yield is due to lower new money investment rates, lower limited partnership income, increased levels of non-accrual bonds and lower yields on short-term investments.

Investment returns of £1,540 million in 2001 represented an 8% decrease over 2000. Investment returns were affected by defaults and impairments on bonds resulting in realized losses of £331 million (net of related DAC amortization) in the year. This resulted in a £67 million charge to the current year operating result.

Investment income (before realized gains and losses and net of certain investment expenses) was £1,601 million in 2001 compared to £1,632 million in 2000. This reflects investment yields of 6.41% on average invested assets of £25,439 million in 2001 versus investment yields of 7.56% on average invested assets of £22,388 million in 2000. The 14% increase in average invested assets was due to growth in stable value and fixed annuity products. The reduction in investment yield was attributable to lower limited partnership income, lower new money investment rates and a higher level of non-accrual bonds.

Asia

Actual investment returns for 2002 were £143 million, up 68% from £85 million in 2001. The improvement principally reflects an increase in unrealized investment gains in Taiwan and Japan combined with a reduction in unrealized losses in Singapore, offset by an increase in the allocated investment return. The 2001 actual investment return of £85 million is a significant improvement from a loss of £136 million in 2000.

Expenses

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Long-term business:			
United Kingdom	**(1,288)**	(1,503)	(1,456)
United States	**(288)**	(161)	(196)
Asia	**(417)**	(358)	(271)
Europe	**(86)**	(76)	(57)
Total	**(2,079)**	(2,098)	(1,980)

	Year Ended December 31,		

Total expenses of £2,079 million in 2002 were slightly lower than the £2,098 million of expenses incurred in 2001, reflecting a substantial reduction in UK expenses offset by increases in the United States and in Asia. Total expenses of £2,098 million in 2001 were slightly higher than the £1,980 million of expenses incurred in 2000, principally due to expense increases in Asia and in the United Kingdom offset by a reduction in the United States.

United Kingdom

Total UK expenses in 2002 were £1,288 million, comparable to £1,503 million in 2001 and £1,456 million in 2000. These expenses exclude £38 million and £200 million of costs associated with restructurings in 2002 and 2001, respectively. See "Item 4: Information on the Company Business of Prudential UK Business UK Restructuring". The reduction between 2002 and 2001 reflects the lower UK cost base as the impact of the cost reduction program emerges. The increase in expenses between 2000 and 2001 primarily reflected increased commission on higher sales levels.

United States

Net operating and investment expenses of £288 million in 2002 were 79% higher than net operating and investment expenses in 2001 of £161 million, primarily due to increased DAC amortization. The increase in DAC amortization of £106 million includes an increase of £85 million in respect of variable annuity products and £16 million in respect of equity-indexed annuities. A consequence of the review of GMDB provisions and the resulting strengthening has been a reduction in the expected future gross profits from variable annuity products, which has itself resulted in a higher level of variable annuity DAC amortization.

When calculating the DAC amortization the long-term return on variable annuity business is assumed to be 8.4%, gross of investment management and mortality and expense charges. This assumption is implemented through use of a mean reversion methodology. If the mean reversion was eliminated as of December 31, 2002, so that the long term return on separate account business was assumed to be 8.4% per annum in all future years, DAC values would be reduced by approximately £32 million. Should these assumptions not be met in future periods a further increase in variable annuity DAC amortization may be required.

Net operating and investment expenses of £161 million in 2001 were 18% lower than net operating and investment expenses of £196 million in 2000. Costs relating to the acquisition of new business are capitalized as DAC and amortized. The reduction in expenses primarily represented lower levels of DAC amortization reflecting lower spread income and variable annuity fees and improved persistency. Commission expenses were lower in 2001 reflecting lower variable annuity sales. However, this was offset by lower deferred acquisition costs.

Asia

Total Asian expenses, excluding regional head office costs, in 2002 were £417 million, an increase of £59 million compared to £358 million in 2001 and £271 million in 2000. This was due to the growth of the business across all countries as demonstrated by the 33% compound increase in gross premiums between 2000 and 2002 and the growth in the number of operations from 12 at the end of 1999 to 22 by the end of 2002.

Benefits and Claims

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Long-term business:			
United Kingdom	**(7,896)**	(11,507)	(12,470)
United States	**(7,050)**	(6,028)	(6,171)

	Year Ended December 31,		
Asia	**(1,421)**	(1,556)	(790)
Europe	**(39)**	(69)	(97)
Total	**(16,406)**	(19,160)	(19,528)

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).

Total benefits and claims decreased by £2,754 million in 2002 to £16,406 million, compared to £19,160 million in 2001. This principally reflects a reduction in benefits and claims in the United Kingdom and Asia, offset by an increase in the United States.

Total benefits and claims decreased by £368 million in 2001 to £19,160 million, compared to £19,528 million in 2000. This principally reflects a reduction of £963 million, or 8%, with respect to the United Kingdom, offset by an increase in Asia of £766 million. Meanwhile, benefits and claims in the United States in 2001 of £6,028 million were £143 million lower than 2000 while European benefits and claims fell £28 million to £69 million in 2001.

United Kingdom

Overall benefits and claims fell from £11,507 million in 2001 to £7,896 million in 2002. Within this total, payments to policyholders were relatively stable, amounting to £8,365 million in 2001 and £8,663 million in 2002. However, the change in technical provisions, or liabilities relating to long-term business, was markedly different in the two years in 2001 technical provisions increased by £3,142 million whereas in 2002 they fell by £767 million. This difference arose mainly from a reduction in the technical provisions for unitized with-profits business, following the sustained low or negative investment returns over the last three years.

Overall benefits and claims fell from £12,470 million in 2000 to £11,507 million in 2001. A number of factors contributed to the movement including the impact of new valuation regulations in 2000, which led to a strengthening of reserves of £450 million. In addition, investment income in 2001 was significantly lower than in 2000. For unit-linked business this directly affects the amounts owed to policyholders. These two factors were the main reason for the reduction year on year, but were offset by increased premiums being added to policyholder funds and the fact that a large book of ten-year endowment policies written in 1990 matured in 2000, but did not repeat in 2001.

The annual movements in benefits and claims also include changes in the pension mis-selling provision, which decreased in 2002, 2001 and 2000. For a detailed analysis of this provision, see Item 4, "Information on the Company Business of Prudential UK Business Compliance Pension Mis-selling". With the consent of the UK regulator, the total cost of pension mis-selling is included within the transfer to the fund for future appropriations of the Prudential Assurance long-term with-profits fund. Payments related to pension mis-selling will be met from the surplus assets in the Prudential Assurance long-term with-profits fund and not from amounts intended to fund existing and future bonuses.

As described in "United Kingdom Basis of Profit" above, because shareholders' profit from the Prudential Assurance long-term with-profits fund represents an amount of up to one-ninth of the value of that year's bonus declaration to policyholders, shareholders' profit from the fund has not been affected by the increase in the provision for pensions mis-selling. Given the strength of the fund, Prudential does not believe that pension mis-selling costs will have an adverse impact on the levels of bonuses paid to policyholders and, therefore, shareholders' profit from the fund. In the unlikely event that this proves not to be the case, Prudential's intention would be that an appropriate contribution to the long-term with-profits fund be made from shareholders' funds with a consequential impact on shareholders' profit.

United States

In 2002, benefits and claims increased by 17% to £7,050 million. This movement reflects a 4% increase in death benefits, maturities, and surrenders of deposit products to £4,483 million, and a 51% increase in the change in technical provisions to £2,567 million.

The increase in death benefits, maturities and surrenders of deposit products in 2002 primarily reflects an increase in stable value product surrenders and maturities, partially offset by a fall in annuity surrenders and maturities. The overall change in technical provisions of £2,567 million represents an increase of £3,060 million primarily due to an increase in fixed annuity liabilities, partially offset by a £493 million reduction in separate account liabilities. The reduction in separate account liabilities is largely due to the equity market depreciation of separate account assets under management.

Average deposit liabilities of £25,354 million in 2002 were 5% higher than 2001's balance of £24,045 million, driven by record fixed annuity sales. Lowering of crediting rates in 2002 resulted in a lower average interest credited rate of 4.46% in 2002, compared to 5.03% in 2001. Interest credited on deposit liabilities fell by £80 million to £1,130 million due to falling crediting rates, partially offset by growth in deposit liabilities.

In 2001, benefits and claims fell by 2% to £6,028 million. This movement reflected an 11% reduction in death benefits, maturities and surrenders of deposit products to £4,326 million versus £4,866 million in 2000. This has been offset by an increase of 30%, or £397 million, in the change in technical provisions.

The decrease in death benefits, maturities and surrenders of deposit products reflected a reduction in the volume of fixed annuity surrenders as the economic climate led to an increase in the popularity of this product. The overall change in technical provisions of £1,702 million represented an increase of £2,021 million, primarily due to higher fixed annuity liabilities, offset by a £319 million reduction in separate account liabilities. The reduction in separate account liabilities is largely due to the equity market depreciation of separate account assets under management.

Average deposit liabilities of £24,045 million in 2001 were 14% higher than 2000's balance of £21,136 million. Growth in stable value business and lower crediting rates resulted in lower average interest credited rates of 5.03%, compared to 5.45% in 2000. Due to the larger average deposit liabilities, interest credited grew by £57 million to £1,210 million in 2001.

Asia

In 2002, benefits and claims totaled £1,421 million, down 9% from £1,556 million in 2001 as a result of lower with-profits bonuses being declared. In 2001, benefits and claims totaled £1,556 million, a significant increase from £790 million in 2000 reflecting the increased maturity of the business.

Transfer from/(to) the Fund for Future Appropriations

	Year Ended December 31,		
	2002	**2001**	**2000**
	(In £ Millions)		
Long-term business:			
United Kingdom	**5,576**	7,638	3,311
United States			
Asia	**(56)**	116	169
Europe			
Total	**5,520**	7,754	3,480

The fund for future appropriations ("FFA") represents the excess of assets over policyholder liabilities for the group's with-profits funds. The annual excess (shortfall) of income over expenditures of the with-profits fund, after declaration and attribution of the cost of bonuses to policyholders and shareholders, is transferred to (from) the FFA each year through a charge (credit) to the profit and loss account. The balance retained in the FFA represents cumulative retained earnings arising on the with-profits business that have not been allocated to policyholders or shareholders. The balance retained in the FFA is determined after full provision for deferred tax on unrealized appreciation on investments. The FFA in respect of SAIF is wholly attributable, but not yet allocated, to policyholders of that fund. As no with-profits business is written in the United States and Europe, there are no transfers to or from the fund for future appropriations and all profits are attributable directly to shareholders.

United Kingdom

The transfer from the fund for future appropriations in 2002 of £5,576 million compares to the transfer of £7,638 million in 2001, a decrease of £2,062 million. The change in 2002 predominantly reflects an investment return of negative 8.1% on the Prudential Assurance long-term fund compared to negative 3.5% in 2001 due to lower equity returns, offset by a reduction in technical provisions for unitized with-profits business following the sustained low or negative investment return since 2000.

The transfer from the fund for future appropriations in 2001 of £7,638 million compares to the transfer to the fund for future appropriations of £3,311 million in 2000, an increase of £4,327 million. The change in 2001 predominantly reflected an investment return of negative 3.5% on the Prudential Assurance long-term fund compared to positive 3.0% in 2000 due to lower equity returns.

New UK Accounting Pronouncements

No new UK accounting standards were issued during 2002 that are pertinent to Prudential's UK GAAP consolidated financial statements. Recently issued standards that are pertinent are discussed in detail in Note 2 of the notes to Prudential's consolidated financial statements.

US GAAP Analysis

Prudential's consolidated financial statements have been prepared in accordance with UK GAAP, which differs in certain material respects from US GAAP. A summary of these differences and their impact on Prudential's consolidated profit and loss accounts for 2002, 2001 and 2000 and shareholders' funds for 2002 and 2001, along with condensed US GAAP financial statements, is included in Notes 35 and 36 of the notes to Prudential's consolidated financial statements.

The most significant difference in the results of operations between UK GAAP and US GAAP is the treatment of the with-profits business.

Under UK GAAP, profit attributable to shareholders in respect of Prudential's with-profits business reflects up to one-ninth of the value of bonuses paid to policyholders. To the extent the annual earnings of the with-profits fund exceed policyholder bonuses and related shareholder distributions, this excess is added to the fund for future appropriations by a charge to the profit and loss account. However, to the extent the annual earnings of the with-profits fund do not exceed policyholder bonuses and related shareholder distributions, the shortfall is transferred from the fund for future appropriations.

Under US GAAP, the impact of pre-bonus operating results within the with-profits fund is reflected in net income in the period in which it occurs. However, 90% of these results are allocated to with-profits policyholders by a charge to net income. The residual 10% interest is allocated to shareholders.

This treatment of Prudential's with-profits fund under US GAAP causes profits attributable to shareholders to be strongly influenced by annual investment returns, particularly on equities. Annual investment returns include unrealized gains and losses and, accordingly, these returns and shareholders' profits will be subject to considerable volatility in the US GAAP figures.

Other material differences between UK GAAP and US GAAP results include the method of deferral and amortization of acquisition costs, the accounting for certain investments and derivative instruments, revenue and claims recognition on investment type contracts, the measurement of and changes in policyholder benefit and dividend liabilities, and the accounting for deferred income tax.

US GAAP Critical Accounting Policies

Although there are a number of differences between accounting policies under UK GAAP and US GAAP, the critical accounting policies under US GAAP relates to the provision for policy liabilities and the treatment of the with-profits business.

Provision for Policy Liabilities

The concept of providing for policy liabilities is consistent with that under UK GAAP, in that the liabilities are estimated using actuarial methods based on assumptions about premiums, interest rates, investment returns, expenses, mortality and surrenders. However, the underlying classification of policies, reserving methodology and assumptions are different. If actual results differ from the assumptions used then the value of the liabilities would need to be adjusted.

For unitized with-profits life insurance and other investment-type policies, the liability is represented by the policyholders' account balances before any applicable surrender charges. Policyholder benefit liabilities for conventional with-profits life insurance and other protection-type insurance policies are developed using the net level premium method, with assumptions for interest, mortality, morbidity, withdrawals and expenses using best estimates at the date of policy issue plus provisions for adverse deviation based on group experience. Interest assumptions range from 0.935% to 12%. When the policyholder benefit liability plus the present value of expected future gross premiums are insufficient to provide for expected future policy benefits and expenses, using current best estimate assumptions,

deferred acquisition costs are written down and/or a deficiency liability is established by a charge to earnings.

The impact of changes would depend upon whether or not the liabilities being adjusted are for with-profits business, non-participating business of Prudential Annuities Limited (which is owned by the Prudential Assurance long-term fund) or shareholder financed long-term business operations.

For with-profits business, adjustments to liabilities and any related tax effects, are recognized in the income statement. However, an amount equal to nine-tenths of the related increase or decrease in pre-bonus earnings of the with-profits fund is transferred to or from the Undistributed Policyholder Allocation from or to the income statement. US GAAP shareholder profits are therefore only affected to the extent of one-tenth of the change in liabilities.

This effect also applies to changes in liabilities of Prudential Annuities Limited. To the extent that movements in liabilities are recorded in Other Comprehensive Income as shadow adjustments to the income statement under Statement of Financial Accounting Standard No. 115 ("Accounting for certain investments in debt and equity securities", (FAS 115)), an amount equal to nine-tenths of the movement is recognized within Other Comprehensive Income as a consequential change to the Undistributed Policyholder Allocation. Net movements on Other Comprehensive Income for this item will therefore reflect only one-tenth of the gross change.

For shareholder financed long-term business operations, other than for exchange translation effects, changes to policy liabilities will be directly reflected in net income and shareholders' equity.

Treatment of With-profits Business

Under UK GAAP, as described in "Analysis by Geographic Operations United Kingdom Basis of Profits" the shareholders' profit in respect of with-profits business represents an amount of up to one-ninth of the value of that year's bonus declaration to policyholders. As a consequence, current year amounts in respect of premiums, investment returns and operating expenses do not have an effect on the profit attributable to shareholders' in that year. Consistent with this treatment, as mentioned in " UK GAAP Critical Accounting Policies", amounts retained within with-profits funds are accounted for within the fund for future appropriations.

For US GAAP purposes, the provision for the policyholders' share of earnings on with-profits business charged to income represents 90% of the current year's pre-bonus earnings, before income taxes. As a result, reported profit is directly impacted by current year amounts in respect of premiums, investment returns and operating expenses. As investments of with-profits operations are accounted for on a trading basis, the shareholders' 10% share of the pre-bonus earnings is likely to be highly volatile from year to year as a result of the vagaries of market returns, irrespective of underlying performance.

Investment Returns

Except primarily for Jackson National Life and UK annuity business (other than with-profits) all investment returns for long-term insurance business are accounted for on a trading basis. Accordingly investment returns reported in the income statement include unrealized gains and losses. This reflects the fact that policyholder benefits, in particular for with-profits business, includes the impact of unrealized appreciation over time through the bonus mechanism.

Impairment of Assets

The group conducts regular impairment reviews in respect of those investment securities held on an available for sale basis. The group considers indicators, such as serious downgrades in credit ratings, breach of covenants or failure to make interest payments, that may suggest that interest and principal may not be paid in full. Any impairment losses that are not considered temporary are recognized in the

profit and loss account. In assessing the fair value for impairment testing purposes where third party information is not available, the group performs alternative valuation techniques, including discounted cash flow analysis, option-adjusted spread models, and enterprise valuation.

Among the factors considered are whether the decline in fair value results from a change in the quality of the security itself, or from a downward movement in the market as a whole, and the likelihood of recovering the carrying value based on the current and short term prospects of the issuer. Unrealised losses that are considered to be primarily the result of market conditions, such as increasing interest rates, unusual market volatility or industry-related events, and where the group also believes there exists a reasonable expectation for recovery and, furthermore, has the intent and ability to hold the investment until maturity or the market recovers, are usually determined to be temporary.

Deferred Acquisition Costs

Commissions, salesforce direct costs and costs associated with policy issue and underwriting that vary with and are primarily related to the production of new and renewal contracts are deferred. Deferred acquisition costs are regularly evaluated for recoverability and amounts determined not to be recoverable are charged to income. Deferred acquisition costs for conventional with-profits life insurance and other protection-type insurance policies are amortized in relation to premium income using assumptions consistent with those used in computing policyholder benefit provisions. Deferred acquisition costs for unitized with-profits life insurance and investment-type policies are amortized in relation to expected gross profits. Expected gross profits are evaluated regularly against actual experience and revised estimates of future gross profits and amortization are adjusted for the effect of any changes. Deferred acquisition costs associated with internally replaced policies are written off in the year replacement occurs and the incremental commissions and selling costs of the replacement contract are capitalized and amortized over the life of the replacement policy.

The deferral and amortization of deferred acquisition costs is of most relevance to the group's reported profits for shareholder financed long-term business operations, principally Jackson National Life in the United States. In 2002, for Jackson National Life, poor equity market performance has lowered future expected profits on the variable annuity line through lower fee income and an increased provision for future guaranteed minimum death benefit claims. As a result, the deferred acquisition cost asset associated with the variable annuities has become impaired. During 2002, the asset has been reduced through increased amortization compared to 2001 of approximately £85 million, primarily due to the poor market performance. Further impairments or accelerated amortization of this deferred acquisition cost asset are likely to result if future market returns are below assumed levels.

For with-profits funds, the shareholder impact of the accounting policy for acquisition costs is limited to 10% of the direct income statement and balance sheet effect due to 90% of the excess of US GAAP basis assets (including deferred acquisition costs) over liabilities in the funds being allocated to the Undistributed Policyholder Allocation. Accordingly, after this allocation, income before tax includes effectively only 10% of the amortization of deferred acquisition costs and shareholders' equity includes effectively only a 10% shareholder interest in the balance sheet carrying value of deferred acquisition costs.

Deferred Income Tax

Deferred taxes are provided under the liability method for all temporary differences except for undistributed earnings of foreign subsidiaries that are not expected to be remitted for an indefinite period. Deferred tax assets are recognized subject to adjustment for valuation allowances when it is more likely than not that the underlying tax benefit will not be realized.

In the United Kingdom the taxation regime applies separate rules to trading and capital profits and losses. The distinction between timing differences that arise from items of either a capital or trading

nature may affect the recognition of deferred tax assets under FRS 19. Accordingly, for the 2002 results and balance sheet position at December 31, 2002, the possible tax benefit, which may arise from capital losses valued at approximately £1.7 billion, is sufficiently uncertain that it has not been recognized.

Derivative Financial Instruments

Under US GAAP, hedging instruments may only be accounted for as hedges where they are appropriately documented and comply with the strict criteria as required by FAS 133. Derivative financial instruments held by the group's with-profits operations are generally entered into for the purposes of efficient portfolio management rather than as hedges. Consistent with the accounting treatment of other investment assets of with-profits funds, the movements in the fair value of derivative financial instruments are recognized in the income statement with shareholders net income reflecting, as part of the 10% of pre-bonus earnings of the fund, 10% of the movement in the values of the derivative instruments.

For the group's shareholder financed long-term business operations, principally Jackson National Life, which accounts for investments under FAS 115 on an Available-For-Sale basis, the impact of temporary movements in the values of investments are recorded within Other Comprehensive Income. However, although Jackson National Life uses derivatives (primarily interest rate swaps) to hedge certain risks in conjunction with its asset/liability program, it has elected not to incur the costs of restructuring its derivative contracts, segregating investment portfolios and adding the systems personnel required to qualify for hedge accounting treatment on an ongoing basis. Accordingly, value movements on its derivative financial instruments are recognized in income while the largely offsetting change in fair value of hedged investments are reflected as an adjustment to equity in the balance sheet as unrealized gains and losses.

Scottish Amicable Insurance Fund (SAIF)

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